NetApp, Inc.
Form 10-Q
August 29, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 28, 2017

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 000-27130

NetApp, Inc.

(Exact name of registrant as specified in its charter)

Delaware	77-0307520
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

495 East Java Drive,

Sunnyvale, California 94089

(Address of principal executive offices, including zip code)

(408) 822-6000

(Registrant's telephone number, including area code)

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 Website, 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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.

As of August 16, 2017, there were 269,757,582 shares of the registrant's common stock, $0.001 par value, outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

NETAPP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except par value)

(Unaudited)

	July 28, 2017	April 28, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$2,951	$2,444
Short-term investments	2,370	2,477
Accounts receivable	518	731
Inventories	143	163
Other current assets	316	383
Total current assets	6,298	6,198
Property and equipment, net	799	799
Goodwill	1,701	1,684
Other intangible assets, net	124	131
Other non-current assets	677	681
Total assets	$9,599	$9,493
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$289	$347
Accrued expenses	653	782
Commercial paper notes	894	500
Current portion of long-term debt	749	749
Short-term deferred revenue and financed unearned services revenue	1,702	1,744
Total current liabilities	4,287	4,122
Long-term debt	745	744
Other long-term liabilities	250	249
Long-term deferred revenue and financed unearned services revenue	1,549	1,598
Total liabilities	6,831	6,713
Commitments and contingencies (Note 16)		

Stockholders' equity:		
Common stock and additional paid-in capital, $0.001 par value; 270 and 269 shares issued and outstanding as of July 28, 2017 and April 28, 2017, respectively	2,771	2,769
Retained earnings	10	40
Accumulated other comprehensive loss	(13)	(29)
Total stockholders' equity	2,768	2,780
Total liabilities and stockholders' equity	$9,599	$9,493

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share amounts)

(Unaudited)

	Three Months Ended	
	July 28, 2017	July 29, 2016
Revenues:		
Product	$723	$660
Software maintenance	234	241
Hardware maintenance and other services	368	393
Net revenues	1,325	1,294
Cost of revenues:		
Cost of product	371	359
Cost of software maintenance	7	8
Cost of hardware maintenance and other services	113	130
Total cost of revenues	491	497
Gross profit	834	797
Operating expenses:		
Sales and marketing	425	429
Research and development	193	207
General and administrative	68	68
Total operating expenses	686	704
Income from operations	148	93
Other income (expense), net	5	(1)
Income before income taxes	153	92
Provision for income taxes	17	28
Net income	$136	$64
Net income per share:		
Basic	$0.50	$0.23
Diluted	$0.49	$0.23
Shares used in net income per share calculations:		
Basic	270	279
Diluted	278	282
Cash dividends declared per share	$0.20	$0.19

See accompanying notes to condensed consolidated financial statements.

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NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

(Unaudited)

.	Three Months Ended	
	July 28, 2017	July 29, 2016
Net income	$ 136	$ 64
Other comprehensive income (loss):		
Foreign currency translation adjustments	10	(6)
Unrealized gains on available-for-sale securities:		
Unrealized holding gains arising during the period	6	3
Unrealized gains on cash flow hedges:		
Unrealized holding gains arising during the period	—	3
Other comprehensive income (loss)	16	—
Comprehensive income	$ 152	$ 64

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Three Months Ended	
	July 28, 2017	July 29, 2016
Cash flows from operating activities:		
Net income	$136	$64
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	51	60
Stock-based compensation	48	52
Deferred income taxes	2	19
Other items, net	5	(7)
Changes in assets and liabilities, net of acquisition of business:		
Accounts receivable	218	311
Inventories	20	17
Other operating assets	71	32
Accounts payable	(58)	(30)
Accrued expenses	(135)	(198)
Deferred revenue and financed unearned services revenue	(107)	(83)
Other operating liabilities	(1)	(9)
Net cash provided by operating activities	250	228
Cash flows from investing activities:		
Purchases of investments	(275)	(285)
Maturities, sales and collections of investments	387	598
Purchases of property and equipment	(36)	(36)
Acquisition of business, net of cash acquired	(24)	—
Other investing activities, net	5	(1)
Net cash provided by investing activities	57	276
Cash flows from financing activities:		
Proceeds from issuance of common stock under employee stock award plans	48	42
Payments for taxes related to net share settlement of stock awards	(57)	(33)
Repurchase of common stock	(150)	(175)
Proceeds from issuance of commercial paper notes, net	394	—
Repayment of short-term loan	—	(850)
Dividends paid	(54)	(53)
Other financing activities, net	—	(2)
Net cash provided by (used in) financing activities	181	(1,071)

Effect of exchange rate changes on cash and cash equivalents	19	(7)
Net increase (decrease) in cash and cash equivalents	507	(574)
Cash and cash equivalents:		
Beginning of period	2,444	2,868
End of period	$2,951	$2,294

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business and Significant Accounting Policies

NetApp, Inc. (we, us, or the Company) provides global organizations the ability to manage and share their data across on-premises, private and public clouds. Together with our partners, we provide a full range of enterprise-class software, systems and services solutions that customers use to modernize their infrastructures, build next generation data centers and harness the power of hybrid clouds.

Basis of Presentation and Preparation

Our fiscal year is reported on a 52- or 53-week year ending on the last Friday in April. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal months with calendar months. Fiscal years 2018 and 2017, ending on April 27, 2018, and April 28, 2017, respectively, are each 52-week years, with 13 weeks in each of their quarters.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company, and reflect all adjustments, consisting only of normal recurring adjustments, that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, comprehensive income and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, these statements do not include all information and footnotes required by GAAP for annual consolidated financial statements, and should be read in conjunction with our audited consolidated financial statements as of and for the fiscal year ended April 28, 2017 contained in our Annual Report on Form 10-K. The results of operations for the three months ended July 28, 2017 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Such estimates include, but are not limited to, revenue recognition, reserves and allowances; inventory valuation and purchase order accruals; valuation of goodwill and intangibles; restructuring reserves; product warranties; employee compensation and benefit accruals; stock-based compensation; loss contingencies; valuation of investment securities; income taxes and fair value measurements. Actual results could differ materially from those estimates.

There have been no significant changes in our significant accounting policies as of and for the three months ended July 28, 2017, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 28, 2017.

2. Recent Accounting Standards Not Yet Effective

Revenue from Contracts with Customers

In May 2014, the FASB issued an accounting standards update related to the recognition and reporting of revenue that establishes a comprehensive new revenue recognition model designed to depict the transfer of goods or services to a customer in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. The guidance allows for the use of either the full or modified retrospective transition method. We expect to adopt this new standard, as amended, on its effective date in the first quarter of fiscal 2019.

Preliminarily, we plan to adopt the standard using the full retrospective method to restate each prior reporting period presented. Our ability to adopt this standard using the full retrospective method is dependent upon system readiness, for both revenue and commissions, and the completion of the analysis of information necessary to restate prior period financial statements and disclosures. We are continuing to assess the impact of this standard on our financial position, results of operations and related disclosures and have not yet determined whether the effect will be material. We do not expect that the adoption of this standard will have a material impact on our operating cash flows. Additionally, as we continue to assess the new standard along with industry trends and additional interpretive guidance, we may adjust our implementation plan accordingly.

We believe that the new standard will impact our following policies and disclosures:

- removal of the current limitation on contingent revenue for multiple element arrangements, such as that related to the delivery of additional items or meeting other specified performance conditions, may result in revenue being recognized earlier;

- estimation of variable consideration for arrangements with contract terms such as rights of return, potential penalties and acceptance clauses;
- required disclosures, including information about the transaction price allocated to remaining performance obligations and expected timing of revenue recognition; and
- accounting for deferred commissions, including costs that qualify for deferral and the amortization period.

We do not expect that the new standard will result in substantive changes in our deliverables or the amounts of revenue allocated between multiple deliverables, with the exception of contingent revenue discussed above.

Leases

In February 2016, the FASB issued an accounting standards update on financial reporting for leasing arrangements, including requiring lessees to recognize an operating lease with a term greater than one year on their balance sheets as a right-of-use asset and corresponding lease liability, measured at the present value of the lease payments. This new standard will be effective for us in our first quarter of fiscal 2020, although early adoption is permitted. Upon adoption, lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently in the assessment phase to determine the adoption methodology and are evaluating the impact of this new standard on our consolidated financial statements and disclosures. We expect that most of our operating lease commitments will be subject to the new standard and recognized as lease liabilities and right-of-use assets upon adoption, which will increase the total assets and total liabilities we report.

Credit Losses on Financial Instruments

In June 2016, the FASB issued an accounting standards update on the measurement of credit losses on financial instruments. The standard introduces a new model for measuring and recognizing credit losses on financial instruments, requiring financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. It also requires that credit losses be recorded through an allowance for credit losses. This new standard will be effective for us in our first quarter of fiscal 2021, although early adoption is permitted. Upon adoption, companies must apply a modified retrospective transition approach through a cumulative-effect adjustment to retained earnings, though a prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. Based on the composition of our investment portfolio, current market conditions, and historical credit loss activity, the adoption of this standard is not expected to have a material impact on our consolidated financial statements.

Income Taxes on Intra-Entity Transfers of Assets

In October 2016, the FASB issued an accounting standards update that requires entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. This amends current GAAP which prohibits recognition of current and deferred income taxes for all types of intra-entity asset transfers until the asset has been sold to an outside party. This new standard will be effective for us in our first quarter of fiscal 2019, although early adoption is permitted. Upon adoption, companies must apply a modified retrospective transition approach through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. We are currently evaluating the impact of this new standard on our consolidated financial statements.

Derecognition of Non-Financial Assets

In February 2017, the FASB issued an accounting standards update that amends guidance on how entities account for the derecognition of a nonfinancial asset or an in substance nonfinancial asset that is not a business. The guidance allows for the use of either the full or modified retrospective transition method. This new standard will be effective for us in our first quarter of fiscal 2019, although early adoption is permitted. We are currently evaluating the impact of this new standard on our consolidated financial statements.

Although there are several other new accounting pronouncements issued or proposed by the FASB that we have adopted or will adopt, as applicable, we do not believe any of these accounting pronouncements has had or will have a material impact on our consolidated financial position, operating results or disclosures.

3. Statements of Cash Flows Additional Information

Non-cash investing activities and supplemental cash flow information are as follows (in millions):

	Three Months Ended July 28, 2017	July 29, 2016
Non-cash Investing Activities:		
Capital expenditures incurred but not paid	$18	$ 38
Supplemental Cash Flow Information:		
Income taxes paid, net of refunds	$22	$ 62
Interest paid	$21	$ 23

4. Business Combination

On June 15, 2017, we acquired all of the outstanding shares of Plexistor Ltd., a privately-held provider of software defined memory architecture based in Israel, for $24 million in cash, of which we allocated $6 million to developed technology, $17 million to goodwill, and the remainder to other assets.

5. Goodwill and Purchased Intangible Assets, Net

Goodwill activity is summarized as follows (in millions):

Balance as of April 28, 2017	$1,684
Additions	17
Balance as of July 28, 2017	$1,701

Purchased intangible assets, net are summarized below (in millions):

	July 28, 2017 Gross Assets	Accumulated Amortization	Net Assets	April 28, 2017 Gross Assets	Accumulated Amortization	Net Assets
Developed technology	$154	$ (52)	$ 102	$148	$ (44)	$ 104
Customer contracts/relationships	43	(23)	20	43	(19)	24
Other purchased intangibles	9	(7)	2	9	(6)	3
Total purchased intangible assets	$206	$ (82)	$ 124	$200	$ (69)	$ 131

Amortization expense for purchased intangible assets is summarized below (in millions):

	Three Months Ended July 28, 2017	July 29, 2016	Statements of Operations Classification
Developed technology	$8	$ 6	Cost of revenues
Customer contracts/relationships	4	4	Operating expenses
Other purchased intangibles	1	1	Operating expenses
Total	$13	$ 11	

As of July 28, 2017, future amortization expense related to purchased intangible assets is as follows (in millions):

Fiscal Year	Amount
Remainder of 2018	$ 38
2019	44
2020	27
2021	15
Total	$ 124

6. Balance Sheet Details

Cash and cash equivalents (in millions):

	July 28, 2017	April 28, 2017
Cash	$2,630	$2,275
Cash equivalents	321	169
Cash and cash equivalents	$2,951	$2,444

Inventories (in millions):

	July 28, 2017	April 28, 2017
Purchased components	$59	$28
Finished goods	84	135
Inventories	$143	$163

Property and equipment, net (in millions):

	July 28, 2017	April 28, 2017
Land	$132	$132
Buildings and improvements	643	612
Leasehold improvements	95	93
Computer, production, engineering and other equipment	751	741
Computer software	352	353
Furniture and fixtures	94	90
Construction-in-progress	2	26
	2,069	2,047
Accumulated depreciation and amortization	(1,270)	(1,248)
Property and equipment, net	$799	$799

We have classified certain land and buildings previously reported as property and equipment as assets held-for-sale. The book value of these assets is $118 million and is included in other current assets in the condensed consolidated balance sheets.

Other non-current assets (in millions):

	July 28, 2017	April 28, 2017
Deferred tax assets	$523	$525
Other assets	154	156
Other non-current assets	$677	$681

Accrued expenses (in millions):

	July 28, 2017	April 28, 2017
Accrued compensation and benefits	$240	$340
Sale-leaseback financing obligations	130	130
Product warranty liabilities	29	33
Other current liabilities	254	279
Accrued expenses	$653	$782

Product warranty liabilities:

Equipment and software systems sales include a standard product warranty. The following tables summarize the activity related to product warranty liabilities and their balances as reported in our condensed consolidated balance sheets (in millions):

	Three Months Ended	
	July 28, 2017	July 29, 2016
Balance at beginning of period	$ 50	$ 70
Expense accrued during the period	1	4
Warranty costs incurred	(7)	(13)
Balance at end of period	$ 44	$ 61

	July 28, 2017	April 28, 2017
Accrued expenses	$ 29	$ 33
Other long-term liabilities	15	17
Total warranty liabilities	$ 44	$ 50

Warranty expense accrued during the period includes amounts accrued for systems at the time of shipment, adjustments for changes in estimated costs for warranties on systems shipped in the period and changes in estimated costs for warranties on systems shipped in prior periods.

Deferred revenue and financed unearned services revenue (in millions):

	July 28, 2017	April 28, 2017
Deferred product revenue	$ 123	$ 124
Deferred services revenue	2,942	2,999
Financed unearned services revenue	186	219
Total	$ 3,251	$ 3,342
Reported as:		
Short-term	$ 1,702	$ 1,744
Long-term	1,549	1,598
Total	$ 3,251	$ 3,342

Deferred product revenue represents unrecognized revenue related to undelivered product commitments and other product deliveries that have not met all revenue recognition criteria. Deferred services revenue represents customer payments made in advance for services, which include software and hardware maintenance contracts and other services. Financed unearned services revenue represents undelivered services for which cash has been received under certain third-party financing arrangements. See Note 16 for additional information related to these arrangements.

