

GOLFSMITH INTERNATIONAL HOLDINGS INC

Form 10-K

March 31, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**FORM 10-K**

**(Mark One)**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2005**

**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 333-101117**

**GOLFSMITH INTERNATIONAL HOLDINGS, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

Delaware

(State or Other Jurisdiction of Incorporation or  
Organization)

16-1634897

(I.R.S. Employer Identification No.)

11000 N. IH-35

Austin, Texas 78753

(Address of Principal Executive Offices)

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

Securities registered pursuant to Section 12(b) of the Act:

**NONE**

Securities registered pursuant to Section 12(g) of the Act:

**NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the  
Act.

Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained  
herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated  
filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

None of the registrant's common stock is held by non-affiliates of the registrant.

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

Class of Common Stock	Outstanding at March 24, 2006
\$.001 par value	21,594,597 Shares

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**GOLFSMITH INTERNATIONAL HOLDINGS, INC.**  
**Annual Report on Form 10-K**  
**For the Fiscal Year Ended December 31, 2005**  
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**COMPANY INFORMATION**

Golfsmith International Holdings, Inc. was formed on September 4, 2002 and became the parent company of Golfsmith International, Inc. on October 15, 2002 when it acquired all of the outstanding stock of Golfsmith International, Inc. Golfsmith International Holdings, Inc. is a holding company and has no material assets other than all of the capital stock of Golfsmith International, Inc. In this Annual Report, unless the context indicates otherwise, the term *Golfsmith* refers to Golfsmith International, Inc. and its subsidiaries. The term *Golfsmith Holdings* refers to Golfsmith International Holdings, Inc. and its subsidiaries. The terms *we*, *us* and *our* refer to Golfsmith prior to its acquisition by Golfsmith Holdings and to Golfsmith Holdings after giving effect to the acquisition of Golfsmith. Our principal executive office is located at 11000 N. IH-35, Austin, Texas 78753-3195, and our telephone number is (512) 837-8810. Our Internet site address is *www.golfsmith.com*.

**CAUTIONARY NOTICE REGARDING  
FORWARD LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These statements include but are not limited to:

the timing, amount and composition of future capital expenditures;

the timing and number of new store openings and our expectations as to the costs associated with new store openings;

the timing and completion of the remodeling of our existing stores; and

our plans to grow particular areas of our business, including sales of our proprietary branded products, our apparel and tennis products.

These statements may be found in the sections of this Annual Report entitled *Risk Factors*, *Management's Discussion and Analysis of Financial Condition and Results of Operations* and *Business* and in this Annual Report generally, including the sections of this Annual Report entitled *Business Overview* and *Business Industry*, which contain information obtained from independent industry sources. Actual results could differ materially from those anticipated these forward-looking statements as a result of various factors, including all the risks discussed elsewhere in this Annual Report.

In addition, statements that use the terms *believe*, *expect*, *plan*, *intend*, *estimate*, *anticipate* and other expressions are intended to identify forward-looking statements. All forward-looking statements in this Annual Report reflect our current views about future events and are based on assumptions and are subject to risks and uncertainties that could cause our actual results to differ materially from future results expressed or implied by the forward-looking statements. Many of these factors are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. Unless we are required to do so under U.S. federal securities laws or other applicable laws, we do not intend to update or revise any forward-looking statements.

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### **PART I**

#### **Item 1. Business**

##### **Overview**

Golfsmith is the nation's largest specialty retailer of golf equipment, apparel and accessories based on sales. Since our founding in 1967, we have established Golfsmith as a leading national brand in the golf retail industry. We operate as an integrated multi-channel retailer, providing our customers, who we refer to as guests, the convenience of shopping in our 52 stores across the nation, through our leading Internet site, [www.golfsmith.com](http://www.golfsmith.com), and from our comprehensive catalogs. Our stores feature an activity-based shopping environment where our guests can test the performance of golf clubs in our in-store hitting areas. We offer an extensive product selection that features premier national brands as well as our proprietary products and pre-owned clubs. We also offer a number of guest services and customer care initiatives that we believe differentiate us from our competitors, including our SmartFit™ custom club-fitting program, in-store golf lessons, our club trade-in program, our 90-day playability guarantee, our 115% low-price guarantee and our proprietary credit card. Our advanced distribution and fulfillment center and sophisticated management information systems support and integrate our distribution channels and provide a strong and scalable platform to support our planned expansion.

We began as a clubmaking company, offering custom-made clubs, clubmaking components and club repair services. In 1972, we opened our first retail store and, in 1975, we mailed our first general golf products catalog. Over the next 25 years, we continued to expand our product offerings, opened larger retail stores and expanded our direct-to-consumer business by adding to our catalog titles. In 1997, we launched our Internet site to further expand our direct-to-consumer business. In October 2002, an investment fund managed by First Atlantic Capital, Ltd. acquired us from our original founders, Carl, Barbara and Franklin Paul.

##### **Store Operations**

We are the only coast-to-coast golf and tennis retailer in the United States. We opened our first golf store in 1992 and currently operate 52 stores in 13 states. The locations of our stores are more fully described in Item 2, Properties.

We design our stores to provide an exciting, activity-based shopping environment that resonates with the golf and tennis enthusiast and highlights our extensive product offering. We have determined that our store concept is best suited to a 15,000 to 20,000 square foot format. We currently operate larger and smaller stores, based on our historical store base. In the future we may determine to open new stores outside of this basic range depending on local market demographics and real estate prices and availability.

A typical Golfsmith store offers a full line of premier branded clubs, balls, apparel and accessories, as well as our proprietary branded products. Most of our stores also offer club components, clubmaking tools, supplies and on-site clubmaking, custom clubfitting and club repair services. Our stores incorporate technology, lessons and club demos in a range-like setting. All of our stores offer hitting areas, putting greens and ball launch monitor technology. Our larger stores provide a more expansive array of activity-based offerings including partial-flight indoor driving ranges and a wider assortment of demo clubs.

We have entered into relationships with Hot Stix® Technologies and GolfTEC Learning Centers to provide precision club fitting and PGA certified golf instruction to our guests. We currently have GolfTEC Learning Centers in 27 of our 52 stores as of December 31, 2005 and Hot Stix® Technology in 31 of our stores.

