GOLFSMITH INTERNATIONAL HOLDINGS INC
Form 10-K
March 06, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended December 29, 2007

or

o **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 000-52041

GOLFSMITH INTERNATIONAL HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	16-1634847
(State or Other Jurisdiction of Incorporation or Organization)	(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:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.01 par value	The Nasdaq Stock Market

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 o No þ

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 o No þ

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 þ No o

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 þ No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company þ

(Do not check if a smaller
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the Registrant s most recently completed second fiscal quarter was approximately $66.0 million.

There were 15,777,145 shares of the registrant s common stock issued and outstanding as of March 4, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the registrant s 2008 Annual Meeting of Stockholders are incorporated by reference in this Form 10-K

GOLFSMITH INTERNATIONAL HOLDINGS, INC.

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EX-32.2: CERTIFICATION

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COMPANY INFORMATION

Golfsmith International Holdings, Inc., the parent company of Golfsmith International, Inc., is a holding company that 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 ar 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 simil intended to identify forward-looking statements. In addition other statements may also be 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

We are one of the nation s largest specialty retailers of golf and tennis equipment, apparel and accessories. 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, whom we refer to as guests, the convenience of shopping in our 74 stores across the nation, through our Internet site, *www.golfsmith.com*, and from our catalogs. Our stores have knowledgeable employees, whom we refer to as caddies, and feature an activity-based shopping environment where our customers can test the performance of golf clubs in our in-store hitting areas. We offer an extensive product selection that features premier national brands, pre-owned clubs and also our proprietary-branded products, including ASI, Clubmaker, Golfsmith, Hank Haney, Killer Bee, J.G.Hickory, Lynx, Profinity, Snake Eyes, TourTrek, XPC, Zevo and ZTech. We also offer a number of guest services and customer care initiatives including our custom club-fitting program, our club trade-in program, 90-day playability guarantee, 115% low-price guarantee, our proprietary credit card, in-store golf lessons and SmartFit™, our custom club-fitting program. Our distribution and fulfillment center and management information systems support and integrate our distribution channels and provide a 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, and continues to control a majority ownership interest in us. In June 2006, we completed our initial public offering and listing on the Nasdaq Global Market under the ticker symbol GOLF .

Store Operations

We opened our first retail store in 1972 and operated 74 stores in 19 states at December 29, 2007. The locations of our stores are more fully described in Item 2, Properties.

We design our stores in a way that we believe will provide an exciting, activity-based shopping environment that resonates with the golf and tennis enthusiast and highlights our extensive product offering. Our stores range in size from 9,000 to 59,000 square feet. Our store concept can vary in size and format to fit each market depending on local market demographics, competition, real estate prices and availability.

Each Golfsmith store offers premier-branded clubs, balls, apparel and accessories, as well as our proprietary-branded products including Hank Haney, Lynx, Snake Eyes, Tour Trek, Zevo, Z-Tek and others. The majority of our stores also offer club components, clubmaking tools, supplies and on-site clubmaking, custom club-fitting and club repair services as well as tennis racket stringing. 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. In addition, our larger stores provide a more expansive array of activity-based offerings including partial-flight indoor driving ranges and a larger assortment of demo clubs.

We have entered into an agreement with GolfTEC Learning Centers to provide precision club-fitting and PGA-certified golf instruction to our customers. We had GolfTEC Learning Centers in 52 of our stores as of December 29, 2007.

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

- demographic characteristics, such as above-average annual household income and a high number of golfers who play 25 or more rounds per year (avid golfers);
- presence and strength of competition;
- 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;
- proximity to a large metropolitan area; and
- the ability to obtain favorable lease terms;

After we identify a potential site, we analyze demographic and competitive data to project store revenues and develop profitability forecasts.

Our stores accounted for 77.4% of our net revenues in fiscal 2007, 74.0% in fiscal 2006 and 72.3% in fiscal 2005. From January 2005 to December 2007, we increased the number of our stores in operation from 46 to 74.

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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 customers an extensive 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 20.6% of our net revenues in fiscal 2007, 23.8% in fiscal 2006 and 25.7% in fiscal 2005. In fiscal 2007, this year-over-year decrease in direct-to-consumer net revenues as a percentage of total revenues was primarily driven by a decline in our direct-to-consumer channel revenues in addition to the expansion of our retail store base which continued to fuel growth in total revenues. In fiscal 2006, the decrease was primarily due to the expansion of our store base which fueled total revenue growth.

Internet

We offer over 47,000 golf and tennis stock keeping units (SKU s) through our Internet site, *www.golfsmith.com*, which we began in 1997. We also have 31 registered domain names that link to *www.golfsmith.com* including two which are linked to our European website and one to our Canadian website.

Through our Internet site, we seek to extend to the direct-to-consumer channel the innovative services offered in our stores. We have further enhanced the customer shopping experience by featuring, among other items, the following:

- *in-store pickup* - allows customers to order an item online and avoid the delivery expenses and waiting time:
- *search functionality* - allows customers to search for an item of apparel by a specific category, color, brand or material:
- *product reviews* - allows customers to post and read reviews of most products that we offer:
- *tips on equipment* - provides guidance on how to select appropriate golf and tennis equipment:
- *tennis section* - includes a detailed buyer s guide to assist both tennis enthusiasts and recreational tennis players in making their purchases:
- *product personalization services* - allows customers to order personalized merchandise:
- *online SmartFit™ system* - allows customers to custom-fit their golf clubs to their personal specifications by providing step-by-step instructions to walk them through the online club-fitting process:
- *pre-owned club information* - provides customers with full access to our pre-owned club selection and detailed information about the type of club:
- *Club Trade-In Program* - allows customers to trade in their used clubs and receive a merchandise credit for the value of the clubs in exchange:
- *tee times* - allows customers to use our website to obtain tee times at golf courses across the country:
- *Drive section* - is specifically designed for the woman golfer:
- *trip and vacation planner* - allows customers to use our website to plan and book their golfing vacations, including hotel, rounds of golf and rental car; and
- *store and item locator* - allows customers to enter the zip code and locate the store nearest to them in which a selected item is in stock.

We believe our Internet site complements our retail stores and catalogs by building customer awareness of our brand and acting as an effective marketing vehicle for our products and services including new product introductions, special product promotions and our proprietary-branded products. We believe that our Internet site also drives traffic to our stores, as evidenced by the fact that one of the most-used features on the Internet site is the store-locator functionality.