7. Other income (expense), net

Other income (expense), net consists of the following (in millions):

	Three Months Ended	
	July 28, 2017	July 29, 2016
Interest income	$ 16	$ 11
Interest expense	(13)	(15)
Other income, net	2	3
Total other income (expense), net	$ 5	$ (1)

8. Financial Instruments and Fair Value Measurements

The accounting guidance for fair value measurements provides a framework for measuring fair value on either a recurring or nonrecurring basis, whereby the inputs used in valuation techniques are assigned a hierarchical level. The following are the three levels of inputs to measure fair value:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs that reflect quoted prices for identical assets or liabilities in less active markets; quoted prices for similar assets or liabilities in active markets; benchmark yields, reported trades, broker/dealer quotes, inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs that reflect our own assumptions incorporated in valuation techniques used to measure fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

We consider an active market to be one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis, and consider an inactive market to be one in which there are infrequent or few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers. Where appropriate, our own or the counterparty's non-performance risk is considered in measuring the fair values of liabilities and assets, respectively.

Investments

The following is a summary of our investments (in millions):

	July 28, 2017				April 28, 2017			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	$1,600	$ 8	$ (1)	$ 1,607	$1,535	$ 3	$ (2)	$ 1,536
U.S. Treasury and government debt securities	557	—	(2)	555	629	1	(2)	628
Foreign government debt securities	21	—	—	21	21	—	—	21
Commercial paper	409	—	—	409	362	—	—	362
Certificates of deposit	99	—	—	99	99	—	—	99
Mutual funds	32	—	—	32	31	—	—	31
Total debt and equity securities	$2,718	$ 8	$ (3)	$ 2,723	$2,677	$ 4	$ (4)	$ 2,677

As of July 28, 2017 and April 28, 2017, gross unrealized losses related to individual securities were not significant.

The following table presents the contractual maturities of our debt investments as of July 28, 2017 (in millions):

	Amortized Cost	Fair Value
Due in one year or less	$ 1,227	$1,226
Due after one year through five years	1,157	1,159
Due after five years through ten years	297	301
Due after ten years	5	5
	$ 2,686	$2,691

Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay certain obligations.

Fair Value of Financial Instruments

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis (in millions):

	July 28, 2017		
		Fair Value Measurements at Reporting Date Using	
	Total	Level 1	Level 2
Cash	$2,630	$2,630	$—
Corporate bonds	1,607	—	1,607
U.S. Treasury and government debt securities	555	216	339
Foreign government debt securities	21	—	21
Commercial paper	409	—	409
Certificates of deposit	99	—	99
Total cash, cash equivalents and short-term investments	$5,321	$2,846	$2,475
Other items:			
Mutual funds (1)	$6	$6	$—
Mutual funds (2)	$26	$26	$—
Foreign currency exchange contracts assets (1)	$2	$—	$2
Foreign currency exchange contracts liabilities (3)	$(4)	$—	$(4)

(1) Reported as other current assets in the condensed consolidated balance sheets
(2) Reported as other non-current assets in the condensed consolidated balance sheets
(3) Reported as accrued expenses in the condensed consolidated balance sheets

Our Level 2 debt instruments are held by a custodian who prices some of the investments using standard inputs in various asset price models or obtains investment prices from third-party pricing providers that incorporate standard inputs in various asset price models. These pricing providers utilize the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs like market transactions involving identical or comparable securities. We review Level 2 inputs and fair value for reasonableness and the values may be further validated by comparison to multiple independent pricing sources. In addition, we review third-party pricing provider models, key inputs and assumptions and understand the pricing processes at our third-party providers in determining the overall reasonableness of the fair value of our Level 2 debt instruments. As of July 28, 2017 and April 28, 2017, we have not made any adjustments to the prices obtained from our third-party pricing providers.

Fair Value of Debt

As of July 28, 2017 and April 28, 2017, the fair value of our long-term debt was approximately $1,523 million and $1,520 million, respectively. The fair value of our long-term debt was based on observable market prices in a less active market. The fair value of our commercial paper notes approximated their carrying value. All of our debt obligations are categorized as Level 2 instruments.

9. Financing Arrangements

Long-Term Debt

The following table summarizes information relating to our long-term debt (in millions, except interest rates):

July 28, 2017	April 28, 2017

$
886,945

$
842,801

Cost of sales
486,161

529,019

528,043

Gross profit
357,633

357,926

314,758

Selling expenses
228,910

234,231

226,496

General and administrative expenses
68,567

61,662

68,087

Research and development expenses
33,213

31,285

30,937

Total operating expenses
330,690

327,178

325,520

Income (loss) from operations
26,943

30,748

(10,762
)
Interest income
388

438

558

Interest expense
(8,733
)

(9,499
)

(9,123
)
Other income (expense), net
1,465

(48
)

6,005

Income (loss) before income taxes
20,063

21,639

(13,322
)
Income tax provision
5,495

5,631

5,599

Net income (loss)
14,568

16,008

(18,921
)
Dividends on convertible preferred stock
—

—

3,332

Net income (loss) allocable to common shareholders
$
14,568

$
16,008

$
(22,253
)
Earnings (loss) per common share:

Basic
$
0.18

$
0.21

$
(0.31
)
Diluted
$
0.17

$
0.20

$
(0.31
)
Weighted-average common shares outstanding:

Basic
83,116

77,559

72,809

Diluted
84,611

78,385

72,809

Dividends paid per common share
$
0.04

$
0.04

$
0.04

The accompanying notes are an integral part of these consolidated financial statements.

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CALLAWAY GOLF COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Net income (loss)	$14,568	$16,008	$(18,921)
Other comprehensive income (loss):			
Change in fair value of derivative instruments	525	—	—
Foreign currency translation adjustments	(11,542)	(12,973)	(2,593)
Comprehensive income (loss)	$3,551	$3,035	$(21,514)

The accompanying notes are an integral part of these consolidated financial statements.

CALLAWAY GOLF COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2015	2014	2013
Cash flows from operating activities:			
Net income (loss)	$14,568	$16,008	$(18,921)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	17,379	21,236	25,543
Deferred taxes	128	604	(2,309)
Share-based compensation	7,542	5,740	3,533
(Gain) loss on disposal of long-lived assets and deferred gain amortization	(1,006)	(1,331)	2,242
Discount amortization on convertible notes	531	739	702
Changes in assets and liabilities:			
Accounts receivable, net	(11,591)	(23,314)	(6,690)
Inventories	(5,347)	47,334	(60,966)
Other assets	7,060	2,884	(190)
Accounts payable and accrued expenses	5,382	(30,578)	34,663
Accrued employee compensation and benefits	(3,395)	6,328	11,523
Income taxes receivable and payable	(370)	(4,125)	2,761
Accrued warranty expense	99	(799)	(1,133)
Other liabilities	(399)	(3,846)	293
Net cash provided by (used in) operating activities	30,581	36,880	(8,949)
Cash flows from investing activities:			
Capital expenditures	(14,369)	(10,753)	(13,038)
Note receivable	(3,104)	—	—
Proceeds from sale of property, plant and equipment	2	458	4,148
Investment in golf-related ventures	(940)	(14,771)	(13,637)
Net cash used in investing activities	(18,411)	(25,066)	(22,527)
Cash flows from financing activities:			
Exercise of stock options	6,565	2,291	1,652
Dividends paid, net	(3,391)	(3,105)	(5,599)
Acquisition of treasury stock	(1,960)	(1,006)	—
(Repayment of) proceeds from asset-based credit facilities, net	(266)	(10,425)	25,660
Credit facility amendment costs	—	(608)	—
Equity issuance costs	—	(7)	(341)
Other financing activities	—	(26)	(32)
Net cash provided by (used in) financing activities	948	(12,886)	21,340
Effect of exchange rate changes on cash and cash equivalents	(952)	1,914	(5,074)
Net increase (decrease) in cash and cash equivalents	12,166	842	(15,210)
Cash and cash equivalents at beginning of year	37,635	36,793	52,003
Cash and cash equivalents at end of year	$49,801	$37,635	$36,793
Supplemental disclosures:			
Cash paid for interest and fees	$6,641	$8,124	$6,741
Cash paid for income taxes, net	$5,454	$8,098	$4,986
Noncash investing and financing activities:			
Conversion of convertible notes to common stock, net of discount (Note 3)	$109,105	$—	$—
Issuance of treasury stock and common stock for compensatory stock awards released from restriction	$3,762	$86	$1,649

Accrued capital expenditures at period end	$2,255	$466	$1,467
Acquisition of treasury stock for minimum statutory withholding taxes	$—	$7	$364
Issuance of common stock in exchange for preferred stock	$—	$—	$42,278

The accompanying notes are an integral part of these consolidated financial statements.

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CALLAWAY GOLF COMPANY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands)

	Callaway Golf Shareholders										
	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Non-controlling Interest	Total
	Shares	Amount	Shares	Amount				Shares	Amount		
Balance, December 31, 2012	418	$4	72,264	$723	$204,510	$113,831	$14,770	(1,267)	$(14,848)	$2,718	$321,708
Preferred stock to common stock exchange	(417)	(4)	5,920	59	(55)	—	—	—	—	—	—
Redemption of preferred stock	(1)	—	—	—	(30)	—	—	—	—	—	(30)
Equity issuance costs	—	—	—	—	(341)	—	—	—	—	—	(341)
Acquisition of treasury stock	—	—	—	—	—	—	—	(56)	(364)	—	(364)
Exercise of stock options	—	—	—	—	(820)	—	—	216	2,472	—	1,652
Tax deficit from exercise of stock options and compensatory stock	—	—	—	—	(2)	—	—	—	—	—	(2)
Compensatory awards released from restriction	—	—	—	—	(1,649)	—	—	140	1,649	—	—
Share-based compensation	—	—	56	—	3,533	—	—	—	—	—	3,533
Stock dividends	—	—	75	1	566	(567)	—	—	—	—	—
Cash dividends	—	—	—	—	—	(5,599)	—	—	—	—	(5,599)
Equity adjustment from foreign currency translation	—	—	—	—	—	—	(2,593)	—	—	—	(2,593)
Change in non-controlling interest	—	—	—	—	—	—	—	—	—	(2,718)	(2,718)
Deconsolidation of subsidiaries	—	—	—	—	—	(11,706)	—	—	—	—	(11,706)
Net loss	—	—	—	—	—	(18,921)	—	—	—	—	(18,921)
Balance, December 31, 2013	—	$—	78,315	$783	$205,712	$77,038	$12,177	(967)	$(11,091)	$—	$284,619
	—	—	—	—	(7)	—	—	—	—	—	(7)

Equity issuance costs											
Acquisition of treasury stock	—	—	—	—	—	—	—	(133)	(1,013)	—	(1,013)
Exercise of stock options	—	—	—	—	(1,284)	—	—	312	3,575	—	2,291
Tax deficit from exercise of stock options and compensatory stock	—	—	—	—	(26)	—	—	—	—	—	(26)
Compensatory awards released from restriction	—	—	58	1	(87)	—	—	8	86	—	—
Share-based compensation	—	—	—	—	5,740	—	—	—	—	—	5,740
Stock dividends	—	—	1	—	9	(9)	—	—	—	—	—
Cash dividends	—	—	—	—	—	(3,105)	—	—	—	—	(3,105)
Equity adjustment from foreign currency translation	—	—	—	—	—	—	(12,973)	—	—	—	(12,973)
Net income	—	—	—	—	—	16,008	—	—	—	—	16,008
Balance, December 31, 2014	—	$—	78,374	$784	$210,057	$89,932	$(796)	(780)	$(8,443)	$—	$291,534
Convertible notes to common stock exchange	—	—	15,000	150	108,955	—	—	—	—	—	109,105
Acquisition of treasury stock	—	—	—	—	—	—	—	(217)	(1,960)	—	(1,960)
Exercise of stock options	—	—	277	3	(5)	—	—	637	6,567	—	6,565
Tax deficit from exercise of stock options	—	—	—	—	(1)	—	—	—	—	—	(1)
Compensatory awards released from restriction	—	—	110	1	(3,763)	—	—	353	3,762	—	—
Share-based compensation	—	—	—	—	7,542	—	—	—	—	—	7,542
Stock dividends	—	—	8	—	8	(62)	—	5	54	—	—
Cash dividends	—	—	—	—	—	(3,391)	—	—	—	—	(3,391)
Equity adjustment from foreign currency translation	—	—	—	—	—	—	(11,542)	—	—	—	(11,542)
Change in fair value of derivative	—	—	—	—	—	—	525	—	—	—	525

instruments											
Net income	—	—	—	—	—	14,568	—	—	—	—	14,568
Balance, December 31, 2015	—	$—	93,769	$938	$322,793	$101,047	$(11,813)	(2)	$(20)	$—	$412,945

The accompanying notes are an integral part of these consolidated financial statements.

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CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Note 1. The Company
Callaway Golf Company (“Callaway Golf” or the “Company”), a Delaware corporation, together with its subsidiaries, designs, manufactures and sells high quality golf clubs (drivers, fairway woods, hybrids, irons, wedges and putters), golf balls, golf bags and other golf-related accessories. The Company generally sells its products to golf retailers (including pro shops at golf courses and off-course retailers), sporting goods retailers and mass merchants, directly and through its wholly-owned subsidiaries, and to third-party distributors in the United States and in over 100 countries around the world. The Company also sells pre-owned Callaway Golf products through its website www.callawaygolfpreowned.com and sells new Callaway Golf products through its websites www.callawaygolf.com and www.odysseygolf.com. In addition, the Company licenses its trademarks and service marks in exchange for a royalty fee to third parties for use on golf related accessories including golf apparel and footwear, golf gloves, prescription eyewear and practice aids.
Note 2. Summary of Significant Accounting Policies
Principles of Consolidation
The accompanying consolidated financial statements include the accounts of the Company and its domestic and foreign subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.
Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Examples of such estimates include provisions for warranty, uncollectible accounts receivable, inventory obsolescence, sales returns, tax contingencies, estimates on the valuation of share-based awards and recoverability of long-lived assets and investments. Actual results may materially differ from these estimates. On an ongoing basis, the Company reviews its estimates to ensure that these estimates appropriately reflect changes in its business or as new information becomes available.
Recent Accounting Standards

On February 25, 2016, the Financial Accounting Standards Board ("FASB") issued its new lease accounting guidance in Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)." Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (i) a lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged and lessees will no longer be provided with a source of off-balance sheet financing. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.
In January 2016, the FASB issued ASU No. 2016-01, "'Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendment requires (i) equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, (ii) public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and (iii)

separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). This amendment eliminates the

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requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. This amendment is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes." This amendment eliminates the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent. For public business entities, the amendment is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company opted to early adopt this ASU and has applied this amendment to its deferred tax assets and liabilities in its consolidated balance sheet as of December 31, 2015 on a prospective basis. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In July 2015, FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory." Topic 330, Inventory, currently requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The amendments apply to inventory that is measured using first-in, first-out (FIFO) or average cost. An entity should measure in-scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments in this update more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements.