We intend to selectively expand our store base in existing and new markets in locations that fit our selection criteria, which include:

- demographic characteristics, such as a high number of avid golfers and above-average annual household incomes;

- visibility from and access to highways or other major roadways;

- the level of our penetration in a given market, either through our existing retail stores or our direct-to-consumer channel;

original equipment manufacturer information indicating that a location is within a top merchandising market;

proximity to a large metropolitan area;

presence and strength of competition;

the ability to obtain favorable lease terms; and

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Big Box retail co-tenants that are likely to draw guests who we would otherwise target within the site's relevant market.

After we identify a potential site, we analyze demographic and competitive data to project store revenues and develop profitability forecasts. Once we approve a site, we negotiate lease terms and begin planning the appropriate store design and configuration for the particular location.

Our stores accounted for 72.3% of our net revenues in fiscal 2005, 69.0% in fiscal 2004 and 62.9% in fiscal 2003. From January 2003 to December 2005, we increased the number of our stores from 26 to 52.

### **Direct-to-Consumer**

Our direct-to-consumer channel consists of our Internet and catalog businesses. Through our direct-to-consumer distribution channel, we offer our guests a complete line of golf and tennis products, including equipment, apparel and accessories, as well as clubmaking components and tools. Our direct-to-consumer channel accounted for 25.7% of our net revenues in fiscal 2005, 28.5% in fiscal 2004 and 34.5% in fiscal 2003. The decrease in the percentage of our net revenues derived from our direct-to-consumer channel correlates with our increased number of stores and the related growth in net revenues.

### **Internet**

We offer over 33,000 golf and tennis products through our Internet site, *www.golfsmith.com*, which we began in 1997. We also have 24 registered domain names that link to *www.golfsmith.com*.

Our Internet site features, among other things:

An online custom SmartFit™ club-fitting for all golf clubs;

An in-store pick-up delivery option;

A retail store locator;

A full pre-owned club selection;

A club trade-in program;

Designated Women's and Tennis shopping sections; and

Additional How-to-buy and golf and tennis play tips.

Our Internet site also complements our retail stores and catalogs by building guest awareness of our brand and acting as an effective marketing vehicle for new product introductions, special product promotions and our proprietary branded products.

### **Catalogs**

We have a 39-year history as a catalog retailer. Our principal catalog publications are the Golfsmith Consumer Catalog and the Golfsmith Clubmaking Catalog. In 2005, we launched our first Annual Buyer's Guide, which is designed to be the most extensive and informative catalog of golf-related equipment and accessories, providing pictures and descriptions of many of the 12,000 SKUs offered. We also launched our Drive catalog in 2005, to specifically target the woman golfer. Our catalog titles are designed and produced by our in-house staff of writers, photographers and graphic artists. The monthly production and distribution schedule of our consumer catalogs permits us to introduce new products regularly and make price adjustments as necessary.

We maintain one of the largest information databases in our industry containing approximately 2.5 million names of guests who have purchased our products since 2000 and other individuals who have requested to receive our periodic mailings. We have developed this database largely through our catalog and Internet site order processing and, to a lesser extent, through contests and point-of-sale data collection in our stores. We use statistical evaluation and selection techniques to determine which guest segments are likely to contribute the greatest revenues per mailing.

### **Products and Merchandising**

We offer a broad assortment of golf and tennis brands and products, including our own proprietary brands, through our retail stores, catalogs and our Internet site. We generally price our products consistently across our



channels. We also tailor the merchandise selection in our particular stores to meet the regional preferences of our customers.

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### ***Premier Branded Products***

We are one of the largest retailers of premier branded golf merchandise.

*Clubs.* We carry a wide variety of premier branded golf clubs from leading national golf manufacturers including Callaway®, Cobra®, Nike®, Ping®, TaylorMade®, Titleist® and Cleveland®.

*Apparel and footwear.* We offer a range of golf and tennis apparel including shirts, sweaters, vests, pants, shorts and outerwear along with such accessories as jewelry, watches and leather goods from such premier brands as adidas®, Callaway®, Greg Norman®, Nike® and Ping®. We also offer footwear for both golf and tennis for men, women and juniors from such top national brands as adidas®, Bite®, Callaway®, Ecco®, Etonic®, FootJoy®, Lady Fairway®, Nike® and Oakley®.

*Golf balls.* We offer a broad range of nationally recognized golf ball brands including Bridgestone®, Callaway®, Maxfli®, Nike®, Titleist® and Top-Flite®. These premier branded golf balls provide our guests with the ability to select products that suit their desire for distance and control.

*Accessories.* We provide an extensive range of golf and tennis accessories to support our guests' golf and tennis activities including tees, sunglasses, cleaning and repair kits, towels, tennis bags, tennis strings and golf cart heaters. The premier brands of the accessories that we offer include Bushnell®, Coleman®, Head®, Nike®, Oakley®, Prince®, Team Effort® and Wilson®.

*Racquets.* We offer a variety of premier national tennis racquet brands, such as Babolat®, Head®, Prince®, Volkl® and Wilson®.

### ***Golfsmith Proprietary Brands***

Our proprietary trademarks and service marks include Golfsmith®, Black Cat®, Crystal Cat®, Killer Bee®, Lynx®, Parallax®, Predator®, Snake Eyes®, Tigress®, Zevo®, ASI™, GearForGolf™ and GiftsForGolf™. In fiscal 2005, our proprietary branded products accounted for \$50.3 million of our net sales. We maintain proprietary merchandise in a number of categories including clubs, gloves, apparel, golf bags and shoes.

Our proprietary brands provide high quality products at attractive prices and generally have higher gross margins than the non-proprietary branded products we offer. We control the product development of our proprietary brands through our internal research and development team.

We position our proprietary branded products to target a different customer base so as not to compete with the premier-branded merchandise that we offer. By maintaining an inventory of premier branded merchandise and our proprietary brands, we are able to supply our guests a broad assortment of products along a continuum of price points. We believe that in addition to representing an attractive source of revenues and profits, our portfolio of proprietary brands also enhances recognition of the Golfsmith national brand.

### ***Club Components***

We offer a large selection of club components, including club heads (consisting primarily of our proprietary brands), shafts and grips from the leading national brands in club components, including Aldila®, Fujikura®, Golf Pride®, Lamkin®, Royal Precision®, True Temper®, UST® and Winn®.