Catalogs

We have a 40-year history as a catalog retailer and believe that we are one of the industry s leading golf specialty catalog retailers. Our principal catalog publications are the Golfsmith Consumer Catalog, targeting the avid golfer, and the Golfsmith Clubmaking Catalog, a specialty catalog for people who build their own clubs. We also distribute our Annual Buyer s Guide, designed to be the most extensive and informative catalog of golf-related equipment and accessories, providing pictures and descriptions of many of the 15,000 SKUs offered in 220 pages. Our Drive catalog specifically targets the women golfer and offers fashionable apparel and state-of-the-art golf equipment while our Center Court tennis catalog carries major brands of tennis equipment, apparel and accessories for our tennis customers.

Our catalog titles are designed and produced by our in-house staff of art directors, writers and photographers. The regular production and distribution schedule of our consumer catalogs permits us to introduce new products regularly and make price adjustments as necessary. Our continued strategy of producing more targeted catalog vehicles promotes our specialty and lifestyle brand and follows the industry trend towards developing more niche, targeted publications for our customers.

Our customer database contains approximately 3.3 million names of individuals who have either purchased our products or have requested to receive our periodic mailings. We have developed this database largely through our catalog and website 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 customer segments are likely to contribute the greatest revenues per mailing. In addition, we prospect for potential customers by sending catalogs to individuals whose contact information we have licensed. We do not add these individuals to our customer database on a permanent basis unless they purchase products or request additional mailings.

Products and Merchandising

We offer a broad assortment of golf and tennis brands and products, including our own proprietary brands, through our sales channels. We generally price our products consistently across our channels. We also tailor the merchandise selection in our stores to meet the regional preferences of our customers. By providing a wide-ranging, in-depth assortment, we believe we will continue to attract the full spectrum of customers from avid to recreational golfers as well as both tennis enthusiasts and recreational tennis players with buying interest across all price points.

Technological cycles. Substantial technological advancements in equipment over the past decade have shortened product replacement cycles and increased club retail prices. Significant advances have been achieved in club head, shaft and golf ball construction, design and materials. We believe the introduction of new and improved products, together with advertising and promotions by equipment manufacturers and retailers emphasizing the importance of proper equipment to one s game, has encouraged golfers to change their equipment more frequently.

The launch of geometrically shaped drivers in fiscal 2007 helped to drive club replacement cycles. In 2008, we believe we will see the same geometric technologies introduced into other clubs such as fairway woods and hybrids. In addition, a few of the largest vendors in the golf product industry are introducing interchangeable head and shaft technology for drivers. This technology has been used in the past in custom fittings, but is now allowed for use in USGA sponsored events.

Branded-products. We are a retailer of premier-branded golf and tennis merchandise. We believe that carrying a broad selection of the latest premier-branded merchandise is critical to driving sales among our highest-spending and most passionate customers, the avid golf and tennis player.

Clubs. We carry a wide variety of premier-branded golf clubs from leading national manufacturers catering to both avid and recreational golfers. We have continued to increase our assortment of pre-owned premier-branded clubs as we have expanded our Club Trade-in program. This has enabled us to provide value-conscious customers with additional price-points on premium branded clubs. The premier golf club brands that we offer include, among others, Callaway, Cleveland, Cobra, Nike, Ping, TaylorMade, and Titleist.

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, Ashworth, Ben Hogan, Callaway, Greg Norman, Nike, Ping and Under Armour. We also offer footwear for both golf and tennis for men, women and juniors from top national brands such as adidas, Bite, Callaway, Ecco, Etonic, FootJoy, Lady Fairway, Nike, Oakley, Prince and Wilson.

Golf balls. We offer a broad range of nationally recognized golf ball brands including Bridgestone, Callaway, Nike, TaylorMade, Titleist, and Top-Flite. These premier-branded golf balls provide our customers 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 customers golf and tennis activities including technology devices such as Global Position System (GPS) range finder units and other golf and tennis accessories, such as 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, SkyHawk, Team Effort and Wilson.

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

Golfsmith Proprietary Brands. Our proprietary brand trademarks include ASI, Clubmaker, Golfsmith, Hank Haney, Killer Bee, J.G.Hickory, Lynx, Profinity, Snake Eyes, TourTrek, XPC, Zevo and ZTech. In fiscal 2007, our proprietary-branded products accounted for $55.4 million of our net sales. We develop and promote proprietary merchandise in the majority of our golf related product categories and classes, including clubs, club components, apparel, golf bags and covers, pull and push carts, shoes, furnishings, accessories, training aids and gifts.

Our proprietary brands provide quality products at attractive prices and generally have higher gross margins than the premier-branded products we offer due to a direct from manufacturer to consumer business model. We oversee the entire product development process of our proprietary brands through the combined efforts of a dedicated brand management and product development team, internal golf club R&D team, and full service third-party vendor partners. Additionally, a combination of our 40+ year leadership position in clubmaking along with our proprietary-branded products, allows us to appeal to custom clubmakers and enhances our status as equipment and product design experts.

We position our proprietary-branded products in two distinct ways. In premium name-brand dominated product categories such as clubs, clothing, shoes and balls, we complement and strategically co-exist with the premier-branded products by offering similar technology at lower price points. While the premier-branded merchandise we offer generally attracts avid golfers who are typically more brand-conscious, our proprietary brands generally serve our more value-conscious customers who are less brand-conscious. In commodity categories such as accessories, tees, and gifts where brands do not play a large role, we stock higher quantities of our proprietary products. By maintaining an inventory of the leading premier-branded merchandise, in combination with our broad line strategy of supplying high-quality but value conscious proprietary-branded items, we are able to supply our customers a large assortment of products along a continuum of price points that we believe meets the needs of any type of golfer and improves company profitability.

Club Components

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

Seasonality

Our sales and net operating income are typically driven by the periods during the year that include the warm weather months and the December holiday gift-giving season.

Customer Care Initiatives

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

90/90 Playability Guarantee. This initiative allows our customers to purchase and use certain clubs for up to 90 days and to return the clubs for a merchandise credit equal to 90% of the price if they are not satisfied with them.

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

Club Trade-Ins. Our Club Trade-In Program allows customers to receive a merchandise credit for their pre-owned clubs which can be applied toward the purchase price of new clubs or other products. Customers can trade in their clubs at any store, through our Internet site or through our catalog. Our Club Trade-In Program is enhanced by periodic initiatives such as our National Trade-In Days program where customers are given additional value for trading in their used clubs.