In April 2015, the FASB has issued ASU No. 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." Existing GAAP does not include explicit guidance about a customer's accounting for fees paid in a cloud computing arrangement. Examples of cloud computing arrangements include: (a) software as a service; (b) platform as a service; (c) infrastructure as a service; and (d) other similar hosting arrangements. The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the customer's accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. For public business entities, the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. The Company does not expect that the adoption of this amendment will have a material impact on the Company's consolidated financial statements and disclosures.

In April 2015, the FASB issued ASU No. 2015-03, "Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The guidance in ASU 2015-03 (see paragraph 835-30-45-1A) does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff stated that they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments for this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments is permitted for financial statements that have not been previously issued. The Company does not expect that the adoption of this amendment will have a material impact on the Company’s consolidated financial statements and disclosures.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern." This ASU is intended to define management’s responsibility to evaluate whether there is substantial doubt about an organization’s ability to continue as a going concern and to provide related footnote disclosures, and provides guidance to an organization’s management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. Until the issuance of this ASU, U.S. GAAP lacked guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The Company does not expect that the adoption of this amendment will have a material impact on its consolidated financial statements and disclosures.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." This ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period, be treated as a performance condition. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Based on the Company's evaluation of this ASU, it will not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: (Topic 606)." This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, "Revenue Recognition," and most industry-specific guidance. In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, "Property, Plant, and Equipment," and intangible assets within the scope of Topic 350, "Intangibles-Goodwill and Other") are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this ASU. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is currently evaluating the impact this ASU will have on its consolidated financial statements and disclosures.

Revenue Recognition

Sales are recognized, in general, as products are shipped to customers, net of an allowance for sales returns and sales programs in accordance with Accounting Standards Codification ("ASC") Topic 605, "Revenue Recognition." In certain cases, the Company recognizes sales when products are received by customers. The criteria for recognition of revenue are met when persuasive evidence that an arrangement exists and both title and risk of loss have passed to the customer, the price is fixed or determinable and collectability is reasonably assured. Sales returns are estimated based upon historical returns, current economic trends, changes in customer demands and sell-through of products. The Company also records estimated reductions to revenue for sales programs such as incentive offerings. Sales program accruals are estimated based upon the attributes of the sales program, management's forecast of future product demand, and historical customer participation in similar programs.

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The following table provides a reconciliation of the activity related to the Company's allowance for sales returns:

	Years Ended December 31,		
	2015	2014	2013
	(In thousands)		
Beginning balance	$8,944	$7,334	$6,383
Provision	35,746	36,980	32,127
Sales returns	(36,542)	(35,370)	(31,176)
Ending balance	$8,148	$8,944	$7,334

Revenues from gift cards are deferred and recognized when the cards are redeemed. In addition, the Company recognizes revenue from unredeemed gift cards when the likelihood of redemption becomes remote and under circumstances that comply with any applicable state escheatment laws. The Company's gift cards have no expiration. To determine when redemption is remote, the Company analyzes an aging of unredeemed cards (based on the date the card was last used or the activation date if the card has never been used) and compares that information with historical redemption trends. The deferred revenue associated with outstanding gift cards increased to $1,119,000 at December 31, 2015 from $1,082,000 at December 31, 2014. The amounts are recorded in accounts payable and accrued expenses on the accompanying consolidated balance sheets.

Royalty income is recorded in net sales as underlying product sales occur, subject to certain minimums, in accordance with the related licensing arrangements. The Company recognized royalty income under its various licensing agreements of $8,062,000, $8,881,000 and $9,130,000 during 2015, 2014 and 2013, respectively.

Warranty Policy

The Company has a stated two-year warranty policy for its golf clubs. The Company's policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty.

The following table provides a reconciliation of the activity related to the Company's reserve for warranty expense:

	Years Ended December 31,		
	2015	2014	2013
	(In thousands)		
Beginning balance	$5,607	$6,406	$7,539
Provision	5,220	4,724	5,177
Claims paid/costs incurred	(5,121)	(5,523)	(6,310)
Ending balance	$5,706	$5,607	$6,406

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability (the exit price) in the principal and most advantageous market for the asset or liability in an orderly transaction between market participants. The Company measures and discloses the fair value of nonfinancial and financial assets and liabilities utilizing a hierarchy of valuation techniques based on whether the inputs to a fair value measurement are considered to be observable or unobservable in a marketplace. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. This hierarchy requires the use of observable market data when available. The measurement of assets and liabilities at fair value are classified using the following three-tier hierarchy:

Level 1: Quoted market prices in active markets for identical assets or liabilities;

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

Level 3: Fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

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The Company measures fair value using a set of standardized procedures that are outlined herein for all assets and liabilities which are required to be measured at fair value. When available, the Company utilizes quoted market prices from an independent third-party source to determine fair value and classifies such items in Level 1. In some instances where a market price is available, but the instrument is in an inactive or over-the-counter market, the Company consistently applies the dealer (market maker) pricing estimate and uses a midpoint approach on bid and ask prices from financial institutions to determine the reasonableness of these estimates. Assets and liabilities subject to this fair value valuation approach are typically classified as Level 2.

Items valued using internally-generated valuation techniques are classified according to the lowest level input that is significant to the fair value measurement. As a result, the asset or liability could be classified in either Level 2 or Level 3 even though there may be some significant inputs that are readily observable. The Company utilizes a discounted cash flow valuation model whenever applicable to derive a fair value measurement on long-lived assets and goodwill and intangible assets. The Company uses its internal cash flow estimates discounted at an appropriate rate, quoted market prices, royalty rates when available and independent appraisals as appropriate. The Company also considers its counterparty’s and own credit risk on derivatives and other liabilities measured at their fair value.

Advertising Costs

The Company's primary advertising costs are from television and print media advertisements. The Company’s policy is to expense advertising costs, including production costs, as incurred. Advertising expenses for 2015, 2014 and 2013 were $57,392,000, $55,502,000 and $53,707,000, respectively.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs for 2015, 2014 and 2013 were $33,213,000, $31,285,000 and $30,937,000, respectively.

Foreign Currency Translation and Transactions

A significant portion of the Company’s business is conducted outside of the United States in currencies other than the U.S. dollar. As a result, changes in foreign currency exchange rates can have a significant effect on the Company’s financial results. Revenues and expenses that are denominated in foreign currencies are translated using the average exchange rate for the period. Assets and liabilities are translated at the rate of exchange on the balance sheet date. Gains and losses from assets and liabilities denominated in a currency other than the functional currency of the entity on which they reside are generally recognized currently in the Company's statements of operations. Gains and losses from the translation of foreign subsidiary financial statements into U.S. dollars are included in accumulated other comprehensive income or loss (see Accumulated Other Comprehensive Income policy below).

The Company recorded a net loss in foreign currency transactions of $1,611,000, $6,198,000 and $821,000 in 2015, 2014 and 2013, respectively.

Derivatives and Hedging

In order to mitigate the impact of foreign currency translation on transactions, the Company uses foreign currency forward contracts that are accounted for as non-designated and designated hedges pursuant to ASC Topic 815, “Derivatives and Hedging” ("ASC Topic 815"). ASC Topic 815 requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as designated cash flow hedge that offsets certain exposures. Certain criteria must be satisfied in order for derivative financial instruments to be classified and accounted for as a cash flow hedge. Gains and losses from the remeasurement of qualifying cash flow hedges are recorded as a component of other comprehensive income and released into earnings as a component of cost of goods sold or net sales during the period in which the hedged transaction takes place. Gains and losses on the ineffective portion of hedges (hedges that do not meet accounting requirements due to ineffectiveness) and derivatives that are not elected for hedge accounting treatment are immediately recorded in earnings as a component of other income (expense).

Cash and Cash Equivalents

Cash equivalents are highly liquid investments purchased with original maturities of three months or less.

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Trade Accounts Receivable

The Company records its trade accounts receivable at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect any loss anticipated on the trade accounts receivable balances and charged to the provision for doubtful accounts. An estimate of uncollectible amounts is made by management based upon historical bad debts, current customer receivable balances, age of customer receivable balances, the customer's financial condition and current economic trends, all of which are subject to change. Actual uncollected amounts have historically been consistent with the Company's expectations. The decrease in the allowance for estimated losses as of December 31, 2015 was primarily the result of a significant bad debt recovery recognized in 2015. The following table provides a reconciliation of the activity related to the Company's allowance for doubtful accounts:

	Years Ended December 31,		
	2015	2014	2013
	(In thousands)		
Beginning balance	$6,460	$11,655	$6,544
Provision	992	2,143	6,798
Write-off of uncollectible amounts, net of recoveries	(1,807)	(7,338)	(1,687)
Ending balance	$5,645	$6,460	$11,655

Inventories

Inventories are valued at the lower of cost or fair market value. Cost is determined using the first-in, first-out (FIFO) method. The inventory balance, which includes material, labor and manufacturing overhead costs, is recorded net of an estimate for obsolete or unmarketable inventory. This estimate is based upon current inventory levels, sales trends and historical experience as well as management's estimates of market conditions and forecasts of future product demand, all of which are subject to change.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives as follows:

Buildings and improvements	10-30 years
Machinery and equipment	5-10 years
Furniture, computers and equipment	3-5 years
Production molds	2-5 years

Normal repairs and maintenance costs are expensed as incurred. Expenditures that materially increase values, change capacities or extend useful lives are capitalized. The related costs and accumulated depreciation of disposed assets are eliminated and any resulting gain or loss on disposition is included in net income/(loss). Construction in-process consists primarily of costs associated with building improvements, machinery and equipment that have not yet been placed into service, unfinished molds as well as in-process internally developed software.

In accordance with ASC Topic 350-40, “Internal-Use Software,” the Company capitalizes certain costs incurred in connection with developing or obtaining internal use software. Costs incurred in the preliminary project stage are expensed. All direct external costs incurred to develop internal-use software during the development stage are capitalized and amortized using the straight-line method over the remaining estimated useful lives. Costs such as maintenance and training are expensed as incurred.

Long-Lived Assets

In accordance with ASC Topic 360-10-5, “Impairment or Disposal of Long-Lived Assets”, the Company assesses potential impairments of its long-lived assets whenever events or changes in circumstances indicate that the asset's carrying value may not be recoverable. An impairment charge would be recognized when the carrying amount of a long-lived asset or asset group is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset or asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group.

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Goodwill and Intangible Assets
Goodwill and intangible assets, which consist of trade names, trademarks, service marks, trade dress, patents and other intangible assets, were acquired in connection with the acquisition of Odyssey Sports, Inc. in 1997, FrogTrader, Inc. in 2004, and certain foreign distributors.
In accordance with ASC Topic 350, "Intangibles—Goodwill and Other," goodwill and intangible assets with indefinite lives are not amortized but instead are measured for impairment at least annually or more frequently when events indicate that an impairment exists. The Company calculates impairment as the excess of the carrying value of goodwill and other indefinite-lived intangible assets over their estimated fair value. If the carrying value exceeds the estimate of fair value a write-down is recorded. To determine fair value, the Company uses its internal discounted cash flow estimates, quoted market prices, royalty rates when available and independent appraisals when appropriate.
The Company completed its annual impairment test and fair value analysis of goodwill and other indefinite-lived intangible assets as of December 31, 2015, and the estimated fair values of the Company's reporting units in the United States, United Kingdom, Canada and Korea, as well as the estimated fair values of certain trade names and trademarks, exceeded their carrying values. As a result, no impairment was recorded as of December 31, 2015.
Intangible assets that are determined to have definite lives are amortized over their estimated useful lives and are measured for impairment only when events or circumstances indicate the carrying value may be impaired in accordance with ASC Topic 360-10-5 discussed above. See Note 6 for further discussion of the Company's goodwill and intangible assets.
Investments
The Company determines the appropriate classification of its investments at the time of acquisition and reevaluates such classification at each balance sheet date. Investments that do not have readily determinable fair values are stated at cost. The Company monitors investments for impairment in accordance with ASC Topic 325-35-2, "Impairment" and ASC Topic 320-35-17 through 35-35, "Scope of Impairment Guidance." See Note 7 for further discussion of the Company's investments.
Share-Based Compensation
The Company accounts for its share-based compensation arrangements in accordance with ASC Topic 718, "Compensation—Stock Compensation" ("ASC Topic 718"), which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and non-employees based on estimated fair values. ASC Topic 718 further requires a reduction in share-based compensation expense by an estimated forfeiture rate. The forfeiture rate used by the Company is based on historical forfeiture trends. If actual forfeiture rates are not consistent with the Company's estimates, the Company may be required to increase or decrease compensation expenses in future periods.
Performance share units are stock-based awards in which the number of shares ultimately received depends on the Company's performance against specified goals that are measured over a designated performance period from the date of grant. These performance goals are established by the Company at the beginning of the performance period. At the end of the performance period, the number of shares of stock that could be issued is fixed based upon the degree of achievement of the performance goals. The number of shares that could be issued can range from 50% to 150% of the participant's target award. Performance share units are initially valued at the Company's closing stock price on the date of grant. Compensation expense for performance share units is recognized over the vesting period and is reduced by an estimate for forfeitures, and will vary based on remeasurements during the performance period. If the performance goals are not probable of achievement during the performance period, compensation expense would be reversed. The awards are forfeited if the performance goals are not achieved as of the end of the performance period. The performance units vest in full at the end of a three year period.
The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options and stock appreciation rights ("SARs") at the date of grant. The Black-Scholes option valuation model requires the input of subjective assumptions to calculate the value of stock options/SARs. The Company uses historical data among other information to estimate the expected price volatility, expected term and forfeiture rate. The Company uses forecasted dividends to estimate the expected dividend yield. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Compensation expense is recognized on a straight-line basis over the vesting period for

stock options. Compensation expense for SARs is recognized on a straight-line basis over the vesting period based on an estimated fair value, which is remeasured at the end of each reporting period. Once vested, the SARs continue to be remeasured to fair value until they are exercised.

The Company records compensation expense for restricted stock awards and restricted stock units (collectively "restricted stock") based on the estimated fair value of the award on the date of grant. The estimated fair value is determined based on the

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closing price of the Company's common stock on the award date multiplied by the number of shares underlying the restricted stock awarded. Total compensation expense is recognized on a straight-line basis over the vesting period. Phantom stock units are a form of share-based awards that are indexed to the Company's stock and are settled in cash. Compensation expense is recognized on a straight-line basis over the vesting period based on the award's estimated fair value. Fair value is remeasured at the end of each interim reporting period through the award's settlement date and is based on the closing price of the Company's stock.