### ***Innovative Customer Care Initiatives***

We offer our guests the following initiatives to foster their loyalty and promote confidence in their purchases:

*90/90 Playability Guarantee.* This initiative allows our guests to purchase and use certain clubs for up to 90 days. If a guest decides to return the clubs, we offer the guest a merchandise credit worth 90% of the price of the clubs.

*115% Price Guarantee.* We offer a 115% low price guarantee whereby we will refund 115% of the difference in purchase price if a guest notifies us within 30 days of purchase of a lower price offered by another authorized retailer.



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*Club Trade-Ins.* Our Club Trade-In Program allows guests to receive a merchandise credit for their pre-owned clubs which can be applied toward the purchase price of new clubs or other products. Guests can trade-in their clubs at any store or through our Internet site. We sell the pre-owned clubs that we acquire through this program in our stores and through our Internet site.

*Golfsmith Credit Card.* We offer our own proprietary credit card, which provides our qualified guests with flexible payment options for their Golfsmith purchases. As a result of our partnership with Wells Fargo, we do not bear any of the financing risk associated with this program.

As part of our guest-first philosophy, we also provide our guests with a number of innovative golf and tennis-related services, including the following:

*SmartFit™ Custom Club Fitting Program.* We offer guests the ability to customize premier and proprietary branded clubs to the guest's physical profile (height, wrist-to-floor distance and hand size), swing speed and their desired game characteristics (trajectory, control and distance). Our SmartFit™ program is available to our guests at every store, as well as through our Internet site and catalogs.

*Hot Stix® Precision Equipment Recommendation.* We license Hot Stix® proprietary technology, which analyzes a guest's swing and recommends the type of clubs and golf balls from our inventory that are best suited to that individual.

*GolfTEC Learning Centers.* Our relationship with GolfTEC Learning Centers complements our outstanding caddy team by providing in-store golf instruction. GolfTEC's proprietary system features digital video, motion analysis and ball-flight projection to allow its staff of PGA-certified teaching pros to analyze our guest's swing and compare it to a database of the swings of various professional golfers. As of December 31, 2005, GolfTEC provided in-store golf lessons in 27 of our stores. During 2006, we plan to modify three of our existing stores to accommodate in-store golf lessons by GolfTEC.

*Club Repair and Clubvantage Program.* We offer repair services at all of our stores. In order to encourage guests to use these services, we offer two-year and three-year plans under our Clubvantage program that enable guests to cover the labor costs associated with re-gripping, re-shafting and repairing individual clubs or club sets for an upfront fee. The program provides additional benefits, such as an additional credit on any clubs that are traded-in and a savings certificate for the Harvey Penick Golf Academy.

*Expert Racquet Stringing.* As a member of the U.S. Racquet Stringers Association, we are able to offer our guests expert racquet stringing services.

## **Marketing and Advertising**

We employ a combination of print, broadcast, radio, direct mail, e-mail and billboard media, as well as in-store events, to drive awareness of the Golfsmith brand, our multi-channel business model and our product selection. On the local level we run newspaper advertisements to promote stores and store events. On the national level, we run printed advertisements in national magazines, such as Golf Digest®, Golf World and Golf for Women. In the past, we have run national advertisements on The Golf Channel® and local television advertisements in select markets to complement our direct marketing campaign. To manage costs and increase effectiveness, we have expanded the use of e-mail for direct marketing.

The catalogs and magazines that we distribute throughout the year are also an important marketing tool. We mail more than 10 million catalogs annually. We believe that our catalogs drive online and in-store traffic and also expand recognition of the Golfsmith® brand.

We employ additional marketing activities prior to key shopping periods, such as Father's Day and Christmas, and in connection with specific sales and promotions. In particular, we hold various theme- or activity-based promotions throughout the year that drive additional traffic into our stores, including demonstration days, appearances by PGA golfers, tour vans and events focusing primarily on the female guest. To reinforce our multi-channel model,

we coordinate these events across both our retail store and direct-to-consumer channels.

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### **Management Information Systems**

Our management information systems provide us with a network and applications that are reliable, scalable and easy to use, maintain and modify. Our management information systems are based on the Oracle ERP system with additional integrated state-of-the-art systems. This infrastructure fully integrates all major aspects of our business across all channels, improves our back-office capabilities, enhances management reporting and analysis capabilities through rapid access to data, lowers operating costs and improves and expands our direct marketing capabilities.

Our in-store, point-of-sale system tracks all sales by category, style and item and allows us to routinely compare current performance with historical and planned performance. The information gathered by this system also supports automatic replenishment of inventory and is integrated into product buying decisions. The system has an intuitive, user-friendly interface that minimizes new user training requirements, allowing our caddies to focus on serving our guests.

The majority of our hardware resides at our corporate headquarters. We have implemented redundant servers and communication lines to limit downtime in the event of power outages or other potential problems. System administrators and network managers monitor and operate our network operations and transactions-processing systems to ensure the continued and uninterrupted operation of our Internet site and transaction-processing systems. Our focus on reliability, availability and scalability has resulted in successful operations through our continued expansion of stores without any interruptions to our point-of-sale system during 2005.

### **Purchasing**

In each of fiscal 2004 and 2005, three of our suppliers, Callaway Golf<sup>®</sup>, TaylorMade<sup>®</sup> / adidas Golf<sup>®</sup>, and Acushnet<sup>®</sup> each supplied approximately 10% of our consolidated purchases. We source substantially all of our proprietary products from contract manufacturers in Asia, which manufacture our equipment according to our specifications. We do not have long-term supply contracts with our vendors and all of our orders are made on a purchase order basis.

Many of our vendors provide us with volume purchasing rebates if we reach certain order targets. In 2005 we initiated a co-operative advertising program pursuant to which the cost of marketing certain vendor's products or services is reimbursed by the vendor. This program offers our vendors differentiated co-operative advertising opportunities. Along with vendor buy-ins to sponsor events, these cross-promotional arrangements have enabled us to expand our own marketing activities as a result of vendor reimbursement of marketing expenses related to their products.

### **Distribution and Fulfillment**

We have developed a hybrid distribution system that combines our central warehouse and distribution infrastructure with the direct-ship expertise of the vendor community. This hybrid distribution model increases our flexibility to allocate inventory to stores on an as-needed basis, thereby improving our in-stock positions.