Golfsmith Credit Card. We offer our own proprietary credit card, which provides our qualified customers with flexible payment options such as no interest, no payments for six or 12 months, for their Golfsmith purchases. As a result of our partnership with a national financial institution, we do not bear any of the financing risk associated with this program.

Loyalty Program. Our Player Rewards loyalty program is free to all customers and provides members with advance notice of sales and special events, exclusive invitations to VIP-only events, trade-in bonuses and coupons and discounts on select products and services.

As part of our *Guest-First* philosophy, we also provide our customers with a number of other golf and tennis-related services, including the following:

Club Repair and Clubvantage Program. We offer club repair services at the majority of our stores. In addition we sell two- and three-year plans under our Clubvantage program that provide for all labor costs for re-gripping, re-shafting and repairing individual clubs or club sets. 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 customers expert racquet stringing services. Our racquet technicians have passed comprehensive tests to ensure their knowledge and understanding of racquet service and provide our customers with a full range of racquet services.

SmartFit   Custom Club Fitting Program. We offer customers the ability to custom-fit their clubs through our SmartFit™ program. Through our SmartFit™ program, we customize premier and proprietary-branded clubs to the customer s physical profile (height, wrist-to-floor distance and hand size), swing speed and the customer s desired game characteristics (trajectory, control and distance). We also have the ability to custom build a set of golf clubs from scratch using our clubmaking technology and components. Our SmartFit™ program is available to our customers at every store, as well as through our Internet site.

GolfTEC Learning Centers. Our relationship with GolfTEC Learning Centers complements our in-store employee 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 customer s swing and compare it to a database of the swings of various professional golfers. In addition, GolfTEC provides software that enables customers to review their lesson, drills and instructor comments online. Customers participation in GolfTEC lessons drives traffic within our stores as our customers buy lesson packages that encourage repeat visits to our store location. As of December 29, 2007, GolfTEC provided in-store golf lessons in 52 of our stores.

Customer Service

We strive to create long-term relationships with our customers through our *Guest-First* philosophy. Through this customer service philosophy we believe we are developing a culture that will enable us to cultivate a loyal customer base.

In order to encourage a knowledgeable employee team, we actively recruit golfing and tennis enthusiasts to serve as sales employees, because we believe that they bring enthusiasm to the shopping experience and are knowledgeable about the products they sell. We also target individuals with a strong retail background, because we believe a general understanding of retail sales is critical for marketing and selling our products. After hiring, we provide extensive product training and test employees knowledge periodically to ensure our they can provide our customers with the most informed assistance available.

A component of our compensation is sales commissions, which we believe motivates sales employees to learn more about our product and service offerings and to demonstrate and explain to our customers the features and benefits of our products and services. Our commission system is designed to ensure that our employees focus on providing the products or services that are well suited to our customers. We believe our compensation package allows us to recruit and retain an educated and professional sales force that leads to a better customer experience.

Marketing and Advertising

Our marketing and advertising programs are designed to promote our extensive selection of premier national brands as well as our own proprietary brands at competitive prices. Through our integrated marketing and advertising, we emphasize our multi-channel business model by utilizing our in-store, catalog and Internet capabilities to promote our brand and advertise our innovative services and events.

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 our brand. On the local level, we run newspaper and television advertisements, sponsor golf tournaments and send targeted mailings to our best customers to promote stores and store events. The clustering of stores in particular markets allows local advertising techniques to be more cost-effective. On the national level, we periodically run advertisements in national golf and tennis magazines and on The Golf Channel. To manage costs and increase effectiveness, we are expanding the use of e-mail for direct marketing.

The catalogs and magazines that we distribute throughout the year are also an important marketing tool. In 2007, we mailed more than 10 million catalogs. 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 the December holiday season, 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 Tour professional golfers, tour vans and events focusing primarily on the female customer. To reinforce our multi-channel model, we coordinate these events across both our retail store and direct-to-consumer channels.

We believe our Player Rewards loyalty program not only helps to foster customer loyalty but also provides us with valuable market intelligence and purchasing information regarding our most frequent customers. We may use this information to focus our advertising efforts to encourage repeat shopping and target communication to our best customers.

Management Information Systems

To enhance scalability, reliability and flexibility, our customer-facing applications are in-house developed, maintained and integrated into our Oracle Enterprise Resource Planning environment.

Our core networking infrastructure, which serves as the backbone of our application landscape, is designed to offer redundancy and is built upon the Cisco campus model. In addition, our communication lines, which are critical to our e-commerce business, are multi-vendor sourced and in redundant configurations.

Our production environments are hosted out of our corporate headquarters where our dedicated teams of systems administrators and applications developers staff our Operations Center to monitor networks, applications, user traffic and retail store Point-of-Sale activity. Our systems are integrated with vendor partners through Electronic Data Interchange (EDI) to send purchase orders and to receive invoices helping us to improve operating efficiencies.

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 employees to focus on serving our customers.

In 2007, we took significant steps to embrace the green initiative by purchasing only energy efficient hardware for our desktops and servers. In addition, virtualization technology has been deployed to replace a significant portion of our server environment. These changes help us to reduce heating and air-conditioning power usages which should result in reduced energy consumption and associated costs.

Purchasing

We have developed relationships with many of the major equipment vendors in the industry giving us a diverse network of suppliers. In each of the 2007 and 2006 fiscal years, three of our suppliers, Callaway Golf, TaylorMade-adidas Golf and Acushnet each individually supplied at least 10% of our consolidated purchases. We source substantially all of our proprietary products from contract manufacturers in Asia who manufacture our equipment according to our specifications. We generally do not enter into long-term supply contracts with our vendors, and all of our orders are made on a purchase-order basis.

Due to our size and the volume of purchases we make, some of our vendors provide us with access to large quantities of the prior year s models at discounted rates or other volume purchasing rebates if we reach certain annual order targets. In addition, a majority of our vendors participate in our annual co-operative advertising program that provides them with differentiated co-operative advertising opportunities due to our multi-channel business model and activity-based store environment. We work closely with our vendors to find co-operative opportunities and negotiate mutually beneficial terms.

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, 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 shipped to our stores by third-parties. 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 advanced 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 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 employees ship the product directly to the customer. This capability allows us to optimize our use of inventory across our supply chain and increases our order fill rates.