Income Taxes

Current income tax expense or benefit is the amount of income taxes expected to be payable or receivable for the current year. A deferred income tax asset or liability is established for the difference between the tax basis of an asset or liability computed pursuant to ASC Topic 740 and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. The Company maintains a valuation allowance for a deferred tax asset when it is deemed to be more likely than not that some or all of the deferred tax asset will not be realized. In evaluating whether a valuation allowance is required under such rules, the Company considers all available positive and negative evidence, including prior operating results, the nature and reason for any losses, its forecast of future taxable income, and the dates on which any deferred tax assets are expected to expire. These assumptions require a significant amount of judgment, including estimates of future taxable income. These estimates are based on the Company's best judgment at the time made based on current and projected circumstances and conditions. In 2011, as a result of this evaluation, the Company recorded a valuation allowance against its U.S. deferred tax assets due to losses generated in the United States. At the end of each interim and annual reporting period, as the U.S. deferred tax assets are adjusted upwards or downwards, the associated valuation allowance and income tax expense are also adjusted. If sufficient positive evidence arises in the future, such as a sustained return to profitability in the U.S. business, any existing valuation allowance could be reversed as appropriate, decreasing income tax expense and creating a significant one-time non-cash tax benefit in the period that such conclusion is reached. Prospectively, the Company would then report an effective U.S. income tax rate that is closer to statutory rates. The Company concluded that with respect to non-U.S. entities, there is sufficient positive evidence to conclude that the realization of its deferred tax assets is deemed to be likely, and no significant allowances have been established. For further information, see Note 9 "Income Taxes."

Pursuant to ASC Topic 740-25-6, the Company is required to accrue for the estimated additional amount of taxes for uncertain tax positions if it is deemed to be more likely than not that the Company would be required to pay such additional taxes.

The Company is required to file federal and state income tax returns in the United States and various other income tax returns in foreign jurisdictions. The preparation of these income tax returns requires the Company to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax paid by the Company. The Company accrues an amount for its estimate of additional tax liability, including interest and penalties in income tax expense, for any uncertain tax positions taken or expected to be taken in an income tax return. The Company reviews and updates the accrual for uncertain tax positions as more definitive information becomes available. Historically, additional taxes paid as a result of the resolution of the Company's uncertain tax positions have not been materially different from the Company's expectations. The Company recognizes interest and/or penalties related to income tax matters in income tax expense. For further information, see Note 9 "Income Taxes."

Other Income (Expense), Net

Other income (expense), net primarily includes gains and losses on foreign currency forward contracts and foreign currency transactions. The components of other income (expense), net are as follows:

	Years Ended December 31,		
	2015	2014	2013
	(In thousands)		
Foreign currency forward contract gains, net	$2,877	$6,356	$6,764
Foreign currency transaction losses, net	(1,611)	(6,198)	(821)
Other	199	(206)	62
	$1,465	$(48)	$6,005

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Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes the impact of foreign currency translation adjustments and the change in fair value of derivative instruments designated for hedge accounting. As the Company has met the permanent reinvestment criteria, it does not accrue income taxes on foreign currency translation adjustments. The total equity adjustment from foreign currency translation included in accumulated other comprehensive income were losses of $11,542,000 and $12,973,000 as of December 31, 2015 and 2014, respectively. The total equity adjustment from the change in fair value of derivative instruments was a net gain of $525,000 as of December 31, 2015. The Company did not have derivative instruments that qualified for hedge accounting as of December 31, 2014. See Note 16 "Derivatives and Hedging" for a tabular roll-forward of accumulated other comprehensive income (loss).

Segment Information

The Company’s operating segments are organized on the basis of products and consist of golf clubs and golf balls. The golf clubs segment consists primarily of Callaway Golf woods, hybrids, irons, wedges and putters as well as Odyssey putters, pre-owned clubs, golf-related accessories and royalties from licensing of the Company’s trademarks and service marks. The golf balls segment consists of Callaway Golf balls that are designed, manufactured and sold by the Company. The Company also discloses information about geographic areas. This information is presented in Note 18 “Segment Information.”

Concentration of Risk

The Company operates in the golf equipment industry and has a concentrated customer base, which is primarily comprised of golf equipment retailers (including pro shops at golf courses and off-course retailers), sporting goods retailers and mass merchants and foreign distributors. On a consolidated basis, no one customer accounted for more than 9% of the Company’s consolidated revenues in 2015, and no one customer accounted for more than 8% of the Company's consolidated revenue in each of 2014 and 2013. The Company's top five customers accounted for approximately 26% of the Company's consolidated revenues in 2015, 25% in 2014 and 23% in 2013. With respect to the Company's segments, in 2015 and 2014, the Company's top five golf club customers accounted for approximately 25% of total consolidated golf club sales, and approximately 23% of total consolidated golf club sales in 2013. The top five golf ball customers accounted for approximately 30% of total consolidated golf ball sales in each of 2015 and 2014, and 27% in 2013. A loss of one or more of these customers could have a significant effect on the Company's net sales.

With respect to the Company's trade receivables, the Company performs ongoing credit evaluations of its customers’ financial condition and generally requires no collateral from these customers. The Company maintains reserves for estimated credit losses, which it considers adequate to cover any such losses. At December 31, 2015, the Company had one customer with an outstanding balance greater than 10% of the Company's outstanding consolidated accounts receivable. At December 31, 2014, no single customer represented over 9% of the Company’s outstanding accounts receivable balance. Managing customer-related credit risk is more difficult in regions outside of the United States. Of the Company’s total net sales, approximately 47% was derived from sales outside of the United States in 2015, and approximately 52% in each of 2014 and 2013, respectively. Prolonged unfavorable economic conditions could significantly increase the Company’s credit risk with respect to its outstanding accounts receivable.

The Company is dependent on a limited number of suppliers for its clubheads and shafts, some of which are single sourced. Furthermore, some of the Company’s products require specially developed manufacturing techniques and processes which make it difficult to identify and utilize alternative suppliers quickly. In addition, many of the Company’s suppliers are not well capitalized and prolonged unfavorable economic conditions could increase the risk that they will go out of business. If current suppliers are unable to deliver clubheads, shafts or other components, or if the Company is required to transition to other suppliers, the Company could experience significant production delays or disruption to its business. The Company also depends on a single or a limited number of suppliers for the materials it uses to make its golf balls. Many of these materials are customized for the Company. Any delay or interruption in such supplies could have a material adverse impact upon the Company’s golf ball business. If the Company were to experience any such delays or interruptions, the Company may not be able to find adequate alternative suppliers at a reasonable cost or without significant disruption to its business.

The Company's financial instruments that are subject to concentrations of credit risk consist primarily of cash equivalents, trade receivables and foreign currency forward contracts.

From time to time, the Company invests its excess cash in money market accounts and short-term U.S. government securities and has established guidelines relative to diversification and maturities in an effort to maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates.

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The Company enters into foreign currency forward contracts for the purpose of hedging foreign exchange rate exposures on existing or anticipated transactions. In the event of a failure to honor one of these contracts by one of the banks with which the Company has contracted, management believes any loss would be limited to the exchange rate differential from the time the contract was made until the time it was settled.

Note 3. Financing Arrangements

In addition to cash on hand, as well as cash generated from operations, the Company relies on its primary and Japan asset-based revolving credit facilities to manage seasonal fluctuations in liquidity and to provide additional liquidity when the Company's operating cash flows are not sufficient to fund the Company's requirements. As of December 31, 2015, the Company had $14,969,000 outstanding under these facilities, $1,030,000 in outstanding letters of credit, and $49,801,000 in cash and cash equivalents. The combined maximum amount that could have been outstanding under both facilities on December 31, 2015, after letters of credit, was $105,492,000, resulting in total available liquidity, including cash on hand, of $155,293,000. The maximum amount that could have been outstanding under the Company's primary asset-based revolving credit facility on December 31, 2014 was $55,611,000, and total available liquidity, including cash on hand was $93,246,000. The Company did not have its Japan ABL Facility in 2014.

Primary Asset-Based Revolving Credit Facility

The Company's primary credit facility is a Loan and Security Agreement with Bank of America N.A. (as amended, the "ABL Facility") which provides a senior secured asset-based revolving credit facility of up to $230,000,000, comprised of a $160,000,000 U.S. facility, a $25,000,000 Canadian facility, and a $45,000,000 United Kingdom facility, in each case subject to borrowing base availability under the applicable facility. The amounts outstanding under the ABL Facility are secured by certain assets, including cash (to the extent pledged by the Company), inventory and accounts receivable, of the Company's subsidiaries in the United States, Canada and the United Kingdom.

As of December 31, 2015, the Company had no borrowings outstanding under the ABL Facility and $1,030,000 in outstanding letters of credit. The maximum amount of additional indebtedness (as defined by the ABL Facility) that could have been outstanding on December 31, 2015, after outstanding borrowings and letters of credit, was approximately $88,860,000. The maximum availability under the ABL Facility fluctuates with the general seasonality of the business and increases and decreases with changes in the Company's inventory and accounts receivable balances. The maximum availability is at its highest during the first half of the year when the Company's inventory and accounts receivable balances are higher and is lower during the second half of the year when the Company's inventory levels decrease and its accounts receivable decrease as a result of cash collections and lower sales. Average outstanding borrowings during the year ended December 31, 2015 were $37,352,000, and average amounts available under the ABL Facility during the year ended December 31, 2015, after outstanding borrowings and letters of credit, was approximately $123,846,000. Amounts borrowed under the ABL Facility may be repaid and borrowed as needed. The entire outstanding principal amount (if any) is due and payable at June 23, 2019.

The ABL Facility includes certain restrictions including, among other things, restrictions on the incurrence of additional debt, liens, stock repurchases and other restricted payments, asset sales, investments, mergers, acquisitions and affiliate transactions. In addition, the ABL Facility imposes restrictions on the amount the Company could pay in annual cash dividends, including meeting certain restrictions on the amount of additional indebtedness and requirements to maintain a certain fixed charge coverage ratio under certain circumstances. As of December 31, 2015, the Company was in compliance with all financial covenants of the ABL Facility. Additionally, the Company is subject to compliance with a fixed charge coverage ratio covenant during, and continuing 30 days after, any period in which the Company's borrowing base availability, as amended, falls below $23,000,000. The Company's borrowing base availability was above $23,000,000 during the year ended December 31, 2015, and the Company was in compliance with the fixed charge coverage ratio as of December 31, 2015. Had the Company not been in compliance with the fixed charge coverage ratio as of December 31, 2015, the Company's maximum amount of additional indebtedness that could have been outstanding on December 31, 2015 would have been reduced by $23,000,000.

The interest rate applicable to outstanding loans under the ABL Facility fluctuates depending on the Company's "availability ratio," which is expressed as a percentage of (i) the average daily availability under the ABL Facility to (ii) the sum of the Canadian, the U.K. and the U.S. borrowing bases, as adjusted. The applicable margin for any month will be reduced by 0.25% if the Company's availability ratio is greater than or equal to 67% and the Company's “leverage ratio” (as defined below) is less than 4.0 to 1.0 as of the last day of the month for which financial statements have been delivered, so long as no default or event of default exists. The Company’s “leverage ratio” is the ratio of the amount of debt for borrowed money to the 12-month trailing EBITDA (as defined in the ABL Facility), each determined on a consolidated basis. At December 31, 2015, the Company's trailing 12 months average interest rate applicable to its outstanding loans under the ABL Facility, including the fees described below, was 4.43%.

In addition, the ABL Facility provides for monthly fees ranging from 0.25% to 0.375% of the unused portion of the ABL Facility, depending on the prior month's average daily balance of revolver loans and stated amount of letters of credit relative to lenders' commitments.

The fees incurred in connection with the origination and amendment of the ABL Facility totaled $4,961,000, which will be amortized into interest expense over the term of the ABL Facility agreement. Unamortized origination fees as of December 31, 2015 and 2014 were $1,781,000 and $2,233,000, respectively, of which $509,000 and $496,000, respectively, was included in other current assets and $1,272,000 and $1,737,000, respectively, was included in other long-term assets in the accompanying consolidated balance sheets.

Japan ABL Facility

In January 2015, the Company entered into a separate asset-based loan and guarantee agreement (the "Japan ABL Facility") between its subsidiary in Japan and The Bank of Tokyo-Mitsubishi UFG, Ltd and The Development Bank of Japan. The Company can borrow up to 2 billion Yen (or $16,632,000, using the exchange rate in effect as of December 31, 2015) over a one-year term, and the amounts outstanding are secured by certain assets, including eligible inventory. The Japan ABL Facility is subject to an effective interest rate of 1.48%, and includes certain restrictions including covenants related to certain pledged assets and financial performance metrics. As of December 31, 2015, the Company was in compliance with these covenants. The Company had $14,969,000 outstanding under this facility at December 31, 2015, and the maximum amount that could have been outstanding at December 31, 2015 was $16,632,000.

In January 2016, the Company renewed the Japan ABL Facility for an additional two-year term, subject to an effective interest rate equal to TIBOR plus 0.25%. The agreement expires on January 22, 2018

Convertible Senior Notes

In August 2012, the Company issued $112,500,000 of 3.75% Convertible Senior Notes (the "convertible notes"). The convertible notes were convertible, at the option of the note holder, at any time on or prior to the close of business on the business day immediately preceding August 15, 2019, into shares of common stock at an initial conversion rate of 133.3333 shares per $1,000 principal amount of convertible notes, which is equal to an aggregate of 15,000,000 shares of common stock at a conversion price of approximately $7.50 per share, subject to customary anti-dilution adjustments. The Company incurred transactional fees of $3,537,000 which were being amortized over the term of the convertible notes.

During the second half of 2015, the convertible notes were eliminated pursuant to certain exchange transactions and shareholder conversions, which resulted, among other things, in the issuance of 15,000,000 shares of common stock to the note holders. In connection with the elimination of the convertible notes, the Company recorded $108,955,000 in shareholders' equity as of December 31, 2015, net of the outstanding discount of $3,395,000. There were no convertible notes outstanding as of December 31, 2015.

In connection with the elimination of the convertible notes in 2015, the Company accelerated the amortization of transaction fees, which resulted in charges of $2,042,000 during 2015. There were no transaction fees remaining to be amortized at December 31, 2015. Unamortized transactions fees as of December 31, 2014 were $2,358,000, of which $505,000 was included in other current assets and $1,853,000 was included in other long-term assets, respectively, in the accompanying consolidated financial statements.

The net carrying amount of the convertible notes as of December 31, 2014 was $108,574,000, and the unamortized discount was $3,926,000. Total interest and amortization expense recognized during the years ended December 31, 2015 and 2014 was $3,158,000 and $4,957,000, respectively.