We operate a 240,000 square foot distribution and fulfillment center in Austin, Texas which handles selected store inventory replenishment and substantially all direct-to-consumer order fulfillment requirements. Store inventory replenishment is accomplished using a warehouse management system that separates and collates shipments which are trucked to our stores by a third party dedicated fleet. For those vendors whose infrastructure supports direct shipment to retail locations, our hybrid system also allows for a direct-ship component.

We dedicate 100,000 square feet of our distribution and fulfillment center to our direct-to-consumer shipping facility, which can handle over one million packages annually. This facility utilizes the latest technology, including an automated conveyor system that efficiently moves merchandise through the picking and shipping areas. While most direct-to-consumer orders are filled from this facility, our advanced information systems allow us to search store inventory if the distribution and fulfillment center is out of stock. If needed, pick tickets are automatically generated at the appropriate store, and store caddies ship the item directly to the guest. This capability allows us to optimize our use of inventory across our supply chain and increases order fill rates.

We also have two smaller distribution facilities in Toronto, Canada and near London, England, from which we service our Canadian and European guests, respectively.

### **International**

We work with a group of international agents and distributors to offer golf club components and equipment to clubmakers and golfers in selected regions outside the United States. In the United Kingdom, we sell our proprietary branded equipment through a commissioned sales force directly to retailers. Throughout most of Europe and parts of Asia and other parts of the world,

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we sell our products through a network of agents and distributors. Sales through our international distributors and our distribution and fulfillment center near London accounted for 1.5% of our revenues in fiscal 2005, 2.2% in fiscal 2004 and 2.3% in fiscal 2003.

### **Harvey Penick Academy**

In 1993, we partnered with Austin native and well-known golf instructor, the late Harvey Penick, to form the Harvey Penick Golf Academy. The academy has attracted over 20,000 students since its inception. We believe the academy helps contribute to sales at our adjacent Austin store. The academy accounted for approximately 0.2% of our net revenues in fiscal 2005, 0.3% in fiscal 2004 and 0.3% in fiscal 2003.

### **Industry Overview**

We estimate that the golf retail market that we target represented over \$6 billion in sales in the United States in 2005. Over the last 35 years, the golf industry has realized significant growth in both participation and popularity. According to the National Golf Foundation, the number of rounds played in the United States grew from 266.0 million in 1970 to a peak of 518.4 million rounds played in 2000. This growth has been driven by the increased number of golf courses, greater television exposure to golf and golfing events and technological advances in golf equipment. More recently, however, there has been a slight decline in the number of rounds of golf played from the peak in 2000 to 499.6 million rounds in 2005, according to the National Golf Foundation. This decrease in rounds played over the last five years can be attributed to a variety of factors that have impacted recreational activities including the state of the nation's economy, unfavorable weather conditions and reduced discretionary spending.

Another key indicator for the strength of the golf industry is the total number of golfers. Total golfers as a percentage of the United States population has increased since 1970. In 2004, the National Golf Foundation determined the number of people who play golf in the United States had grown from 11.2 million (approximately 5.5%) in 1970 to 27.3 million in 2004 (approximately 9.2%). Approximately 6.0 million of those golfers are categorized as avid golfers, who play 25 or more rounds per year.

### **Competition**

The golf industry is highly fragmented and competitive. We compete both in the off-course specialty retail segment and in the online and catalog retail segment. The off-course specialty retail segment is characterized by sales of a complete selection of golf equipment and apparel, a unified store image, favorable pricing and knowledgeable staff. The online and catalog retail segment is characterized by competitive pricing, shopping convenience and a wide product selection.

Our primary competitors in the off course specialty retail segment are Edwin Watts and Golf Galaxy. Our primary competitors in the online and catalog retail segment are The Golf Warehouse and Edwin Watts. Other competitors include franchise and independent golf retailers such as Nevada Bob's, Pro Golf Discount and Golf USA; on-course pro-shops; conventional sporting goods retailers such as Dick's Sporting Goods and the Sports Authority; and mass merchants such as Wal-Mart, Target and Costco. We compete on the basis of brand image, technology, quality and performance of our products, method of distribution, price, style and intellectual property protection.

### **Facilities**

With the exception of the Austin store at our corporate headquarters, we lease all of our retail stores. All leased premises are held under long-term leases with differing provisions and expiration dates. Leases generally provide for monthly rentals, typically computed on the basis of a fixed amount. Three of our leases also provide for payments based on sales at those locations. Most leases contain provisions permitting us to renew for one or more specified terms.

We own a 41-acre Austin, Texas campus, which is home to our general offices, distribution and fulfillment center, contact center, clubmaker training facility and the Harvey Penick® Golf Academy. The Austin campus also includes a golf testing and practice area. Details of our facilities are more fully described in Item 2, Properties of this Annual Report.

### **Proprietary Rights and Intellectual Property**

We are the registrant of, or have pending registrations for, over 90 trademarks and service marks in more than 25 countries including Golfsmith®, Black Cat®, Crystal Cat®, Killer Bee®, Lynx®, Parallax®, Predator®, Snake Eyes®, Tigress®, Zevo®, ASI™, GearForGolf™ and GiftsForGolf™. We are also the owner of 25 registered domain names.





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We believe that our trademarks and service marks have important value and are integral to building our name recognition.

**Employees**

We typically staff our stores with a general manager, up to two assistant managers and, on average, 15 to 20 full-time and part-time sales staff depending on store volume and time of year. As of December 31, 2005, we employed approximately 800 full-time and 530 part-time personnel. We generally supplement our workforce with seasonal full-time and part-time workers at peak times during our second and fourth quarters. None of our work force is unionized. We have not experienced any work stoppages, and we consider our relations with our associates to be good.

We offer competitive wages, comprehensive medical and dental insurance, company-paid and supplemental life insurance programs, associated long-term and short-term disability insurance and a 401(k) plan to our full-time employees and some of our part-time employees.