We also have two smaller distribution facilities near London, England and in Toronto, Canada, from which we service our European and Canadian customers, 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, we sell our products through a network of agents, distributors and through our website. Sales through our international distributors and our distribution and fulfillment center near London, England accounted for 1.7% of our net revenues in fiscal 2007, 1.6% in fiscal 2006, and 1.5% in fiscal 2005.

Harvey Penick Academy

In 1993, we partnered with Austin, Texas native and golf instructor, the late Harvey Penick, to form the Harvey Penick Golf Academy. The academy has attracted over 22,000 students since its inception. We believe the academy helps contribute to sales at our adjacent Austin store.

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Competition

The golf industry is highly fragmented and competitive. We compete in both 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 golf equipment and apparel, favorable pricing and a knowledgeable staff. The online and catalog retail segment is characterized by competitive pricing, shopping convenience and a wide product selection.

Off-course specialty retailers. Due to the fragmented nature of the golf industry, off-course specialty retail stores vary significantly in size, strategy and geographic location. Some focus on specific areas of the country, and some have focused more heavily on a single channel, being slow to develop into other channels of commerce or develop multi-channel expertise. Our primary competitors in this category are Edwin Watts, Golf Galaxy, PGA Tour Superstore and World Wide Golf. In certain markets, we compete with one or all of these competitors.

Internet or catalog specific retailers of golf equipment. Online and catalog retailers of golf equipment sell a wide selection of merchandise through the use of catalogs or the Internet. The products are competitively priced and the direct channel offers a certain convenience to consumers. However, catalog and Internet-only retailers are not able to offer hands-on product testing and fitting. These retailers typically have a limited channel focus that limits their ability for cross-channel marketing and sales as well as for cross-channel brand promotion. Our primary competitors in this category are GolfDiscount.com and The Golf Warehouse.

Franchise and independent golf retailers. Franchise and independent golf retailers tend to be comprised of smaller stores with 2,000 to 5,000 square feet. Due in part to their more limited space we believe these stores generally offer a less extensive selection of golf clubs, equipment, accessories and apparel. Many promote sales of their private-label or lesser-known brands. They also do not typically have PGA-certified professionals assisting customers or advanced demonstration and testing facilities. Our main competitors in this category include Golf USA, Nevada Bob s and Pro Golf Discount.

On-course pro shops. On-course pro shops are located on-site at golf courses or on-site at other golf facilities such as driving ranges. These retailers have significantly smaller stores with which to offer merchandise. While these shops generally have PGA professionals on staff, they generally offer a less extensive selection of golf clubs and equipment, choosing to devote more of their limited space to showcasing apparel. These shops also generally do not offer advanced demonstrations or diagnostic or testing equipment such as ball launch monitors.

Conventional sporting goods retailers. Conventional sporting goods retailers are generally large format 20,000 to 100,000 square foot stores that offer a wide range of sporting goods merchandise covering a variety of categories, including merchandise related to most sports. These stores apply a single store format to numerous specialty areas. Prices at these stores are generally competitive, but we believe that the limited space they devote to golf products restricts the breadth of their golf offering. These retailers often do not have full access to all of the premier national brands and to the full assortment of those brands lines. Most do not currently have PGA-certified professionals, advanced demonstration and trial facilities or club repair services. Our main competitors in this category are Dick s Sporting Goods and The Sports Authority.

Mass merchants and warehouse clubs. These stores typically range in size from 50,000 to 200,000 square feet and above. These merchants and clubs offer a wide-range of products, but golf merchandise tends to represent a very small portion of their retail square footage and their total sales. We believe that their limited product selection and limited access to the range of premier national brands does not appeal to many golf enthusiasts. These stores also do not focus on services which address the needs of golfers specifically. Examples of such stores are Costco, Target and Wal-Mart.

Facilities

With the exception of our corporate headquarters in Austin, Texas and the store at our corporate headquarters, all premises are held under long-term leases with differing provisions and expiration dates. Our lease rents are generally fixed amounts with increases over the terms, and some leases include percentage rent requirements based on sales. Most of our 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 corporate headquarters, including general offices, distribution and fulfillment center, contact center, clubmaker training facility and the Harvey Penick Golf Academy. The Austin campus also includes a 30,000 square foot retail store, an equipment testing area and driving range. Details of our facilities are more fully described in Item 2, Properties of this Annual Report on Form 10-K.

Proprietary Rights and Intellectual Property

We are the registrant of, or have pending registrations for, over 80 trademarks and service marks in more than 25 countries including

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Golfsmith®, ASIt®, Black Cat®, Crystal Cat®, Dry18®, Hank Haney®, JG Hickorym, Killer Bee®, Lynx®, Parallax®, Predator®, Profinity™, Snake Eyes®, Tigress®, TourTrek™, Maggie Lane™, Zevo® and Z-Tek™.We are also the owner of 31 registered domain names. 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 three 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 29, 2007, we employed 954 full-time and 711 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.

Item 1A. Risk Factors

A reduction in the number of rounds of golf played or a decline in popularity of golf or tennis may adversely affect our sales.

We generate substantially all of our net revenues from the sale of golf and tennis equipment, apparel and accessories. The demand for golf and tennis products is directly related to the popularity of golf and tennis, the number of golf and tennis participants and the number of rounds of golf being played in the United States. If golf participation and the number of rounds of golf played decrease, sales of our products may be adversely affected. We cannot assure you that the overall dollar volume of the market for golf and tennis-related products will grow, or that it will not decline, in the future. For example, in 2007, rounds played decreased by 0.5% and our comparable store percentage decreased by 3.7%. Accordingly, as rounds played increase or decrease in the future, we cannot provide any assurance that our revenues will increase or decrease proportionately.

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 cause a decrease in our sales of golf products, which could negatively impact our results of operations and financial condition.

Our operating costs and profitability could be adversely affected if we are unable to accurately predict and respond to seasonal fluctuations in our business.

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 December 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. The months encompassing these seasons are responsible for the majority 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 expenditures 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 financial condition.

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, cost of living, interest rates, the availability of consumer credit, taxation and consumer confidence in current and 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 discretionary spending or 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 one or more of our stores are located, could lead to reduced sales of our products and could have an adverse effect on our results of operations and financial condition.

Competition from new and existing competitors will have an adverse effect on our sales and profitability.