Note 4. Preferred Stock

In August 2013, the Company exchanged 233,843 shares of its then outstanding 7.50% Series B Cumulative Perpetual Convertible Preferred Stock (the "Series B Preferred Stock") for 3,316,922 shares of the Company's common stock at the stated conversion rate of 14.1844 plus an additional 75,342 common shares as an inducement. The Company also paid the exchanging holders cash dividends through December 15, 2013 on their shares of Series B Preferred Stock surrendered in the exchange. During the fourth quarter of 2013, the Company issued a notice of redemption and holders of 183,496 shares of Series B Preferred Stock

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converted their holdings into 2,602,770 shares of the Company's common stock at the stated conversion rate of 14.1844. The Company redeemed the remaining 300 shares of Series B Preferred Stock for $30,000.
In November 2014, the Company eliminated the Series B Preferred Stock and restored their status to undesignated shares of preferred stock. As of December 31, 2015 and 2014, there were no outstanding shares of the preferred stock.
Note 5. Earnings (Loss) per Common Share
Basic earnings per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the period.
Diluted earnings per common share reflects the potential dilution that could occur if convertible securities, or other contracts to issue common stock, were exercised or converted into common stock. Dilutive securities are included in the calculation of diluted earnings per common share using the treasury stock method and the if-converted method in accordance with ASC Topic 260, "Earnings per Share." Dilutive securities include the common stock equivalents of preferred stock, convertible notes, options granted pursuant to the Company's stock option plans and outstanding restricted stock units and performance share units granted to employees and non-employee directors (see Note 13). There were no outstanding shares of the preferred stock at December 31, 2015 and 2014 (see Note 4), and no outstanding convertible notes at December 31, 2015.
Weighted-average common shares outstanding—diluted is the same as weighted-average common shares outstanding—basic in periods when a net loss is reported or in periods when diluted earnings per share is higher than basic earnings per share.
The following table summarizes the computation of basic and diluted earnings (loss) per share:

	Years Ended December 31,		
	2015	2014	2013
	(In thousands, except per share data)		
Earnings (loss) per common share—basic			
Net income (loss)	$14,568	$16,008	$(18,921)
Less: Preferred stock dividends	—	—	3,332
Net income (loss) allocable to common shareholders	$14,568	$16,008	$(22,253)
Weighted-average common shares outstanding—basic	83,116	77,559	72,809
Basic earnings (loss) per common share	$0.18	$0.21	$(0.31)
Earnings (loss) per common share—diluted			
Net income (loss)	$14,568	$16,008	$(18,921)
Less: Preferred stock dividends	—	—	3,332
Net income (loss) allocable to common shareholders	$14,568	$16,008	$(22,253)
Weighted-average common shares outstanding—basic	83,116	77,559	72,809
Options and restricted stock	1,495	826	—
Weighted-average common shares outstanding—diluted	84,611	78,385	72,809
Dilutive earnings (loss) per common share	$0.17	$0.20	$(0.31)

Earnings (loss) per share—diluted, reflects the potential dilution that could occur if convertible securities, or other contracts to issue common stock, were exercised or converted into common stock. Options with an exercise price in excess of the average market value of the Company's common stock during the period have been excluded from the calculation as their effect would be antidilutive.
Antidilutive securities excluded from the earnings per share computation are summarized as follows:

- For the year ended December 31, 2015, securities outstanding totaling approximately 10,812,000, including common shares underlying convertible senior notes of 10,248,000, in addition to antidilutive options and restricted stock.
- For the year ended December 31, 2014, securities outstanding totaling approximately 16,000,000, including common shares underlying convertible senior notes of 15,000,000, in addition to anti-dilutive options and restricted stock.

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• For the year ended December 31, 2013, securities outstanding totaling approximately 25,029,000, including common shares underlying preferred stock of 4,293,000, and common shares underlying convertible senior notes of 15,000,000, in addition to antidilutive options and restricted stock.

Note 6. Goodwill and Intangible Assets

Goodwill at December 31, 2015 decreased to $26,500,000 from $27,821,000 at December 31, 2014 due to $1,321,000 in foreign currency fluctuations. Gross goodwill before impairments at December 31, 2015 and 2014 was $28,249,000 and $29,570,000, respectively.

In accordance with ASC Topic 350, "Intangibles—Goodwill and Other," the Company's goodwill and certain intangible assets are not amortized, but are subject to an annual impairment test. The following sets forth the intangible assets by major asset class:

	Useful Life (Years)	December 31, 2015			December 31, 2014		
		Gross	Accumulated Amortization (In thousands)	Net Book Value	Gross	Accumulated Amortization (In thousands)	Net Book Value
Indefinite-lived:							
Trade name, trademark and trade dress and other	NA	$88,590	$—	$88,590	$88,590	$—	$88,590
Amortizing:							
Patents	2-16	31,581	31,389	192	31,581	31,338	243
Developed technology and other	1-9	7,961	7,961	—	7,961	7,961	—
Total intangible assets		$128,132	$39,350	$88,782	$128,132	$39,299	$88,833

Aggregate amortization expense on intangible assets was approximately $51,000, $68,000 and $288,000 for the years ended December 31, 2015, 2014 and 2013, respectively. Amortization expense related to intangible assets at December 31, 2015 in each of the next five fiscal years and beyond is expected to be incurred as follows (in thousands):

2016	$51
2017	51
2018	51
2019	39
	$192

Note 7. Investments

The Company owns a minority interest in Topgolf International, Inc., doing business as the Topgolf Entertainment Group ("Topgolf"), the owner and operator of Topgolf entertainment centers, which ownership consists of common stock and various classes of preferred stock. In connection with this investment, the Company has a preferred partner agreement with Topgolf in which the Company has preferred signage rights, rights as the preferred supplier of golf products used or offered for use at Topgolf facilities at prices no less than those paid by the Company's customers, preferred retail positioning in the Topgolf retail stores, access to consumer information obtained by Topgolf, and other rights incidental to those listed above.

In December 2014, the Company remitted funds to subscribe for $1,699,000 in preferred shares of Topgolf. In January 2015, the subscription was accepted and the Company acquired the $1,699,000 in preferred shares. In December 2015, the Company invested an additional $940,000 in preferred shares of Topgolf, thereby increasing the Company's total investment as of December 31, 2015 to $53,315,000. In addition, in December 2015, the Company and Topgolf entered into a shareholder loan agreement, which resulted in a note receivable from Topgolf for $3,200,000. The loan was subject to an annual interest rate of 10%, and was due and payable on March 30, 2016. The loan was paid in full in February 2016.

The Company's total ownership interest in Topgolf, including the Company's voting rights in the preferred shares of Topgolf, remains at less than 20% of the outstanding equity securities of Topgolf. As of December 31, 2015, the Company did not have

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the ability to significantly influence the operating and financing activities and policies of Topgolf, and accordingly, the Company's investment in Topgolf is accounted for at cost in accordance with ASC Topic 325, "Investments—Other." During 2015, the Company did not conduct a fair value analysis of its investment in Topgolf as it was not practicable to do so. However, there were no events or changes in circumstances that would have had a significant adverse effect on the fair value of this investment. In January 2016, the Company exercised certain stock options to acquire additional common shares in Topgolf for $1,259,000. This additional investment did not increase the Company's ownership percentage above 20%.

On February 22, 2016, Topgolf announced that Providence Equity Partners L.L.C. ("Providence Equity") has made a significant minority preferred stock investment in Topgolf (the "Providence Equity Investment"). In connection with the Providence Equity Investment, Topgolf intends to use a portion of the proceeds it receives to repurchase shares from its existing shareholders, other than Providence Equity (the "Topgolf Repurchase Program"). The Company has agreed to sell approximately 9.6% to 10.9% of its shares in Topgolf in the Topgolf Repurchase Program, which amount may vary based on how many other existing Topgolf shareholders participate in the Topgolf Repurchase Program.

In connection with the sale of its Topgolf shares in the Topgolf Repurchase Program, the Company expects to recognize a gain of approximately $17,377,000 to $19,696,000 in the first half of 2016, which amount will vary based on the number of shares Topgolf ultimately repurchases from the Company. The Company's total investment in Topgolf accounted for on a cost-basis prior to these transactions is $54,574,000, which includes $1,259,000 invested in connection with the exercise of certain stock options in January 2016. The Company's participation in the Topgolf Repurchase Program will reduce its total investment in Topgolf by approximately $5,674,000 to $6,431,000, to a net total investment accounted for at cost of $48,144,000 to $48,901,000.

Based upon the transactions described above, the Company estimates the fair value of its Topgolf shares to be within the range of $230,000,000 to $240,000,000 immediately prior to the Providence Equity Investment (and prior to the Topgolf Repurchase Program). This fair value estimate is based solely upon the valuations and pricing in the Providence Equity Investment and related Topgolf Repurchase Program. No discount has been attributed to this fair value estimate for any preferred terms, including any shareholder, governance or other rights provided to Providence Equity that may differ from those held by the Company, and no premium has been attributed to this fair value estimate for any incremental value that might otherwise apply in the case of a change in control transaction (e.g. an initial public offering or sale of Topgolf). The Company's Topgolf shares are illiquid and there is no assurance that the Company could sell its shares for the estimated fair value, or at all. Further, this estimate represents the fair value as of a point in time immediately preceding the Providence Equity Investment. The future value of the Company's shares may differ materially from the estimated fair value. The future fair value will be affected by many factors, including the availability of interested and willing buyers, the future performance of the Topgolf business, Topgolf's future capital structure, potential future dilution, and private and public equity market valuations and market conditions. In the absence of the Providence Equity Investment, it would not have been practicable for the Company to estimate the fair value of its Topgolf shares and there is no assurance that the Company will be able to estimate the fair value of its Topgolf shares in the future.

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Note 8. Selected Financial Statement Information

	December 31,	
	2015	2014
	(In thousands)	
Accounts receivable, net:		
Trade accounts receivable	$129,400	$125,252
Allowance for sales returns	(8,148)	(8,944)
Allowance for doubtful accounts	(5,645)	(6,460)
	$115,607	$109,848
Inventories:		
Raw materials	$53,876	$47,661
Work-in-process	703	519
Finished goods	154,304	159,049
	$208,883	$207,229
Property, plant and equipment, net:		
Land	$7,260	$7,365
Buildings and improvements	63,754	62,784
Machinery and equipment	107,495	107,845
Furniture, computers and equipment	96,674	122,501
Production molds	19,478	18,787
Construction-in-process	5,507	1,463
	300,168	320,745
Accumulated depreciation	(244,360)	(262,652)
	$55,808	$58,093
Accounts payable and accrued expenses:		
Accounts payable	$54,789	$46,154
Accrued expenses	46,933	56,819
Accrued goods in-transit	20,898	20,278
	$122,620	$123,251
Accrued employee compensation and benefits:		
Accrued payroll and taxes	$24,118	$28,219
Accrued vacation and sick pay	8,408	8,149
Accrued commissions	992	1,018
	$33,518	$37,386

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Note 9. Income Taxes

The Company's income (loss) before income tax provision was subject to taxes in the following jurisdictions for the following periods (in thousands):

	Years Ended December 31,		
	2015	2014	2013
United States	$6,864	$6,981	$(28,622)
Foreign	13,199	14,658	15,300
	$20,063	$21,639	$(13,322)

The expense (benefit) for income taxes is comprised of (in thousands):

	Years Ended December 31,		
	2015	2014	2013
Current tax provision (benefit):			
Federal	$271	$496	$195
State	431	612	382
Foreign	4,393	4,930	6,487
	5,095	6,038	7,064
Deferred tax expense (benefit):			
Federal	(41)	(1,549)	1,100
State	113	70	(817)
Foreign	328	1,072	(1,748)
	400	(407)	(1,465)
Income tax provision	$5,495	$5,631	$5,599

On November 20, 2015, the FASB issued ASU No 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes" which requires all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. The new accounting guidance is effective for annual reporting periods beginning after December 31, 2016 and interim periods therein. Early adoption is permitted as of the beginning of interim or annual reporting periods. The Company has adopted the standard prospectively as of December 31, 2015 and no adjustment was made to prior periods.

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Deferred tax assets and liabilities of prior periods are classified as current or noncurrent according to the classification of the related asset or liability. Significant components of the Company's deferred tax assets and liabilities as of December 31, 2015 and 2014 are as follows (in thousands):

	December 31, 2015	December 31, 2014
Deferred tax assets:		
Reserves and allowances not currently deductible for tax purposes	$14,292	$15,861
Basis difference related to fixed assets	10,170	10,943
Compensation and benefits	8,964	8,147
Basis difference for inventory valuation	1,764	1,526
Compensatory stock options and rights	3,659	4,334
Deferred revenue and other	169	201
Operating loss carryforwards	96,067	100,227
Tax credit carryforwards	19,787	15,987
Basis difference related to intangible assets with a definite life	16,617	15,557
Other	(162)	435
Total deferred tax assets	171,327	173,218
Valuation allowance for deferred tax assets	(164,616)	(165,427)
Deferred tax assets, net of valuation allowance	$6,711	$7,791
Deferred tax liabilities:		
Prepaid expenses	(868)	(1,368)
Basis difference related to intangible assets with an indefinite life	(33,974)	(34,065)
Total deferred tax liabilities	(34,842)	(35,433)
Net deferred tax liabilities	$(28,131)	$(27,642)
Net deferred tax assets (liabilities) are shown on the accompanying consolidated balance sheets as follows:		
Current deferred tax assets	$—	$5,081
Non-current deferred tax assets	6,962	2,346
Current deferred tax liabilities	—	(26)
Non-current deferred tax liabilities	(35,093)	(35,043)
Net deferred tax liabilities	$(28,131)	$(27,642)

The change in net deferred taxes in 2015 of $489,000 is comprised of a net deferred expense of $26,000 related to the change in the basis difference of intangible assets with an indefinite life, a net deferred expense of $121,000 related to foreign and separate state jurisdictions for which no valuation allowance has been provided, and an expense of $342,000 related to foreign currency translation adjustments.

Deferred tax assets and liabilities result from temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that are anticipated to be in effect at the time the differences are expected to reverse. The realization of the deferred tax assets, including the loss and credit carry forwards listed above, is subject to the Company generating sufficient taxable income during the periods in which the temporary differences become realizable. In accordance with the applicable accounting rules, the Company maintains a valuation allowance for a deferred tax asset when it is deemed to be more likely than not that some or all of the deferred tax assets will not be realized. In evaluating whether a valuation allowance is required under such rules, the Company considers all available positive and negative evidence, including prior operating results, the nature and reason for any losses, its forecast of future taxable income, and the dates on which any deferred tax assets are expected to expire. These assumptions require a significant amount of judgment, including estimates of future taxable income. These estimates are based on the Company's best judgment at the time made based on current and projected circumstances and conditions.

In 2011, the Company established a valuation allowance against its U.S. deferred tax assets and discontinued recognizing income tax benefits related to its U.S. net operating losses. At December 31, 2015 and 2014, the valuation allowance against the Company’s U.S. deferred tax assets was $164,616,000 and $165,427,000, respectively. If sufficient positive evidence arises in the

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future, such as a sustained return to profitability, any existing valuation allowance could be reversed as appropriate, decreasing income tax expense and creating a significant one-time non-cash tax benefit in the period that such conclusion is reached. Prospectively, the Company would then report an effective U.S. income tax rate that is closer to its statutory rates.

The Company's valuation allowance does not preclude the Company from using net operating loss carry forwards or other deferred tax assets in the future, except as described below. Until the Company re-establishes a pattern of continuing profitability, in accordance with the applicable accounting guidance, U.S. income tax expense or benefit related to the recognition of deferred tax assets in the consolidated statement of operations for future periods will be offset by decreases or increases in the valuation allowance with no net effect on the consolidated statement of operations.