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We generate substantially all of our net revenues from the sale of golf equipment, apparel and accessories. The demand for golf products is directly related to the popularity of golf, the number of golf participants and the number of rounds of golf being played by these participants. According to the National Golf Foundation, the number of rounds played annually in the United States declined from 518.4 million in 2000 to 499.6 million in 2005. This decline is attributable to a number of factors, including the state of the nation's economy. If golf participation and the number of rounds of golf played decreases, sales of our products may be adversely affected. We cannot assure you that the overall dollar volume of the market for golf-related products will grow, or that it will not decline, in the future.

The demand for golf products is also directly related to the popularity of magazines, cable channels and other media dedicated to golf, television coverage of golf tournaments and attendance at golf events. We depend on the exposure of the products we sell, especially the premier branded golf merchandise, through advertising and the media or at golf tournaments and events. Any significant reduction in television coverage of, or attendance at, golf tournaments and events or any significant reduction in the popularity of golf magazines or golf channels, may reduce the visibility of the brands that we sell and could adversely affect our sales.

***We may not be able to incur additional indebtedness or secure alternate funds, if needed, to expand our business or compete effectively and, as a result, our net revenues and profitability may be materially affected.***

The indenture governing our senior secured notes and our senior secured credit facility limit almost completely our ability to borrow additional funds. We believe that the terms of the liens securing our senior secured credit facility and our senior secured notes effectively preclude us from borrowing additional funds, other than under our senior credit facility. As a result, to the extent that we do not have borrowing availability under our senior credit facility we will have to fund our operations, including new store openings and capital expenditures as well as any future acquisitions, with cash flow from operations. If we do not generate sufficient cash flow from our operations to fund these expenditures, we may not be able to compete effectively and our sales and profitability would likely be materially adversely affected.

Our ability to open new stores depends on the availability of adequate capital, which in turn depends in large part on our cash flow from operations and the availability of equity and debt financing. We currently anticipate spending approximately \$1.8 million to open each additional store, which includes pre-opening expenses, capital expenditures and inventory costs. We cannot assure you that our cash flow from operations will be sufficient or that we will be able to obtain equity or debt financing on acceptable terms or at all to implement our growth strategy.

On March 14, 2006, we filed a Registration Statement on Form S-1 with the Securities and Exchange Commission proposing the registration of shares of our common stock under an initial public offering. Estimated proceeds from this offering of \$115 million are expected to be used: (1) to retire the principle amount of our senior secured notes; (2) to repay indebtedness under our existing senior secured credit facility; (3) to pay a one-time \$3 million fee to terminate our management consulting agreement with First Atlantic Capital, Ltd. ("First Atlantic Capital"), and (4) for general corporate purposes. We cannot assure you that this offering will be completed or completed in a timely manner upon terms favorable to us.

***A reduction in discretionary consumer spending could reduce sales of golf products.***

Golf products are recreational in nature and are therefore discretionary purchases for consumers. Consumers are generally more willing to make discretionary golf product purchases during favorable economic conditions. Discretionary spending is affected by many factors, including general business conditions, interest rates, the availability of consumer credit, taxation and consumer confidence in future economic conditions. Purchases of our products could decline during periods when disposable income is lower, or during periods of actual or perceived unfavorable economic conditions. Any significant decline in general economic conditions or uncertainties regarding future economic prospects that adversely affect discretionary consumer spending, whether in the United States generally or in a particular geographic area in which our stores are located, could lead to reduced sales of our products.

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***Our sales and profits may be adversely affected if we or our suppliers fail to develop and introduce new and innovative products that appeal to our customers.***

Our future success depends, in part, upon our and our suppliers' continued ability to develop and introduce new and innovative products. This is particularly true with respect to golf clubs, which accounted for approximately 45% of our net sales in fiscal 2005. We believe our guests' desire to test the performance of the latest golf equipment drives traffic into our stores and increases sales. This is particularly true when significant technological advancements in golf clubs and other equipment occur, although such advances generally only occur every few years. Furthermore, the success of new products depends not only upon their performance, but also upon the subjective preferences of golfers, including how a club looks, sounds and feels, and the level of popularity that a golf club enjoys among professional and recreational golfers. Our success depends, in large part, on our and our suppliers' ability to identify and anticipate the changing preferences of our customers and our ability to stock our stores with a wide selection of quality merchandise that appeals to customer preferences. If we or our suppliers fail to successfully develop and introduce on a timely basis new and innovative products that appeal to our customers, our revenues and profitability may suffer.

On the other hand, if our suppliers introduce new golf clubs too rapidly, it could result in closeouts of existing inventories. Closeouts can result in reduced margins on the sale of older products, as well as reduced sales of new products given the availability of older products at lower prices. These reduced margins and sales may adversely affect our results of operations.

***Our success depends on our ability to compete with our existing major competitors and with new competitors that may enter the golf retail market.***

Our principal competitors are currently other off-course specialty retailers, franchise and independent golf retailers, on-course pro shops, conventional sporting goods retailers, mass merchants and warehouse clubs, and online retailers of golf equipment. These businesses compete with us in one or more product categories. In addition, traditional sports retailers and specialty golf retailers are expanding more aggressively in marketing and supplying brand-name golf equipment, thereby competing directly with us for products, customers and locations. Some of these potential competitors have greater financial or marketing resources than we do and may be able to devote greater resources to sourcing, promoting and selling their products. We may also face increased competition due to the entry of new competitors, including current suppliers that decide to sell their products directly. As a result of this competition, we may experience lower sales and margins or greater operating costs, such as marketing costs, which would have an adverse effect on our results of operations and financial position.

***Our growth depends primarily upon our ability to open new stores and operate them profitably, and our failure to do so could have a material adverse effect on our business.***

Our growth strategy involves opening additional stores in new and existing markets. We are in the early stages of our store expansion. At the end of 2005, we had 52 stores, more than half of which we opened or acquired during the last three years. We plan to open between 10 and 12 new stores in 2006 and between 14 and 16 new stores in 2007. In addition to capital requirements, our ability to open new stores on a timely and profitable basis is subject to various contingencies, including but not limited to, our ability to successfully:

identify suitable store locations that meet our target demographics;

negotiate and enter into long-term leases upon acceptable terms;

build-out or refurbish sites on a timely and cost-effective basis;

hire, train and retain skilled managers and personnel; and

integrate new stores into existing operations.