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 and catalog 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 selling brand-name golf equipment, thereby competing directly with us for products, customers and locations. Some of these 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 or greater operating costs, such as marketing costs, which would have an adverse effect on our margins and our results of operations in general. Some of our markets are growing increasingly competitive, specifically the Atlanta, Georgia, Dallas, Texas and Phoenix, Arizona markets. Significant competitors are opening larger store formats in close geographic proximity to some of our store locations in these markets. As a result certain stores are experiencing decreased revenues and margin pressure. We expect the increase in competition in the specialty golf and tennis retail industry, as well as in other competitive channels, to continue, which could negatively impact our results from operations and financial condition. In addition to increased competition, our higher profit margin club component business has been in decline for the last several years and may continue to decline, thus negatively impacting our results from operations and financial condition.

If we cannot hire a new Chief Executive Officer and maintain continuity of our executive team, our ability to effectively manage ongoing operations may be negatively impacted.

In January 2008, James D. Thompson, our Chief Executive Officer (CEO) for the previous five years resigned, and his role has been filled on an interim basis by the Chairman of the Board, Martin Hanaka. We have initiated a search for a new CEO and are seeking to fill the position within the next three to six months. If we are unable to fill the position or to attract and retain a person with talent necessary for implementing our plan, our ability to effectively manage our ongoing operations may be negatively impacted, and adversely affect our results from operations and financial condition.

We depend on the continued service of our executive officers, who possess 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 may be unable to expand our business if adequate capital is not available.

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. Historically, we have spent approximately $1.8 million, net of tenant allowances and extended vendor terms, to open each additional store, which includes pre-opening expenses, capital expenditures and inventory costs. These expenditures can vary depending on the store s size, geographic market conditions and the level of work required for the property when received from the landlord. 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 a growth strategy and we provide no assurances about our future growth or expansion.

Our Amended and Restated Credit Facility contains provisions which restrict our ability to incur additional indebtedness, or make substantial asset sales which might otherwise be used to finance our expansion. Our obligations under the Amended and Restated Credit Facility are secured by substantially all of our assets, which may further limit our access to capital or lending sources. As a result, we cannot assure you that we will have adequate capital to finance our current expansion plans.

If we fail to regain compliance with Nasdaq s audit committee requirements, our common stock may be delisted from the Nasdaq Global Select Market, which may reduce the price of our common stock and levels of liquidity available to our stockholders.

Our continued listing on the Nasdaq Global Market requires us to comply with Nasdaq s audit committee requirements. Upon his appointment as our interim Chief Executive Officer, Martin Hanaka, Chairman of the Board of Directors of the Company, and previously an independent director and a member of our Audit Committee, resigned from the Audit Committee in order to comply with the Audit Committee independence requirement as set forth in Marketplace Rule 4350 of Nasdaq Stock Market, Inc. (Nasdaq), leaving two independent directors on that committee. Because Rule 4350 requires a listed issuer to have an audit committee consisting of at least three independent directors, we received a Staff Determination letter from Nasdaq stating that we are no longer compliant with the requirements for continued listing. Consistent with Nasdaq Marketplace Rule 4350(d)(4), Nasdaq provided us with a cure period until July 7, 2008 in order to regain compliance. We may not be able to identify and attract a suitable candidate who will be deemed independent under the Nasdaq marketplace rules for our Audit Committee prior to July 7, 2008. If we fail to regain compliance with Nasdaq s audit committee requirements, our common stock may be delisted from the Nasdaq Global Select Market. Therefore, there can be no assurance that the Listing Council will determine to continue the listing of our common stock on Nasdaq. If our common stock is delisted, it may become more difficult for our stockholders to sell our stock in the public market and the price of our common stock may be adversely affected. Delisting from Nasdaq could also result in other negative implications including the potential loss or reduction of confidence by customers, creditors, suppliers and employees, the potential loss or reduction of investor interest, and fewer business development opportunities, any of which could materially adversely affect our results of operations and financial condition.

If we fail to generate consistent positive cash flows at individual store locations we may be required to record future impairments of assets at our stores.

If an individual store fails to produce positive cash flows at any point in time, if we anticipate that it may fail to produce positive cash flows or if we believe that an alternative location may be better, we may decide to discontinue operations at that location. If we decide to discontinue operations at any location, the existing assets at such location may be impaired to the extent that their carrying value exceeds an amount that represents the expected future cash flows. In fiscal 2007 we recorded a $1.4 million impairment of long-lived assets at certain stores. Such future impairments could negatively impact our results from operations and financial condition.

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 47% and 46% of our net revenues in fiscal 2007 and 2006, respectively. We believe our customers 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 advances 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 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, the introduction of new golf clubs or other equipment by our suppliers could result in close-outs of existing inventories. Close-outs 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 and financial condition.

Our growth will be adversely affected if we are unable to open new stores and operate them profitably.

Our growth strategy involves opening additional stores in new and existing markets albeit at a slower rate in 2008 than in past years. At December 29, 2007, we operated 74 stores, of which almost 40% were opened in the past three fiscal years. 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 with 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 lease with a base term of approximately 10 years. Our leases typically result in financial obligations that we are obligated to pay regardless of whether the store generates sufficient traffic and sales. New stores may also have lower sales volumes or profits compared to previously opened stores or they may have losses. In the past, from time to time, we have experienced delays and cost-overruns in obtaining proper permitting, building and refurbishing stores. We anticipate that we may 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 resources. If we fail to open additional stores successfully we may not be able to grow our revenues, and furthermore additional stores may not be profitable. If we are unable to grow revenues from the successful opening of additional stores, or if such additional stores are not profitable 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 and payment terms, our sales and profitability may be reduced.

We rely on a limited number of suppliers for a significant portion of our product sales. During fiscal 2006 and 2007, three of our suppliers each accounted for at least 10% of our purchases. We depend on access to the latest golf equipment, apparel and accessories from the premier national brands in order to attract 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 and payment terms, our sales and profitability may be reduced, which could have a material adverse affect on our results of operations and financial condition.

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 and financial condition.

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 customers. 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 or damages. We may be required to expend significant capital and other resources to protect against security breaches or to alleviate problems caused by breaches thereby adversely impacting our results from operations and financial condition.

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 leased 73 of the 74 stores that we were operating at December 29, 2007. We did not close any stores due to expiring leases during fiscal years 2007 or 2006. 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 in our target markets and on favorable terms. If we cannot maintain our existing store locations, extend the leases or locate alternative sites on favorable or acceptable terms, results from operations and financial condition could be adversely affected.

Many of our stores are clustered in particular metropolitan areas, and an economic downturn or other adverse events in these areas may significantly reduce the sales for stores located in such areas.