The Company has concluded that with respect to non-U.S. entities, there is sufficient positive evidence to conclude that realization of its deferred tax assets is more likely than not under applicable accounting rules, and no significant allowances have been established.

At December 31, 2015, the Company had federal and state income tax credit carryforwards of $15,136,000 and $11,994,000, respectively, which will expire at various dates beginning in 2020. Such credit carryforwards expire as follows (in thousands):

U.S. foreign tax credit	$8,983	2020 - 2025
U.S. research tax credit	$6,135	2030 - 2035
U.S. business tax credits	$18	2030 - 2035
State investment tax credits	$795	Do not expire
State research tax credits	$11,199	Do not expire

The Company has recorded a deferred tax asset reflecting the benefit of operating loss carryforwards. The net operating losses expire as follows (in thousands):

U.S. loss carryforwards	$244,923	2031 - 2035
State loss carryforwards	$172,259	2015 - 2035

Although the Company has set up a valuation allowance against the majority of its U.S. federal and state deferred tax assets, which include net operating loss carry forwards, other losses and credit carryforwards, such allowance does not preclude the Company from using the deferred tax assets in the future. However, the Company’s ability to utilize the losses and credits to offset future taxable income may be deferred or limited significantly if the Company were to experience an “ownership change” as defined in section 382 of the Internal Revenue Code of 1986, as amended (the “Code”). In general, an ownership change will occur if there is a cumulative change in ownership of the Company’s stock by “5-percent shareholders” (as defined in the Code) that exceeds 50 percentage points over a rolling three-year period. The Company determined that no ownership change has occurred for purposes of Section 382 for the period ended December 31, 2015.

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A reconciliation of the effective tax rate on income or loss and the statutory tax rate is as follows:

	Years Ended December 31,		
	2015	2014	2013
Statutory U.S. tax rate	35.0 %	35.0 %	35.0 %
State income taxes, net of U.S. tax benefit	3.5 %	1.9 %	0.9 %
Federal and State tax credits, net of U.S. tax benefit	(11.5)%	(9.8)%	22.6 %
Foreign income taxed at other than U.S. statutory rate	(2.4)%	(13.4)%	(5.1)%
Effect of foreign rate changes	0.9 %	1.3 %	(4.2)%
Foreign tax credit	(12.0)%	(13.5)%	9.4 %
Basis differences of intangibles with an indefinite life	0.1 %	0.1 %	(4.1)%
Change in deferred tax valuation allowance	0.3 %	35.3 %	(76.8)%
Accrual for interest and income taxes related to uncertain tax positions	(0.3)%	(7.3)%	(0.1)%
Income (loss) from flowthrough entities	(2.0)%	(1.9)%	1.3 %
Meals and entertainment	3.4 %	3.3 %	(7.2)%
Group loss relief	(3.7)%	(2.6)%	4.9 %
Stock option compensation	(1.9)%	2.3 %	(6.9)%
Foreign dividends and earnings inclusion	7.1 %	(0.9)%	(6.8)%
Foreign tax withholding	1.4 %	2.4 %	(1.5)%
Executive compensation limitation	4.3 %	— %	— %
Other	5.2 %	(6.2)%	(3.4)%
Effective tax rate	27.4 %	26.0 %	(42.0)%

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	2015	2014	2013
Balance at January 1	$6,559	$11,851	$7,064
Additions based on tax positions related to the current year	1,120	638	4,853
Additions for tax positions of prior years	132	121	545
Reductions for tax positions of prior years	(255)	(3,691)	(538)
Settlement of tax audits	—	(258)	—
Reductions due to lapsed statute of limitations	(466)	(2,102)	(73)
Balance at December 31	$7,090	$6,559	$11,851

As of December 31, 2015, the gross liability for income taxes associated with uncertain tax benefits was $7,090,000. This liability could be reduced by $1,368,000 of offsetting tax benefits associated with the correlative effects of potential transfer pricing adjustments, which was recorded as a long-term income tax receivable, as well as $4,674,000 of deferred taxes. The net amount of $1,048,000, if recognized, would affect the Company’s financial statements and favorably affect the Company’s effective income tax rate.

The Company does expect changes to the unrecognized tax benefits in the next 12 months; however, the Company does not expect the changes to have a material impact on its results of operations or its financial position.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company recognized tax benefits of approximately $2,000 and $101,000 for the years ended December 31, 2015 and 2014, respectively, and a tax expense of approximately $229,000 for the year ended December 31, 2013, related to interest and penalties in the provision for income taxes. As of December 31, 2015 and 2014, the gross amount of accrued interest and penalties included in income taxes payable in the accompanying consolidated balance sheets was $1,060,000 and $1,062,000, respectively.

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The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is generally no longer subject to income tax examinations by tax authorities in its major jurisdictions as follows:

Major Tax Jurisdiction	Years No Longer Subject to Audit
U.S. federal	2010 and prior
California (U.S.)	2008 and prior
Canada	2009 and prior
Japan	2008 and prior
South Korea	2009 and prior
United Kingdom	2011 and prior

As of December 31, 2015, the Company did not provide for United States income taxes or foreign withholding taxes on a cumulative total of $111,953,000 of undistributed earnings from certain non-U.S. subsidiaries that will be permanently reinvested outside the United States. Upon remittance, certain foreign countries impose withholding taxes, subject to certain limitations, for use as credits against the Company's U.S. tax liability, if any. If the foreign earnings were remitted, the Company does not anticipate a material impact to the Company's federal or state income taxes due to the Company's available net operating losses and credits. The Company estimates that it would have withholding taxes of $1,125,000 upon remittance.

In 2015 and 2014, the Company ceased its business operations in Thailand and Malaysia, respectively, and accordingly, the Company no longer maintains a permanent reinvestment assertion with respect to these two entities. The Company intends to repatriate the undistributed earnings from these two entities to the United States at the time that the winding-down process has been completed. As of December 31, 2015, the Company has accrued for the estimated incremental U.S. income taxes related to reversing its permanent indefinite reinvestment assertion. However, these incremental U.S. income taxes are expected to be offset by the utilization of the Company's cumulative U.S. net operating losses incurred through December 31, 2015.

Note 10. Commitments & Contingencies

Legal Matters

The Company is subject to routine legal claims, proceedings and investigations incident to its business activities, including claims, proceedings, and investigations relating to commercial disputes and employment matters. The Company also receives from time to time information claiming that products sold by the Company infringe or may infringe patent, trademark or other intellectual property rights of third parties. One or more such claims of potential infringement could lead to litigation, the need to obtain licenses, the need to alter a product to avoid infringement, a settlement or judgment or some other action or material loss by the Company, which also could adversely affect the Company's overall ability to protect its product designs and ultimately limit its future success in the marketplace. In addition, the Company is occasionally subject to non-routine claims, proceedings or investigations.

The Company regularly assesses such matters to determine the degree of probability that the Company will incur a material loss as a result of such matters as well as the range of possible loss. An estimated loss contingency is accrued in the Company's financial statements if it is probable the Company will incur a loss and the amount of the loss can be reasonably estimated. The Company reviews all claims, proceedings and investigations at least quarterly and establishes or adjusts any accruals for such matters to reflect the impact of negotiations, settlements, advice of legal counsel and other information and events pertaining to a particular matter. All legal costs associated with such matters are expensed as incurred.

Historically, the claims, proceedings and investigations brought against the Company, individually and in the aggregate, have not had a material adverse effect upon the consolidated results of operations, cash flows or financial position of the Company. The Company believes that it has valid legal defenses to the matters currently pending against the Company. These matters are inherently unpredictable and the resolutions of these matters are subject to many uncertainties and the outcomes are not predictable with assurance. Consequently, management is unable to estimate the ultimate aggregate amount of monetary loss, amounts covered by insurance or the financial impact that will result from such matters. Management believes that the final resolution of the current matters pending against the Company, individually and in the aggregate, will not have a material adverse effect upon the Company's consolidated financial position. The Company’s results of operations or cash flows, however, could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

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Lease Commitments
The Company leases certain warehouse, distribution and office facilities, vehicles and office equipment under operating leases, and certain office equipment under capital leases. Lease terms range from one to ten years expiring at various dates through December 2025, with options to renew operating leases at varying terms. Commitments for minimum lease payments under non-cancelable operating and capital leases as of December 31, 2015 are as follows (in thousands):

	Operating Leases	Capital Leases
2016	$7,612	$237
2017	5,841	171
2018	3,048	177
2019	2,082	46
2020	1,779	—
Thereafter	1,857	—
	$22,219	$631

Rent expense for the Company's operating lease commitments for the years ended December 31, 2015, 2014 and 2013 was $13,245,000, $12,479,000 and $13,686,000, respectively. At December 31, 2015, the minimum rental payments under capital leases totaled $631,000. Minimum rental payments under operating leases with initial or remaining terms of one year or more totaled $22,219,000, net of sublease receipts of $2,369,000 at December 31, 2015.
Unconditional Purchase Obligations
During the normal course of its business, the Company enters into agreements to purchase goods and services, including purchase commitments for production materials, endorsement agreements with professional golfers and other endorsers, employment and consulting agreements, and intellectual property licensing agreements pursuant to which the Company is required to pay royalty fees. It is not possible to determine the amounts the Company will ultimately be required to pay under these agreements as they are subject to many variables including performance-based bonuses, severance arrangements, the Company's sales levels, and reductions in payment obligations if designated minimum performance criteria are not achieved. As of December 31, 2015, the Company has entered into many of these contractual agreements with terms ranging from one to four years. The minimum obligation that the Company is required to pay under these agreements is $43,317,000 over the next four years. In addition, the Company also enters into unconditional purchase obligations with various vendors and suppliers of goods and services in the normal course of operations through purchase orders or other documentation or that are undocumented except for an invoice. Such unconditional purchase obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in this total. Future purchase commitments as of December 31, 2015, are as follows (in thousands):

2016	$40,168
2017	1,885
2018	816
2019	448
	$43,317

Other Contingent Contractual Obligations
During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company's customers and licensees in connection with the use, sale and/or license of Company product or trademarks, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to the goods and services provided to the Company or based on the negligence or willful misconduct of the Company and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued guarantees in the form of standby letters of credit of $1,030,000 as of

December 31, 2015.

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The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company's financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that payments under the commitments and guarantees described above will have a material effect on the Company's financial condition. The fair value of indemnities, commitments and guarantees that the Company issued during and as of the year ended December 31, 2015 was not material to the Company's financial position, results of operations or cash flows.

Employment Contracts

In addition, the Company has made contractual commitments to each of its officers and certain other employees providing for severance payments, including salary continuation, upon the termination of employment by the Company without substantial cause or by the officer for good reason or non-renewal. In addition, in order to assure that the officers would continue to provide independent leadership consistent with the Company's best interest, the contracts also generally provide for certain protections in the event of a change in control of the Company. These protections include the payment of certain severance benefits, such as salary continuation, upon the termination of employment following a change in control.

Note 11. Non-Controlling Interests

In July 2013, the Company terminated its Golf Ball Manufacturing and Supply Agreement and certain ancillary agreements with Qingdao Suntech Sporting Goods Limited Company ("Suntech"). As a result, during the year ended December 31, 2013, the Company recognized charges of $5,579,000, the majority of which were related to the write-off of certain manufacturing equipment and inventory located at the Suntech manufacturing facility, and were recognized in cost of sales within the Company's golf balls operating segment.

Due to the nature of the arrangement, as well as the controlling influence the Company had in the Suntech operations through July 2013, the Company was required to consolidate the financial results of Suntech in its consolidated financial statements in accordance with ASC Topic 810, "Consolidations." The Company deconsolidated the financial results of Suntech in 2013 as a result of its termination of the Golf Ball Manufacturing Supply Agreement.

Note 12. Capital Stock

Common Stock and Preferred Stock

As of December 31, 2015, the Company has an authorized capital of 243,000,000 shares, $0.01 par value, of which 240,000,000 shares are designated common stock, and 3,000,000 shares are designated preferred stock. Of the preferred stock, 240,000 shares are designated Series A Junior Participating Preferred Stock and the remaining shares of preferred stock are undesignated as to series, rights, preferences, privileges or restrictions.

The holders of common stock are entitled to one vote for each share of common stock on all matters submitted to a vote of the Company's shareholders.   Although to date no shares of Series A Junior Participating preferred stock have been issued, if such shares were issued, each share of Series A Junior Participating Preferred Stock would entitle the holder thereof to 1,000 votes on all matters submitted to a vote of the shareholders of the Company. The holders of Series A Junior Participating Preferred Stock and the holders of common stock shall generally vote together as one class on all matters submitted to a vote of the Company's shareholders. Shareholders entitled to vote for the election of directors are entitled to vote cumulatively for one or more nominees.

Treasury Stock and Stock Repurchases

In August 2014, the Company's Board of Directors authorized a $50,000,000 share repurchase program under which the Company is authorized to repurchase shares of its common stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities. The repurchases will be made consistent with the terms of the Company's credit facility which defines the amount of stock that can be repurchased. The repurchase program will remain in effect until completed or until terminated by the Board of Directors.

During 2015, the Company repurchased approximately 217,000 shares of its common stock under the 2014 repurchase program at an average cost per share of $9.03, for a total cost of $1,960,000. The Company's repurchases of shares of common stock are recorded at cost and result in a reduction of shareholders' equity. As of December 31, 2015, the total amount remaining under the repurchase authorization was $47,027,000.

In November 2013, the Company redeemed the final 300 shares of its Series B Cumulative Perpetual Convertible Preferred Stock for cash (see Note 4).

Note 13. Share-Based Employee Compensation

The Company accounts for its share-based compensation arrangements in accordance with ASC Topic 718, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. ASC Topic 718 further requires a reduction in share-based compensation expense by an estimated forfeiture rate. The forfeiture rate used by the Company is based on historical forfeiture trends. If actual forfeiture rates are not consistent with the Company’s estimates, the Company may be required to increase or decrease compensation expenses in future periods.

The Company uses the alternative transition method for calculating the tax effects of share-based compensation pursuant to ASC Topic 718. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (“APIC Pool”) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC Pool and consolidated statements of cash flows of the tax effects of employee and director share-based awards that were outstanding upon adoption of ASC Topic 718.

Stock Plans

As of December 31, 2015, the Company had two shareholder approved stock plans under which shares were available for equity-based awards: the Callaway Golf Company Amended and Restated 2004 Incentive Plan (the "2004 Incentive Plan") and the 2013 Non-Employee Directors Stock Incentive Plan (the "2013 Directors Plan").

The 2004 Incentive Plan permits the granting of stock options, stock appreciation rights, restricted stock awards, restricted stock units and other equity-based awards to the Company’s officers, employees, consultants and certain other non-employees who provide services to the Company. All grants under the 2004 Incentive Plan are discretionary, although no participant may receive awards in any one year in excess of 2,000,000 shares. The maximum number of shares issuable over the term of the 2004 Incentive Plan is 24,000,000.