After identifying a new store site, we typically try to negotiate a long-term lease, generally between 10 and 20 years. Long-term leases typically result in long-term financial obligations that we are obligated to pay regardless of whether the store generates sufficient traffic and sales. There can be no assurance that new stores will generate sales levels necessary to achieve store-level profitability or profitability comparable to that of existing stores. New stores

may also have lower sales volumes or profits compared to previously opened stores or they may have losses. In the past, we have experienced delays and cost-overruns in obtaining proper permitting, building and refurbishing stores. We cannot assure you that we will not experience these problems again in the future.

Furthermore, our expansion into new and existing markets may present competitive, distribution, and merchandising challenges that differ from our current challenges, including competition among our stores clustered in a single market, diminished novelty of our activity-based store design and concept, added strain on our distribution and fulfillment center and management information systems, and diversion of management attention from existing operations. We cannot assure you that we will be successful in meeting the challenges described above or that any of our new stores will be a profitable deployment of our capital

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resources. If we fail to open additional stores successfully or if any of our new stores are not profitable, we may not be able to grow our revenues and our results of operations and financial position may be adversely affected.

***If our key suppliers limit the amount or variety of products they sell to us or if they fail to deliver products to us in a timely manner and upon customary pricing terms, our business could be adversely affected.***

We rely on a limited number of suppliers for a significant portion of our product sales. During fiscal 2004 and 2005, three of our suppliers each accounted for approximately 10% of our purchases. We depend on access to the latest golf equipment, apparel and accessories from the premier national brands in order to drive traffic into our stores and through our direct-to-consumer channel. We do not have any long-term supply contracts with our suppliers providing for continued supply, pricing, allowances or other terms. In addition, certain of our vendors have established minimum advertised pricing requirements, which, if violated, could result in our inability to obtain certain products. If our suppliers refuse to distribute their products to us, limit the amount or variety of products they make available to us, or fail to deliver such products on a timely basis and upon customary pricing terms, our business could be materially and adversely affected.

In addition, some of our proprietary products require specially developed manufacturing molds, techniques or processes which make it difficult to identify and utilize alternative suppliers quickly. Any significant production delay or the inability of our current suppliers to deliver products on a timely basis, including clubheads and shafts in sufficient quantities, or the transition to alternate suppliers, could have a material adverse effect on our results of operations.

***Our sales could decline if we are unable to process increased traffic or prevent security breaches on our Internet site and our network infrastructure.***

A key element of our strategy is to generate high-volume traffic on, and increase sales through, our Internet site. Accordingly, the satisfactory performance, reliability and availability of our Internet site, transaction processing systems and network infrastructure are critical to our reputation and our ability to attract and retain guests. Our Internet revenues will depend on the number of visitors who shop on our Internet site and the volume of orders we can fill on a timely basis. Problems with our Internet site or order fulfillment performance would reduce the volume of goods sold and could damage our reputation. We may experience system interruptions from time to time. If there is a substantial increase in the volume of traffic on our Internet site or the number of orders placed by customers, we may be required to expand and further upgrade our technology, transaction processing systems and network infrastructure. We cannot assure you that we will be able to accurately project the rate or timing of increases, if any, in the use of our Internet site, or that we will be able to successfully and seamlessly expand and upgrade our systems and infrastructure to accommodate such increases on a timely and cost-effective basis.

The success of our Internet site depends on the secure transmission of confidential information over network and the Internet and on the secure storage of data. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission and storage of confidential information, such as customer credit card information. In addition, we maintain an extensive confidential database of customer profiles and transaction information. We cannot assure you that advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments will not result in a compromise or breach of the security we use to protect customer transaction and personal data contained in our customer database. In addition, other companies in the retail sector have from time to time experienced breaches as a result of actions by their employees. If any compromise of our security were to occur, it could have a material adverse effect on our reputation, business, operating results and financial condition, and could result in a loss of customers. A party who is able to circumvent our security measures could damage our reputation, cause interruptions in our operations and/or misappropriate proprietary information which, in turn, could cause us to incur liability for any resulting losses. We may be required to expend significant capital and other resources to protect against security breaches or to alleviate problems caused by breaches.

***We lease almost all of our store locations. If we are unable to maintain those leases or locate alternative sites for our stores on terms that are acceptable us, our net revenues and profitability could be adversely affected.***

We lease 51 of our 52 current stores. In fiscal 2005, we closed two stores when the leases for those locations expired. In both instances, we opened a new store in similar locations during fiscal 2005. We cannot assure you that

we will be able to maintain our existing store locations as leases expire, extend the leases or be able to locate alternative sites on favorable terms. If we cannot maintain our existing store locations, extend the leases or locate alternative sites on favorable or acceptable terms, our net revenues and profitability could be adversely affected.

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***Our operating results are subject to seasonal fluctuations which could cause the market price of our common stock to fluctuate.***

Our business is seasonal. The golf season and the number of rounds played in the markets we serve fluctuate based on a number of factors, including the weather. Accordingly, our sales leading up to and during the warm weather golf season, as well as the Christmas holiday gift-giving season, have historically contributed to a higher percentage of our annual net revenues and annual net operating income than other periods in our fiscal year. During fiscal 2005, the fiscal months of March through September and December, which together comprise 36 weeks of our 52-week fiscal year, contributed over three-quarters of our annual net revenues and substantially all of our annual operating income. We make decisions regarding merchandise well in advance of the season in which it will be sold. We incur significant additional expenses leading up to and during these periods in anticipation of higher sales, including acquiring additional inventory, preparing and mailing our catalogs, advertising, creating in-store promotions and hiring additional employees. In the event of unseasonable weather during the peak season in certain markets, our sales may be lower and we may not be able to adjust our inventory or expenses in a timely fashion. This seasonality may result in volatility or have an adverse effect on our results of operations and the market price of our common stock.

***Our stores are clustered in particular areas and adverse events in those areas may have a disproportionate effect on our business.***

A significant portion of our stores are clustered in certain geographic areas, including seven in each of the Tri-State (New York, New Jersey and Connecticut) and the San Francisco Bay area, six in Los Angeles, four in each of Chicago and Dallas, and three in each of Atlanta, Denver, Detroit, Houston and Phoenix. If any of these areas were to experience a downturn in economic conditions, natural disasters such as hurricanes, floods or earthquakes, terrorist attacks, or other negative events, the stores in these areas may be adversely affected, which would adversely affect our operating results.