A significant portion of our stores are clustered in certain geographic areas, including eleven in the Tri-State (New York, New Jersey and Connecticut) area, seven in the San Francisco Bay area, six in the Los Angeles area, five each in the Chicago and Dallas areas, four in the Houston area and three in each of the Atlanta, Denver, Detroit, Minneapolis and Phoenix areas. 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 thereby adversely impacting our results from operations and financial condition.

Our comparable store sales may decline, 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;

- changes in our product mix;
- our decision to relocate or refurbish certain stores;
- the launch of promotional events;
- the opening of new stores by us and our competitors in our existing markets; and
- changes in economic conditions in the areas in which our stores are located.

Our comparable store sales have fluctuated significantly in the past, and such fluctuation may continue in the future. The percentage increase or decrease in comparable store sales compared to the prior fiscal year was (3.7%) in 2007, 2.0% in 2006 and 2.6% in 2005, respectively. We have 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. Some of our markets are growing increasingly competitive, specifically the Dallas, Texas and Atlanta, Georgia markets. We expect the increase in competition in the golf and tennis retail industry to continue, which could negatively impact revenues and therefore operating income. In addition to increased competition, our higher profit margin club component business has been in decline for the last several years and may continue to decline, thus negatively impacting our results from operations and financial condition.

If we fail to generate sufficient revenue from our proprietary-branded products, we may have future impairments of trademark and trade-name intangible assets.

The carrying value of the trademark and trade-name intangible assets on our balance sheet are supported by estimated future positive cash flows generated by our proprietary-branded products. If we fail to create products that appeal to customers and produce sufficient future revenues, our future estimates may be overstated, which could result in an impairment of our intangible assets and thereby adversely impact our results from operations and financial condition.

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 sales and profitability may be adversely affected.

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 depends 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 customers.

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 adversely impact our results from operations and financial condition.

Atlantic Equity Partners III, L.P. has significant influence over us, including the ability to nominate a majority of our board of directors, and its interests may conflict with the interests of our other stockholders.

The largest beneficial owner of our shares, Atlantic Equity Partners III, L.P. (Atlantic Equity Partners), an investment fund managed by First Atlantic Capital, Ltd. (First Atlantic Capital), has voting rights equal to 60.0% of our outstanding common stock. This includes 9.7% of our outstanding stock owned by Carl and Franklin Paul over which First Atlantic Capital has voting rights pursuant to a voting rights and stockholders agreement among Atlantic Equity Partners and Carl and Franklin Paul. Under the agreement, Carl and Franklin Paul have also agreed that they will only transfer the shares subject to the agreement on a pro rata basis when Atlantic Equity Partners transfers its shares. As a result of its own stockholdings and this agreement, Atlantic Equity Partners, and indirectly First Atlantic Capital, will have the ability to control all matters submitted to our stockholders for approval, including:

- the composition of our board of directors, which has the authority to direct our business and appoint and remove our officers;
- approving or rejecting a merger, consolidation or other business combination; and
- amending our certificate of incorporation and bylaws which govern the rights attached to our common stock.

In addition, we and Atlantic Equity Partners have entered into a management rights agreement. Pursuant to this agreement, following a reduction of the equity owned by Atlantic Equity Partners to below 50% of our outstanding equity, it will retain the right to cause the board of directors to nominate a specified number of designees for the board

of directors, and continue to be able to significantly influence our decisions.
This concentration of ownership of our common stock could delay, lead to or affect the results of possible proxy contests, mergers, acquisitions, tender offers, purchases or sales of assets, open-market purchase programs or other public or private transactions involving our common stock or other securities.
Our sales, profitability and company-wide operations would be adversely affected if the operations 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 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 customer 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 could adversely affect our results from operations and financial condition..

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 sales and profitability.

We use a third-party vendor for substantially all of our ground shipments of products sold through our Internet site and catalogs to our customers in the United States. Any significant disruption to our third-party vendors services would impede our ability to deliver our products through our direct-to-consumer channel, which could cause us to lose sales or customers. In addition, if our third-party vendor were to significantly increase its shipping charges, we may not be able to pass these additional shipping costs on to our customers and still maintain the same level of direct-to-consumer sales. In the event of disruption to our third-party vendors 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 our results from operations and financial condition.

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

In the 2007 fiscal year we generated a 20.6% of our revenues through our direct-to-consumer channel, including catalog orders. 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 have a material adverse effect our results from operations and financial condition.

If we are unable to enforce our intellectual property rights, our net revenues and profitability 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 we may need to devote additional resources to advertising and marketing new brands for our products to try to recoup the revenues lost.

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 results from operations and financial condition could be adversely impacted.

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 reputation, adversely affect our sales and cause us to incur substantial costs or pay substantial damages.

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 and, in turn, sales of our products, which could adversely affect our results from operations and our financial condition.

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

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 from which our products are exported or 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 customers, 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 and financial condition.

We may pursue strategic acquisitions, which could have an adverse impact on our sales and operating results, and could divert the attention of our management.

Although we currently do not have any agreement or understanding to make any acquisitions, from time to time, we may grow our business by acquiring complementary businesses, products or technologies. 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 adversely affect our results from operations or financial condition.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

At December 29, 2007, we operated 74 stores in 19 states. 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. Our lease rents are generally fixed amounts with increases over the terms, and some leases include percentage rent requirements based on sales. 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 30,000 square foot retail store and an equipment testing area and practice area. Details of our owned properties and non-store leased facilities are as follows:

Location	Size (sq. ft.)	Facility Type	Owned / Leased
Austin, Texas	60,000	Office	Owned
Austin, Texas	240,000	Distribution and Fulfillment Center	Owned
Austin, Texas	30,000	Retail Store	Owned
Austin, Texas	17 Acres	Driving Range and Training Facility	Owned
	3,906	Direct-to-Consumer Order Fulfillment Facility	Leased

Toronto, Canada			
St. Ives, Cambridgeshire, England	15,900	Office, Warehouse and Shipping Facility	Leased

The following table shows the number of our stores by state as of December 29, 2007:

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Location	Number of Stores
Alabama	1
Arizona	4
California	15
Colorado	3
Connecticut	1
Florida	6
Georgia	3
Illinois	5
Indiana	1
Michigan	3
Minnesota	3
New Jersey	6
New York	5
North Carolina	1
Ohio	2
Oregon	2
Pennsylvania	1
Tennessee	1
Texas	11

Item 3. Legal Proceedings

We are involved in various legal proceedings arising in the ordinary course of conducting business. Although the outcome of most of such matters is currently not determinable, we believe the ultimate outcome of such matters, individually or in the aggregate, would not have a material adverse impact on our financial position, liquidity or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock trades on the Nasdaq Global Market under the symbol GOLF. The following table sets forth for the periods indicated the high and low closing sale prices of our common stock since the completion of our initial public offering on June 15, 2006, as reported by the Nasdaq Global Market.