The 2013 Directors Plan permits the granting of stock options, restricted stock awards and restricted stock units to eligible directors serving on the Company's Board of Directors. The Directors may receive a one-time grant upon their initial appointment to the Board and thereafter an annual grant upon being re-elected at each annual meeting of shareholders, not to exceed 50,000 shares within any calendar year. The maximum number of shares issuable over the term of the 2013 Directors Plan is 1,000,000.

The following table presents shares authorized, available for future grant and outstanding under each of the Company’s plans as of December 31, 2015:

	Authorized	Available	Outstanding(1)
	(In thousands)		
2004 Incentive Plan	24,000	6,915	4,782
2013 Directors Plan	1,000	852	99
Total	25,000	7,767	4,881

(1) Includes accrued incremental dividend equivalent rights on outstanding shares underlying restricted stock units granted under the 2004 Incentive Plan and 2013 Directors Plan.

Stock Options

All stock option grants made under the 2004 Incentive Plan are made at exercise prices no less than the Company’s closing stock price on the date of grant. Outstanding stock options generally vest over a three-year period from the grant date and generally expire up to 10 years after the grant date. The Company recorded $1,396,000, $1,907,000 and $1,839,000 of compensation expense relating to outstanding stock options for the years ended December 31, 2015, 2014 and 2013, respectively.

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. The model uses various assumptions, including a risk-free interest rate, the expected term of the options, the expected stock price volatility, and the expected dividend yield. Compensation expense for employee stock options is recognized over the vesting term and is reduced by an estimate for forfeitures, which is based on the Company’s historical forfeitures of unvested options and awards. The Company did not grant stock options during the years ended December 31, 2015 and 2014. For the year ended December 31, 2015, 2014 and 2013, the weighted average estimated forfeiture rate used was 6.2%, 6.5% and 6.6%, respectively.

The table below summarizes the average fair value assumptions used in the valuation of stock options granted during the year ended December 31, 2013.

	2013	
Dividend yield	0.6	%
Expected volatility	48.8	%
Risk-free interest rate	0.7	%
Expected life	4.3 years	

The Company uses forecasted dividends to estimate the expected dividend yield. The expected volatility is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury yield curve at the date of grant with maturity dates approximately equal to the expected term of the options at the date of the grant. The expected life of the Company's options is based on evaluations of historical employee exercise behavior, forfeitures, cancellations and other factors. The valuation model applied in this calculation utilizes highly subjective assumptions that could potentially change over time. Changes in the subjective input assumptions can materially affect the fair value estimates of an option. Furthermore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by the employee holding the option.

The following table summarizes the Company's stock option activities for the year ended December 31, 2015 (in thousands, except price per share and contractual term):

Options	Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2015	3,659	$ 8.59		
Granted	—	$ —		
Exercised	(914)	$ 7.18		
Forfeited	—	$ —		
Expired	(320)	$ 12.88		
Outstanding at December 31, 2015	2,425	$ 8.55	4.93	$4,889
Vested and expected to vest in the future at December 31, 2015	2,420	$ 8.55	4.92	$4,874
Exercisable at December 31, 2015	1,897	$ 9.11	4.92	$3,370

The weighted-average grant-date fair value of options granted during the year ended December 31, 2013 was $2.47. There were no stock options granted during 2015 or 2014.

At December 31, 2015, there was $187,000 of total unrecognized compensation expense related to options granted to employees under the Company's share-based payment plans. That cost is expected to be recognized over a weighted-average period of 0.2 years. The amount of unrecognized compensation expense noted above does not necessarily represent the amount that will ultimately be realized by the Company in its consolidated statement of operations.

The total intrinsic value for options exercised during the years ended December 31, 2015, 2014 and 2013 was $2,151,000, $569,000 and $243,000, respectively. Cash received from the exercise of stock options for the years ended December 31, 2015, 2014 and 2013 was $6,565,000, $2,291,000 and $1,652,000, respectively.

Restricted Stock Units

Restricted stock units awarded under the 2004 Incentive Plan and the 2013 Directors Plan are recorded at the Company's closing stock price on the date of grant. Restricted stock units generally vest over a three-year period. At December 31, 2015, 2014 and 2013, the weighted average grant-date fair value of restricted stock units granted was $8.33, $8.21 and $6.55, respectively. The Company recorded $3,539,000, $2,530,000 and $1,694,000 of compensation expense related to restricted stock units in 2015, 2014 and 2013, respectively.

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The table below is a roll-forward of the activity for restricted stock units during the 12 months ended December 31, 2015 (in thousands, except fair value amounts):

Restricted Stock Units	Units	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2015	1,223	$ 7.07
Granted	564	8.33
Vested	(470)	6.56
Forfeited	(49)	8.15
Nonvested at December 31, 2015	1,268	$ 7.77

At December 31, 2015, there was $4,563,000 of total unrecognized compensation expense related to nonvested restricted stock units granted to employees under the Company’s share-based payment plans. That cost is expected to be recognized over a weighted-average period of 1.24 years.

Performance Share Units

Performance share units awarded under the 2004 Incentive Plan are stock-based awards in which the number of shares ultimately received depends on the Company's performance against specified financial goals are measured over a designated performance period from the date of grant. These performance goals were established by the Company at the beginning of the performance period. At the end of the performance period, the number of shares of stock that could be issued is fixed based upon the degree of achievement of the performance goals. The number of shares that could be issued can range from 50% to 150% of the participant's target award. Performance share units are initially valued at the Company's closing stock price on the date of grant. Compensation expense is recognized over the vesting period and is reduced by an estimate for forfeitures, and will vary based on remeasurements during the performance period. If the performance goals are not probable of achievement during the performance period, compensation expense would be reversed. The awards are forfeited if the performance goals are not achieved as of the end of the performance period. The performance units vest in full at the end of a three year period.

The Company granted 510,000 and 453,000 performance share units during the years ended December 31, 2015 and 2014, respectively, at a weighted average grant-date fair value of $7.96 and $8.20 per share, respectively. Based on the Company's performance in 2015 and 2014, the participants earned 130.0% and 131.5% of the target award, respectively. The Company did not grant performance share units during the year ended December 31, 2013. During the year ended December 31, 2015, the Company recognized total compensation expense, net of estimated forfeitures, of $2,607,000 for performance share units. At December 31, 2015, the unamortized compensation expense related to these awards was $5,509,000, which is expected to be recognized over a weighted-average period of 1.65 years.

The table below is a roll-forward of the activity for performance share units during the 12 months ended December 31, 2015 (in thousands, except fair value amounts):

Performance Share Units	Units	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2015	453	$ 8.20
Granted	510	7.96
Vested	—	—
Forfeited	(63)	8.14
Nonvested at December 31, 2015	900	$ 8.07

Phantom Stock Units

Phantom stock units awarded under the 2004 Incentive Plan are a form of share-based award that are indexed to the Company’s stock and are settled in cash. Because phantom stock units are settled in cash, compensation expense recognized over the vesting period will vary based on changes in fair value. Fair value is remeasured at the end of each interim reporting period based on the closing price of the Company’s stock. All of the previously granted phantom stock units were fully vested as of December 31, 2015.

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There were no phantom stock units granted in the years ended December 31, 2015, 2014 or 2013.
The table below is a roll-forward of the activity for phantom stock units during the 12 months ended December 31, 2015 (in thousands, except fair value amounts):

Phantom Stock Units	Units	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2015	264	$6.25
Granted	—	—
Vested	(264)	6.25
Forfeited	—	—
Nonvested at December 31, 2015	—	$—

In connection with these awards, the Company recognized compensation expense of $390,000, $649,000 and $1,635,000 for the years ended December 31, 2015, 2014 and 2013, respectively. At December 31, 2014, the Company accrued compensation expense of $1,898,000, which was included in accrued employee compensation and benefits in the accompanying consolidated balance sheets. There were no outstanding phantom stock units as of December 31, 2015.

Stock Appreciation Rights

Cash settled stock appreciation rights ("SARs") granted under the 2004 Incentive Plan are valued using the Black-Scholes option-pricing model on the date of grant. SARs are subsequently remeasured at each interim reporting period based on a revised Black-Scholes value until they are exercised. SARs vest over a three year period. As of December 31, 2015, the remaining SARs outstanding were fully vested.

As of December 31, 2015 and 2013, the Company recognized $3,288,000 and $3,016,000 in compensation expense, respectively, related to these awards, and reversed $1,062,000 in compensation expense related to these awards as of December 31, 2014. At December 31, 2015 and 2014, the Company accrued compensation expense of $1,460,000 and $3,990,000, respectively, which was included in accrued employee compensation and benefits in the accompanying consolidated balance sheets.

The table below summarizes the total number of SARs granted to employees during the year ended December 31, 2015 (in thousands):

Stock Appreciation Rights	Units	Weighted-Average Exercise Price Per Share
Nonvested and Outstanding at January 1, 2015	2,372	$ 6.39
Granted	—	—
Exercised	(1,874)	6.35
Forfeited	—	—
Outstanding at December 31, 2015	498	$ 6.51

Share-Based Compensation Expense

The table below summarizes the amounts recognized in the financial statements for the years ended December 31, 2015, 2014 and 2013 for share-based compensation, including expense for stock options, restricted stock units, performance share units, phantom stock units and cash settled stock appreciation rights (in thousands):

	2015	2014	2013
Cost of sales	$754	$240	$473
Operating expenses	10,466	5,087	7,711
Total cost of employee share-based compensation included in income (loss) before income tax	$11,220	$5,327	$8,184

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Note 14. Employee Benefit Plan

The Company has a voluntary deferred compensation plan under Section 401(k) of the Internal Revenue Code (the "401(k) Plan") for all employees who satisfy the age and service requirements under the 401(k) Plan. Each participant may elect to contribute up to 75% of annual compensation, up to the maximum permitted under federal law, and the Company is obligated to contribute annually an amount equal to 50% of the participant's contributions up to 6% of their eligible annual compensation. For the years ended December 31, 2015, 2014 and 2013 there were no discretionary contributions.

The portion of the participant's account attributable to elective deferral contributions and rollover contributions are 100% vested and nonforfeitable. Participants vest in employer contributions at a rate of 50% per year, becoming fully vested after the completion of two years of service. In accordance with the provisions of the 401(k) Plan, the Company matched employee contributions in the amount of $1,744,000, $1,687,000 and $1,589,000 during 2015, 2014 and 2013, respectively. Additionally, the Company can make discretionary contributions based on the profitability of the Company.

Note 15. Fair Value of Financial Instruments

Certain of the Company's financial assets and liabilities are measured at fair value on a recurring and nonrecurring basis. Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability (the exit price) in the principal and most advantageous market for the asset or liability in an orderly transaction between market participants. Assets and liabilities carried at fair value are classified using the three-tier hierarchy (see Note 2). The following table summarizes the valuation of the Company's foreign currency forward contracts (see Note 16) that are measured at fair value on a recurring basis as of December 31, 2015 and 2014 (in thousands):

	Fair Value	Level 1	Level 2	Level 3
2015				
Foreign currency forward contracts —asset position	$680	$—	$680	$—
Foreign currency forward contracts —liability position	(342)	—	(342)	—
	$338	$—	$338	$—
2014				
Foreign currency forward contracts —asset position	$40	$—	$40	$—
Foreign currency forward contracts —liability position	(246)	—	(246)	—
	$(206)	$—	$(206)	$—

The fair value of the Company's foreign currency forward contracts is based on observable inputs that are corroborated by market data. Gains and losses from the remeasurement of qualifying hedges are recorded as a component of other comprehensive income and released into earnings as a component of cost of goods sold during the period in which the hedged transaction takes place. Gains and losses on the ineffective portion of hedges (hedges that do not meet accounting requirements due to ineffectiveness) and derivatives that are not elected for hedge accounting treatment are immediately recorded in earnings as a component of other income (expense).

Nonrecurring Fair Value Measurements

The Company measures certain assets at fair value on a nonrecurring basis at least annually or when certain indicators are present. These assets include long-lived assets, goodwill and non-amortizing intangible assets that are written down to fair value when they are held for sale or determined to be impaired. In 2015, 2014 and 2013, the Company did not recognize any impairment losses on these assets.

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Disclosures about the Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, trade payables and accrued expenses at December 31, 2015 and 2014 are reasonable estimates of fair value due to the short-term nature of these balances and are therefore classified as Level 1. The table below illustrates information about fair value relating to the Company’s financial assets and liabilities that are recognized on the accompanying consolidated balance sheets as of December 31, 2015 and 2014, as well as the fair value of contingent contracts that represent financial instruments (in thousands):

	December 31, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible notes(1)	$—	$—	$108,574	$126,222
ABL Facility(2)	$—	$—	$15,235	$15,235
Japan ABL Facility(2)	$14,969	$14,969	$—	$—
Standby letters of credit(3)	$1,030	$1,030	$1,142	$1,142

(1) In 2015, the convertible notes were eliminated pursuant to certain exchange transactions and shareholder conversions, which resulted, among other things, in the issuance of shares of the Company's common stock (see Note 3). The carrying value of the convertible notes at December 31, 2014 is net of the unamortized discount of $3,926,000. The fair value of the convertible notes was determined based on secondary quoted market prices, and as such is classified as Level 2 in the fair value hierarchy.

(2) The carrying value of amounts outstanding under the Company's ABL Facility and Japan ABL Facility approximates the fair value due to the short term nature of this obligation. The fair value of this debt is categorized within Level 2 of the fair value hierarchy. See Note 3 for information on the ABL Facility, including certain risks and uncertainties.

(3) The carrying value of the Company's standby letters of credit approximates the fair value as they represent the Company’s contingent obligation to perform in accordance with the underlying contracts. There were no amounts outstanding under these letters of credit at December 31, 2015 or 2014. The fair value of this contingent obligation is categorized within Level 2 of the fair value hierarchy.

Note 16. Derivatives and Hedging

In the normal course of business, the Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to transactions of its international subsidiaries. As part of its strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company uses designated cash flow hedges and non-designated hedges in the form of foreign currency forward contracts to mitigate the impact of foreign currency translation on transactions that are denominated primarily in Japanese Yen, British Pounds, Euros, Canadian Dollars, Australian Dollars and Korean Won.

The Company accounts for its foreign currency forward contracts in accordance with ASC Topic 815. ASC Topic 815 requires the recognition of all derivatives instruments as either assets or liabilities on the balance sheet, the measurement of those instruments at fair value and the recognition of changes in the fair value of derivatives in earnings in the period of change, unless the derivative qualifies as a designated cash flow hedge that offsets certain exposures. Certain criteria must be satisfied in order for derivative financial instruments to be classified and accounted for as a cash flow hedge. Gains and losses from the remeasurement of qualifying hedges are recorded as a component of other comprehensive income and released into earnings as a component of cost of goods sold or net sales during the period in which the hedged transaction takes place. Gains and losses on the ineffective portion of hedges (hedges that do not meet accounting requirements due to ineffectiveness) and derivatives that are not elected for hedge accounting treatment are immediately recorded in earnings as a component of other income (expense).