***Our comparable store sales may fluctuate, which could negatively impact our future operating performance.***

Our comparable store sales are affected by a variety of factors, including, among others:  
customer demand in different geographic regions;

unseasonable weather during certain periods for certain geographic regions;

our ability to efficiently source and distribute products;

changes in our product mix;

our decision to relocate or refurbish certain stores;

promotional events;

effects of competition;

our ability to effectively execute our business strategy; and

general economic conditions.

Our comparable store sales have fluctuated significantly in the past and such fluctuation may continue in the future. For example, the changes in comparable store sales compared to the prior fiscal year was 7.4% in 2003, 0.7% in 2004 and 2.5% in 2005. We have also experienced decreases in comparable store sales during certain quarterly periods during the last two fiscal years and we cannot assure you that our comparable store sales will not decrease again in the future.

***If we fail to accurately target the appropriate segment of the consumer catalog market or if we fail to achieve adequate response rates to our catalogs, our results of operations may suffer.***



Our results of operations depend in part on the success of our direct-to-consumer channel, which consists of our Internet site and multiple catalogs. Within our direct-to-consumer distribution channel, we believe that the success of our catalog operations also contributes to the success of our Internet site, because many of our customers who receive catalogs choose to purchase products through our Internet site. We believe that the success of our catalogs depend on our ability to:

achieve adequate response rates to our mailings;

offer an attractive merchandise mix;

cost-effectively add new customers;

cost-effectively design and produce appealing catalogs; and

timely deliver products ordered through our catalogs to our guests.

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We have historically experienced fluctuations in the response rates to our catalog mailings. If we fail to achieve adequate response rates, we could experience lower sales, significant markdowns or write-offs of inventory and lower margins, which could materially and adversely affect our results of operations.

***If we lose the services of our Chief Executive Officer, we may not be able to manage our operations and implement our growth strategy effectively.***

We depend on the continued service of James D. Thompson, our President and Chief Executive Officer, who possesses significant expertise and knowledge of our business and industry. Currently, we do not maintain key person insurance for any of our officers or managers. We have entered into an employment agreement with Mr. Thompson that expires, subject to automatic one-year extensions, in October 2006. Any loss or interruption of the services of Mr. Thompson could significantly reduce our ability to effectively manage our operations and implement our growth strategy, and we cannot assure you that we would be able to find an appropriate replacement should the need arise.

***We are controlled by one stockholder, which may give rise to a conflict of interest.***

Atlantic Equity Partners III, L.P., owns approximately 74.3% of our common stock on a fully diluted basis, including outstanding stock options. All of our stockholders are parties to a stockholders agreement that contains voting arrangements that give Atlantic Equity Partners III voting control over the election of all but one of our directors. As a result, Atlantic Equity Partners III controls us and effectively has the power to approve any action requiring the approval of the holders of our stock, including adopting certain amendments to our certificate of incorporation and approving mergers or sales of all of our assets. In addition, as a result of Atlantic Equity Partners III's ownership interest, conflicts of interest could arise with respect to transactions involving business dealings between us and Atlantic Equity Partners III or First Atlantic Capital, Ltd., which operates Atlantic Equity Partners III, potential acquisitions of business or properties, the issuance of additional securities, the payment of dividends by us and other matters.

***We rely on our management information systems for inventory management, distribution and other functions. If our information systems fail to perform these functions adequately or if we experience an interruption in their operation, our business and results of operations could be adversely affected.***

The efficient operation of our business is dependent on our management information systems. We rely on our management information systems to effectively manage order entry, order fulfillment, point-of-sale, and inventory replenishment processes. Our management information systems are vulnerable to damage or interruption from:

earthquake, fire, flood and other natural disasters;

power loss, computer systems failure, Internet and telecommunications or data network failure; and

hackers, computer viruses, software bugs or glitches.

Any damage or interruption to our management information systems or the failure of our management information systems to perform as expected could disrupt our business, result in decreased sales, increased overhead costs, excess inventory and product shortages and adversely affect our results of operations.

***Our profitability would be adversely affected if the operation of our Austin, Texas call center or distribution and fulfillment center were interrupted or shut down.***

We operate a centralized call center and distribution and fulfillment center in Austin, Texas. We handle almost all of our Internet site and catalog orders through our Austin facility. We also receive and ship a significant portion of our retail stores' inventory through our Austin facility. Any natural disaster or other serious disruption to this facility would substantially disrupt our operations and could damage all or a portion of our inventory at this facility, impairing our ability to adequately stock our stores and fulfill guest orders. In addition, we could incur significantly higher costs and longer lead times associated with fulfilling our direct-to-consumer orders and distributing our products to our stores during the time it takes for us to reopen or replace our Austin facility. As a result, a disruption at our Austin facility would adversely affect our profitability.

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***A disruption in the service or a significant increase in the cost of our primary delivery service for our direct-to-consumer operations would have a material adverse effect on our business.***

We use United Parcel Service, or UPS, for substantially all of our ground shipments of products sold through our Internet site and catalogs to our guests in the United States. Any significant disruption to UPS's services would impede our ability to deliver our products through our direct-to-consumer channel, which could cause us to lose sales or guests. In addition, if UPS were to significantly increase its shipping charges, we may not be able to pass these additional shipping costs on to our guests and still maintain the same level of direct-to-consumer sales. In the event of disruption to UPS's services or a significant increase in its shipping charges, we may not be able to engage alternative carriers to deliver our products in a timely manner on favorable terms, which could have a material adverse effect on our business.

***An increase in the costs of mailing, paper, and printing our catalogs would adversely affect our profitability.***

Postal rate increases and paper and printing costs affect the cost of our catalog mailings. We rely on discounts from the basic postal rate structure, such as discounts for bulk mailings and sorting by zip code and carrier routes for our catalogs. We are not a party to any long-term contracts for the supply of paper. Our cost of paper has fluctuated significantly during the past three fiscal years, and our future paper costs are subject to supply and demand forces external to our business. A material increase in postal rates or printing or paper costs for our catalogs could materially decrease our profitability.