	Sales Price			
	FY 2007		FY 2006	
	High	Low	High	Low
First Quarter	$11.49	$8.39	*n/a*	*n/a*
Second Quarter	9.34	6.50	$11.10	$9.35
Third Quarter	8.25	5.73	10.30	6.94
Fourth Quarter	7.25	3.75	10.25	7.47

As of December 29, 2007, there were approximately 48 shareholders of record. A shareholder of record is the individual or entity that an issuer carries in its records as the registered holder and is not necessarily reflective of beneficial ownership of the shares. To date, we have paid no cash dividends on our capital stock and have no current intention to do so. We currently expect to retain any future earnings to fund the operation, our debt obligations and possible expansion of our business.

On January 23, 2008, we received a Nasdaq Staff Deficiency Letter indicating that we no longer comply with the Nasdaq audit committee requirement for continued listing as set forth in Marketplace Rule 4350, which requires a listed company to have an audit committee of at least three independent directors. Consistent with this Rule, Nasdaq provided us with a cure period until July 7, 2008 in order to regain compliance. We expect to fill the vacancy created by Mr. Hanaka s resignation from the Audit Committee prior to that deadline.

Report of offering of securities and use of proceeds there from:

On June 20, 2006, we completed our initial public offering in which we sold 6,000,000 shares of common stock at an offering price to the public of $11.50 per share. The net proceeds of the initial public offering to us were approximately $61.2 million after deducting underwriting discounts and offering expenses of $7.9 million. Our common stock trades on the Nasdaq Global Market under the ticker symbol GOLF.

The net proceeds from the initial public offering, along with borrowings under our Amended and Restated Credit Facility (see Note 7 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report) were used to retire the $93.75 million Senior Secured Notes (see Note 7 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report), to repay the entire outstanding balance of our Old Senior Secured Credit Facility, to pay fees and expenses related to our Amended and Restated Credit Facility and to pay a $3.0 million fee to terminate our management consulting agreement with First Atlantic Capital, Ltd., the manager of Atlantic Equity Partners III, L.P., an investment fund, which is the largest beneficial owner of our shares.

The remaining information required by Item 5 is set forth in Note 13 of *Notes to Consolidated Financial Statements* incorporated by reference here.

Item 6. Selected Consolidated Financial Data

You should read the following selected consolidated financial and other data in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes included elsewhere in this Annual Report. The selected balance sheet data as of December 29, 2007 and December 30, 2006 and the statement of operations data for fiscal years ended December 29, 2007, December 30, 2006 and December 31, 2005 have been derived from our audited consolidated financial statements included elsewhere in this Annual Report. The selected consolidated balance sheet data as of January 3, 2004, January 1, 2005 and December 31, 2005 and the statement of operations data for the fiscal year ended January 3, 2004 have been derived from the audited consolidated financial statements of Golfsmith International Holdings, Inc., which are not included in this Annual Report. Our fiscal year ends on the Saturday closest to December 31 of such year. All fiscal years presented include 52 weeks of operations, except 2003, which includes 53 weeks, where week 53 occurred in the fourth quarter of fiscal 2003.

	Fiscal Year Ended				
	January 3, 2004	January 1, 2005	December 31, 2005	December 30, 2006	December 29, 2007
	(in thousands, except share, per share and store data)				
Statement of Operations Data:					
Net revenues	$257,745	$296,202	$323,794	$ 357,890	$ 388,157
Gross profit	86,662	101,188	115,750	125,817	135,902
Impairment of goodwill and long-lived assets (1)					(42,994)
Operating income (loss)	12,662	9,682	14,675	11,561	(36,873)
Loss on debt extinguishment (3)				(12,775)	
Income (loss) from cont. operations before income taxes	1,709	(333)	3,358	(6,831)	(40,159)
Net income (loss)	$ 1,064	$ (4,756)	$ 2,958	$ (8,109)	$ (40,820)
Basic and diluted income (loss) per share of common stock	$ 0.11	$ (0.49)	$ 0.30	$ (0.62)	$ (2.58)
Other Financial Data:					
Gross profit as a percentage of sales	33.6%	34.2%	35.7%	35.2%	35.0%
Store Data (not in thousands):					
Comparable store sales increase (decrease) (4)	7.4%	0.7%	2.5%	2.0%	-3.7%
Number of stores at period end	38	46	52	62	74
Gross square feet at period end	759,981	849,677	905,827	1,094,989	1,381,150
Net sales per sq ft for stores open at beg. and end of period (5)	$ 302	$ 333	$ 353	$ 355	$ 317
Balance Sheet Data (at period end):					
Cash and cash equivalents	$ 1,051	$ 8,575	$ 4,207	$ 1,802	$ 4,025

Inventories	51,213	54,198	71,472	88,175	98,509
Working capital (6)	18,329	20,309	22,800	(9,706)	(6,244)
Total assets	177,449	186,929	204,836	227,919	202,920
Long-term debt	77,483	79,808	82,450		
Total stockholders equity	58,976	54,313	57,127	110,111	70,239

(1) In the fourth quarter of fiscal 2007, as a result our annual review of goodwill valuation as required under Statement of Financial Accounting Standards (SFAS) 142, *Goodwill and Other Intangible Assets* (SFAS 142) we concluded that our goodwill was entirely impaired and subsequently wrote the entire goodwill amount of $41.6 million, down to zero. Also in the fourth quarter of fiscal 2007, in compliance with our accounting policy for long-lived assets, under SFAS 144, *Accounting for the Impairment of Long-Lived Assets* (SFAS 144) we recorded a charge of $1.4 million for the impairment

of fixed assets at certain stores.

(2) On July 20, 2006, we redeemed our Senior Secured Notes using the proceeds generated from its initial public offering and recorded a loss on extinguishment of debt of $12.8 million.