Foreign currency forward contracts are used only to meet the Company’s objectives of minimizing variability in the Company’s operating results arising from foreign exchange rate movements. The Company does not enter into foreign currency forward contracts for speculative purposes. The Company utilizes counterparties for its derivative instruments that it believes are credit-worthy at the time the transactions are entered into and the Company closely monitors the credit ratings of these counterparties.

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The following table summarizes the fair value of the Company's foreign currency forward contracts as well as the location of the asset and/or liability on the consolidated balance sheets at December 31, 2015 and 2014 (in thousands):

	Asset Derivatives			
	December 31, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedging instruments:				
Foreign currency forward contracts	Other current assets	$ 520	Other current assets	$ —
Derivatives not designated as hedging instruments:				
Foreign currency forward contracts	Other current assets	$ 160	Other current assets	$ 40

	Liability Derivatives			
	December 31, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedging instruments:				
Foreign currency forward contracts	Accounts payable and accrued expenses	$296	Accounts payable and accrued expenses	$—
Derivatives not designated as hedging instruments:				
Foreign currency forward contracts	Accounts payable and accrued expenses	$46	Accounts payable and accrued expenses	$246

Cash Flow Hedging Instruments

In January 2015, the Company entered into foreign currency forward contracts designated as qualifying cash flow hedges to help mitigate the Company's foreign currency exposure on intercompany sales of inventory to its foreign subsidiaries. These contracts generally mature within 12 to 15 months from their inception. At December 31, 2015, the notional amount of the Company's foreign currency forward contracts designated as cash flow hedge instruments was approximately $55,938,000. The Company did not enter into cash flow hedging contracts in 2014. The reporting of gains and losses on these cash flow hedging instruments depends on whether the gains or losses are effective at offsetting changes in the cash flows of the underlying hedged items. The Company uses the hypothetical derivative method to measure the effectiveness of the foreign currency forward contracts and evaluates the effectiveness on a quarterly basis. The effective portion of the gains and losses on the hedging instruments are recorded in other comprehensive income until recognized in earnings during the period that the hedged transactions take place. Any ineffective portion of the gains and losses from the hedging instruments is recognized in earnings immediately. The Company would discontinue hedge accounting prospectively if (i) it is determined that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item, (ii) when the derivative expires or is sold, terminated, or exercised, (iii) if it becomes probable that the forecasted transaction being hedged by the derivative will not occur, (iv) if a hedged firm commitment no longer meets the definition of a firm commitment, or (v) if it is determined that designation of the derivative as a hedge instrument is no longer appropriate. The Company estimates the fair value of its foreign currency forward contracts based on pricing models using current market rates. These contracts are classified under Level 2 of the fair value hierarchy (see Note 15).

As of December 31, 2015, the Company recorded a net gain of $2,316,000 in other comprehensive income (loss) related to its hedging activities. Of this amount, $1,791,000 was relieved from other comprehensive income (loss) and recognized in cost of goods sold for the underlying intercompany sales that were recognized during 2015. In addition, the Company recognized $1,149,000 in other income (expense) as a result of hedge ineffectiveness, of which $576,000 was reclassified from other comprehensive income for hedges that no longer met the accounting requirements. Forward points were expensed as incurred. Based on the current valuation, the Company expects to reclassify net gains of $525,000 from accumulated other comprehensive income (loss) into net earnings during the next 12 months.

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The following tables summarize the net effect of all cash flow hedges on the consolidated financial statements for the year ended December 31, 2015 (in thousands):

	Net Gain Recognized in Other Comprehensive Income (Loss) (Effective Portion) Year Ended December 31,	
Derivatives designated as cash flow hedging instruments	2015	2014
Foreign currency forward contracts	$2,316	$—

	Net Gain Reclassified from Other Comprehensive Income (Loss) into Earnings (Effective Portion) Year Ended December 31,	
Derivatives designated as cash flow hedging instruments	2015	2014
Foreign currency forward contracts	$1,791	$—

	Net Gain Recognized in Other Income (Expense) (Ineffective Portion) Year Ended December 31,	
Derivatives designated as cash flow hedging instruments	2015	2014
Foreign currency forward contracts	$1,149	$—

The following table details the amounts reclassified from accumulated other comprehensive loss to cost of goods sold, as well as changes in foreign currency translation for the year ended December 31, 2015 (in thousands). Amounts shown do not include any tax effect due to the valuation allowance on the Company's deferred taxes in the United States (see Note 9).

Beginning balance, December 31, 2014	$(796)
Change in fair value of derivative instruments	2,892
Amounts reclassified from accumulated other comprehensive loss to other income (expense) due to hedge instrument ineffectiveness	(576)
Amounts reclassified from accumulated other comprehensive income to cost of goods sold	(1,791)
Foreign currency translation adjustments	(11,542)
Ending balance, December 31, 2015	$(11,813)

Foreign Currency Forward Contracts Not Designated as Hedging Instruments

At December 31, 2015, 2014 and 2013, the notional amounts of the Company’s foreign currency forward contracts used to mitigate the exposures discussed above were approximately $43,098,000, $62,866,000 and $42,264,000, respectively. The increase in foreign currency forward contracts reflects the general timing of when the Company enters into these contracts. The Company estimates the fair values of foreign currency forward contracts based on pricing models using current market rates, and records all derivatives on the balance sheet at fair value with changes in fair value recorded in the statement of operations. The foreign currency contracts are classified under Level 2 of the fair value hierarchy (see Note 15).

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The following table summarizes the location of gains and losses on the consolidated statements of operations that were recognized during the years ended December 31, 2015, 2014 and 2013, respectively, in addition to the derivative contract type (in thousands):

Derivatives not designated as hedging instruments	Location of gain recognized in income on derivative instruments	Amount of Gain Recognized in Income on Derivative Instruments Years Ended December 31, 2015	2014	2013
Foreign currency forward contracts	Other income (expense), net	$1,322	$6,356	$6,764

In addition, during the years ended December 31, 2015, 2014 and 2013, the Company recognized net foreign currency losses of $1,611,000, $6,198,000 and $821,000, respectively, related to transactions with foreign subsidiaries.

Note 17. Restructuring Initiatives

Cost Reduction Initiatives

In December 2013, the Company completed its cost reduction initiatives that were announced in July 2012 (the “Cost Reduction Initiatives”), which streamlined and simplified the Company’s organizational structure and changed the manner in which the Company approaches and operates its business.

During the year ended December 31, 2013, the Company recognized total cash and non-cash charges of $16,556,000 in connection with these initiatives. Amounts recognized in cost of sales, operating expenses and other income (expense) totaled $11,149,000, $4,719,000 and $688,000, respectively, during the year ended December 31, 2013. Non-cash charges recognized during 2013 included lower of cost or market adjustments to inventory as well as inventory write-offs related to the Company's golf apparel, golf footwear and GPS device businesses. In the aggregate through December 31, 2013, the Company recognized total charges of approximately $70,600,000 in connection with these initiatives, of which approximately two-thirds were non-cash charges. The Company did not recognize any charges in connection with the Cost Reduction Initiatives during the years ended December 31, 2015 or 2014. See Note 18 for charges absorbed by the Company’s operating segments.

The table below depicts the activity and liability balances recorded relating to the Cost Reduction Initiatives during the years ended December 31, 2014, and 2013. Amounts payable as of December 31, 2013 are included in accrued employee compensation and benefits and accounts payable and accrued expenses in the accompanying consolidated balance sheets. There were no amounts payable as of December 31, 2014.

(In thousands)	Cost Reduction Initiatives Workforce Reductions	Transition Costs	Asset Write-offs	Total
Restructuring payable balance, December 31, 2012	$4,531	$591	$—	$5,122
Charges to cost and expense(1)	2,977	8,777	4,802	16,556
Non-cash items	—	(5,130)	(4,802)	(9,932)
Cash payments	(6,702)	(1,737)	—	(8,439)
Restructuring payable balance, December 31, 2013	$806	$2,501	$—	$3,307
Cash payments	$(806)	$(2,501)	$—	$(3,307)
Restructuring payable balance, December 31, 2014	$—	$—	$—	$—

(1) The pre-tax charges for the year ended December 31, 2013 included the following:

- $2,977,000 in continued costs associated with workforce reductions, in addition to $4,459,000 in other transition costs;
- $5,579,000 for the write-off of assets and exit costs associated with the reorganization of golf ball manufacturing (see Note 11); and
- $3,541,000 associated with the transition of the Company's golf apparel, golf footwear and integrated device businesses in the United States and Europe to a third-party licensing arrangement.

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Note 18. Segment Information

The Company has two operating segments that are organized on the basis of products, namely the golf clubs segment and golf balls segment. The golf clubs segment consists of Callaway Golf woods, hybrids, irons and wedges and Odyssey putters. This segment also includes golf apparel and footwear, golf bags, golf gloves, travel gear, headwear and other golf-related accessories, in addition to royalties from licensing of the Company's trademarks and service marks and sales of pre-owned golf clubs. The golf balls segment consists of Callaway Golf and Strata balls that are designed, manufactured and sold by the Company. There are no significant intersegment transactions.

The table below contains information utilized by management to evaluate its operating segments.

	Years Ended December 31,		
	2015	2014	2013
	(In thousands)		
Net sales:			
Golf Clubs	$700,649	$749,956	$711,697
Golf Balls	143,145	136,989	131,104
	$843,794	$886,945	$842,801
Income (loss) before income tax:			
Golf Clubs(1)	$52,999	$50,891	$32,738
Golf Balls(1)	17,724	15,222	(3,472)
Reconciling items(2)	(50,660)	(44,474)	(42,588)
	$20,063	$21,639	$(13,322)
Identifiable assets:(3)			
Golf Clubs	$316,079	$316,710	$374,473
Golf Balls	37,394	37,445	49,261
Reconciling items(3)	277,751	270,656	240,129
	$631,224	$624,811	$663,863
Additions to long-lived assets:			
Golf Clubs	$14,111	$9,425	$13,250
Golf Balls	2,154	327	1,163
	$16,265	$9,752	$14,413
Goodwill:			
Golf Clubs	$26,500	$27,821	$29,212
Golf Balls	—	—	—
	$26,500	$27,821	$29,212
Depreciation and amortization:			
Golf Clubs	$13,084	$18,505	$21,019
Golf Balls	4,295	2,731	4,524
	$17,379	$21,236	$25,543

(1) The tables below includes total charges absorbed by the Company's operating segments from the Cost Reduction Initiatives discussed in Note 17 (in thousands):

	Year Ended December 31, 2013			
	Golf Clubs	Golf Balls	Corporate G&A	Total
Cost Reduction Initiatives	$6,395	$6,973	$3,188	$16,556

(2) Reconciling items represent the deduction of corporate general and administration expenses and other income (expenses), which are not utilized by management in determining segment profitability. The $6,186,000 increase in reconciling items in 2015 compared to 2014 includes increases in employee costs and professional fees, partially offset by a decrease in legal expenses combined with an increase in net foreign currency gains.

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(3) Identifiable assets are comprised of net inventory, certain property, plant and equipment, intangible assets and goodwill. Reconciling items represent unallocated corporate assets not segregated between the two segments.

The Company’s net sales by product category are as follows:

	Years Ended December 31,		
	2015	2014	2013
	(In thousands)		
Net sales:			
Woods	$222,193	$269,468	$249,809
Irons	205,522	200,174	178,771
Putters	86,293	81,161	87,787
Golf Balls	143,145	136,989	131,104
Accessories and Other	186,641	199,153	195,330
	$843,794	$886,945	$842,801

The Company markets its products in the United States and internationally, with its principal international markets being Japan and Europe. The tables below contain information about the geographical areas in which the Company operates. Revenues are attributed to the location to which the product was shipped. Long-lived assets are based on location of domicile.

	Sales	Long-Lived Assets (excluding deferred tax assets)
	(In thousands)	
2015		
United States	$446,474	$205,952
Europe	125,116	8,414
Japan	138,031	4,445
Rest of Asia	70,315	2,868
Other foreign countries	63,858	11,096
	$843,794	$232,775
2014		
United States	$421,773	$210,152
Europe	134,401	7,070
Japan	166,162	4,873
Rest of Asia	89,603	2,936
Other foreign countries	75,006	13,402
	$886,945	$238,433
2013		
United States	$401,478	$206,111
Europe	121,477	7,905
Japan	161,598	6,491
Rest of Asia	84,073	3,627
Other foreign countries	74,175	15,827
	$842,801	$239,961

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Note 19. Transactions with Related Parties

The Callaway Golf Company Foundation (the "Foundation") oversees and administers charitable giving and makes grants to selected organizations. Officers of the Company also serve as directors of the Foundation and the Company's employees provide accounting and administrative services for the Foundation. During 2015, the Company recognized charitable contribution expense of $1,000,000 for the Foundation. During 2014 and 2013, the Company did not make any contributions to the Foundation.

Note 20. Summarized Quarterly Data (Unaudited)

	Fiscal Year 2015 Quarters				
	1st	2nd	3rd	4th	Total
	(In thousands, except per share data)				
Net sales	$284,179	$230,504	$175,780	$153,331	$843,794
Gross profit	$127,266	$101,697	$77,602	$51,068	$357,633
Net income (loss)	$35,819	$12,818	$(3,617)	$(30,452)	$14,568
Net income (loss) allocable to common shareholders	$35,819	$12,818	$(3,617)	$(30,452)	$14,568
Earnings (loss) per common share[(1)]					
Basic	$0.46	$0.16	$(0.04)	$(0.33)	$0.18
Diluted	$0.39	$0.15	$(0.04)	$(0.33)	$0.17

	Fiscal Year 2014 Quarters				
	1st	2nd	3rd	4th	Total
	(In thousands, except per share data)				
Net sales	$351,874	$231,893	$168,572	$134,606	$886,945
Gross profit	$164,897	$90,806	$65,307	$36,916	$357,926
Net income (loss)	$55,312	$3,369	$(1,134)	$(41,539)	$16,008
Net income (loss) allocable to common shareholders	$55,312	$3,369	$(1,134)	$(41,539)	$16,008
Earnings (loss) per common share[(1)]					
Basic	$0.71	$0.04	$(0.01)	$0.54	$0.21
Diluted	$0.61	$0.04	$(0.01)	$0.54	$0.20

(1) Earnings per share is computed individually for each of the quarters presented; therefore, the sum of the quarterly earnings per share may not necessarily equal the total for the year.

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EXHIBIT INDEX

Exhibit	Description
21.1	List of Subsidiaries.
23.1	Consent of Deloitte & Touche LLP.
24.1	Form of Limited Power of Attorney.
31.1	Certification of Oliver G. Brewer III pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Robert K. Julian pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Oliver G. Brewer III and Robert K. Julian pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1	XBRL Instance Document
101.2	XBRL Taxonomy Extension Schema Document
101.3	XBRL Taxonomy Extension Calculation Linkbase Document
101.4	XBRL Taxonomy Extension Definition Linkbase Document
101.5	XBRL Taxonomy Extension Label Linkbase Document
101.6	XBRL Taxonomy Extension Presentation Linkbase Document