***If we are unable to enforce our intellectual property rights our net revenues and profits may decline.***

Our success and ability to compete are dependent, in part, on sales of our proprietary branded merchandise. We currently hold a substantial number of registrations for trademarks and service marks to protect our own proprietary brands. We also rely to a lesser extent on trade secret, patent and copyright protection, employee confidentiality agreements and license agreements to protect our intellectual property rights. We believe that the exclusive right to use trademarks and service marks has helped establish our market share. If we are unable to continue to protect the trademarks and service marks for our proprietary brands, if such marks become generic or if third parties adopt marks similar to our marks, our ability to differentiate our products and services may be diminished. In the event that our trademarks or service marks are successfully challenged by third parties, we could lose brand recognition and be forced to devote additional resources to advertising and marketing new brands for our products.

From time to time, we may be compelled to protect our intellectual property, which may involve litigation. Such litigation may be time-consuming, expensive and distract our management from running the day-to-day operations of our business, and could result in the impairment or loss of the involved intellectual property. There is no guarantee that the steps we take to protect our intellectual property, including litigation when necessary, will be successful. The loss or reduction of any of our significant intellectual property rights could diminish our ability to distinguish our products from competitors' products and retain our market share for our proprietary products. Our proprietary products sold under our proprietary brands generate higher margins than products sold under third party manufacturer brands. If we are unable to effectively protect our proprietary intellectual property rights and fewer of our sales come from our proprietary products, our net revenues and profits may decline.

***We may become subject to intellectual property suits that could cause us to incur substantial costs or pay substantial damages or prohibit us from selling our products.***

Third parties may from time to time assert claims against us alleging infringement, misappropriation or other violations of patent, trademark or other proprietary rights, whether or not such claims have merit. Such claims can be time consuming and expensive to defend and may divert the attention of our management and key personnel from our business operations. Claims for alleged infringement and any resulting lawsuit, if successful, could subject us to significant liability for damages, increase the costs of selling some of our products and damage our reputation. Any potential intellectual property litigation could also force us to stop selling certain products, obtain a license from the owner to use the relevant intellectual property, which license may not be available on reasonable terms, if at all, or redesign our products to avoid using the relevant intellectual property.

***We may be subject to product warranty claims or product recalls which could harm our business, results of operations, and reputation.***

We may be subject to risks associated with our proprietary branded products, including product liability. Our existing or future proprietary products may contain design or materials defects, which could subject us to product liability claims and product recalls. Although we maintain limited product liability insurance, if any successful product liability claim or product recall is not covered by or exceeds our insurance coverage, our business, results of operations and financial condition would be harmed. In addition, product recalls could adversely affect our reputation in the marketplace. In May 2002, we learned that some of our proprietary products sold in the prior two years were not manufactured in accordance with their design specifications. Upon discovery of this discrepancy, we offered our customers refunds, replacements or gift certificates. As a result, in fiscal 2002 we

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recognized \$300,000 in product return and replacement expenses. We cannot assure you that problems like this will not happen again in the future, or if they do, that they will not have a material adverse effect on our business and results of operations. In addition, it is possible that we could face similar risks with respect to the premier branded products we sell.

***Disruption of operations of ports through which our products are imported from Asia could have a material adverse effect on our results of operations.***

We import substantially all of our proprietary products from Asia under short-term purchase orders, and a significant amount of the premier branded products we sell is also manufactured in Asia. If a disruption occurs in the operations of ports through which our products are imported, we and our vendors may have to ship some or all of our products from Asia by air freight. Shipping by air is significantly more expensive than shipping by boat, and if we cannot pass these increased shipping costs on to our guests, our profitability will be reduced. A disruption at ports through which our products are imported would have a material adverse effect on our results of operations.

***Current and future tax regulations may adversely affect our direct-to-consumer business and negatively impact our results of operations.***

Our direct-to-consumer channel may be adversely affected by state sales and use taxes as well as the regulation of Internet commerce. We currently must collect taxes for approximately half of our catalog and Internet sales. An unfavorable change in state sales and use taxes could adversely affect our business and results of operations. In addition, future regulation of the Internet, including the widespread imposition of taxes on Internet commerce, could affect the growth of sales through our Internet site and negatively affect our ability to increase our net revenues.

***We may pursue strategic acquisitions, which could have an adverse impact on our business.***

From time to time, we may grow our business by acquiring complementary businesses, products or technologies. In May 2003, we acquired the assets and technology of Zevo Golf Co., Inc., and in July 2003 we acquired six Don Sherwood Golf & Tennis stores. Other acquisitions that we may make in the future entail a number of risks that could materially and adversely affect our business and operating results. Negotiating potential acquisitions or integrating newly acquired businesses, products or technologies into our business could divert our management's attention from other business concerns and could be expensive and time consuming. Acquisitions could expose our business to unforeseen liabilities or risks associated with entering new markets or businesses. In addition, we might lose key employees while integrating new organizations. Consequently, we might not be successful in integrating any acquired businesses, products or technologies, and might not achieve anticipated sales and cost benefits. In addition, future acquisitions could result in customer dissatisfaction, performance problems with an acquired company, or issuances of equity securities that cause dilution to our existing stockholders. Furthermore, we may incur contingent liabilities or possible impairment charges related to goodwill or other intangible assets or other unanticipated events or circumstances, any of which could harm our financial condition.

**Item 1B. Unresolved Staff Comments**

Not applicable.

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At December 31, 2005, we operated 52 stores in 13 states. We plan to open ten to twelve additional stores during fiscal 2006. With the exception of the Austin store at our corporate headquarters, we lease all of our retail stores. All leased premises are held under long-term leases with differing provisions and expiration dates. Leases generally provide for monthly rentals, typically computed on the basis of a fixed amount. Three of our leases also provide for payments based on sales at those locations. Most leases contain provisions permitting us to renew for one or more specified terms.

We own a 41-acre Austin, Texas campus, which is home to our general offices, distribution and fulfillment center, contact center, clubmaker training facility and the Harvey Penick® Golf Academy. The Austin campus also includes a golf testing and practice area. Details of our non-store properties and facilities are as follows:

<b>Location</b>	<b>Size (sq. ft.)</b>	<b>Facility Type</b>	<b>Owned Leased</b>
Austin, Texas	60,000	Office	Owned
Austin, Texas	240,000	Distribution and Fulfillment Center	Owned
Austin, Texas	17 Acres	Driving Range and Training Facility	Owned
Toronto, Canada	3,906	Direct-to-Consumer Order Fulfillment Facility	Leased