(3) We consider sales by a new store to be comparable commencing in the fourteenth month after the store was opened or acquired. We consider sales by a relocated store to be comparable if the relocated store is expected to serve a comparable customer base and there is not more than a 30-day period during which neither the original store nor the relocated store is closed for business. We consider sales by stores with modified layouts to be

comparable. We consider sales by stores that are closed to be comparable in the period leading up to closure if they met the qualifications of a comparable store and do not meet the qualifications to be classified as discontinued operations under SFAS 144. Comparable store results for a 53-week fiscal year are presented on a 52/52 week basis by omitting the last week of the 53-week period.

(4) Calculated using net sales of all stores open at both the beginning and the end of the period and the selling square footage for such stores. Selling square feet includes all retail space including but not limited to hitting areas, putting greens and check-out areas. It does not include back-room and receiving space,

management offices, employee breakrooms, restrooms, vacant space or area occupied by GolfTEC Learning Centers.

(5) Defined as total current assets minus total current liabilities.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected Consolidated Financial Data and our consolidated financial statements and related notes included elsewhere in this Annual Report.

Overview

We believe that we are the nation s largest specialty retailer of golf and tennis equipment, apparel and accessories based on sales. We were founded in 1967 as a golf club-making company offering custom-made clubs, club-making 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 past three decades we have continued to expand our product offerings, open retail stores and add to our catalog titles. In 1997, we launched our Internet site to further expand our direct-to-consumer business. In October 2002, Atlantic Equity Partners III, L.P., an investment fund managed by First Atlantic Capital, Ltd. acquired us from our original founders, Carl, Barbara and Franklin Paul. On June 20, 2006, we completed an initial public offering of our common stock.

Since 2002, we have expanded our retail presence in the United States by opening 51 new stores, which includes 13 new stores in fiscal 2007. We continue to explore opportunities to open additional stores in existing and new geographic markets, but we do not provide any assurances about the rate at which we will open new stores in the future, and our historical record in this regard is no indication of our current or future strategy. We currently anticipate substantially reducing our 2008 square footage growth as compared to 2007. A major part of our strategy has been the direct-to-consumer channel, and we plan to continue our efforts to grow that channel. In addition, we have acquired and developed a number of proprietary brands, and we plan to continue our efforts to grow our proprietary brand revenue.

As of March 6, 2008, we operate 72 retail stores in 19 states and 25 markets, which include 13 of the top 15 golf markets. We operate as an integrated multi-channel retailer, offering our customers the convenience of shopping in our retail locations across the nation and through our direct channel which includes both our website and our direct mail catalogs.

Along with many other retail sector stocks, our stock price declined during the fourth quarter of 2007, significantly reducing our market capitalization value. Because of this decrease in our market capitalization value, pursuant to SFAS 142 guidelines, we determined that the book value of the enterprise-level reporting unit exceeded its estimated fair value. Under SFAS 142, this is an indicator of impairment which caused us to perform further testing for impairment of goodwill. Upon performance of the additional tests, we determined that our goodwill was completely impaired and, accordingly, we recorded a goodwill impairment of approximately $41.6 million (see Note 3 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report).

In addition, during the fourth quarter, we identified certain stores with significant declining profitability that indicated the possibility that certain store-level long-lived assets may not be recoverable. We evaluated these stores in accordance with our accounting policy for Long-Lived Assets. We determined that the projected future cash flows of three stores did not exceed the book value of the store-level fixed assets, including leasehold improvements, equipment, furniture, and fixtures. We recorded a non-cash impairment of fixed assets at these three stores in the amount of $1.4 million to write the fixed assets down to their estimated fair value (see Note 3 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report).

In connection with our initial public offering in June 2006 (see Note 4 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report), we granted the underwriters an option to purchase 900,000 shares of our common stock at a 7% discount to the initial public offering price, or $10.70 per share, for 30 days commencing on June 15, 2006 (grant date). Since this option extended beyond the closing of the initial public offering, we separately accounted for the call option at its fair value and the change in fair value between the grant date and the expiration date of July 15, 2006 was recorded as other income. We subsequently reevaluated its accounting for the call option and determined that such call option should have been exempted from treatment as a derivative pursuant to SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We have restated our 2006 financial statements to reduce other income and increase additional paid-in capital by $1.1 million. This change did not affect cash, cash flows or total stockholders equity.

Industry Trends

The golf retail industry is highly fragmented among mass merchants, off-course specialty retailers such as ourselves, internet merchants, warehouse-type merchants and on-course pro shops. The off-course specialty golf retail industry is becoming increasingly competitive as existing sporting or specialty goods retailers enter geographical markets that are new to them and new competitors enter the marketplace. In addition, the club component business has been in decline for the last several years and may continue to decline going forward. We believe this decline is due to waning interest by consumers in building their own clubs, the rise of the now more accessible pre-owned club market and the increase of brand name closeouts from the top manufacturers resulting from shorter product life cycles.

Sales of golf products are affected by increases and decreases in the number of golf participants and the number of rounds played annually in the United States. According to the National Golf Foundation (NGF), the number of rounds played has had minimal increases over the past four years and the number of golf participants has stayed fairly flat. The NGF estimates that in 2007 the number of golf participants was approximately 30 million and the number of rounds played was approximately 500 million. The NGF predicts that, over the next 20 years, the number of golf participants in the United States will grow by three to four million and that the number of rounds played will increase by 100-150 million. Because of this slow growth rate, we expect that any significant growth over time for a company that is heavily reliant on the golf industry will result primarily from market share gains.

Fiscal Year

Our fiscal year ends on the Saturday closest to December 31 and generally consists of 52 weeks, although occasionally our fiscal year will consist of 53 weeks. Fiscal 2007, 2006 and 2005 each consisted of 52 weeks and each quarter of those fiscal years consisted of 13 weeks.

Revenues

Revenue channels. We generate substantially all of our revenues from sales of golf and tennis products in our retail stores, and direct-to-consumer distribution channels. We also generate revenues from our international distributors and from the Harvey Penick Golf Academy. The following table provides information about the breakdown of our revenues for the periods indicated:

	Fiscal 2007		**Fiscal 2006**		**Fiscal 2005**	
	(in thousands)		**(in thousands)**		**(in thousands)**	
Stores	$300,533	77.4%	$264,791	74.0%	$234,261	72.3%
Direct-to-consumer	80,024	20.6%	85,285	23.8%	83,040	25.7%
International distributors and other (1)	7,600	2.0%	7,814	2.2%	6,493	2.0%

(1) Consists of (a) sales made through our international distributors and our distribution and fulfillment center near London, England, (b) revenues from the Harvey Penick Golf Academy, and (c) miscellaneous other revenue items.

Our revenue growth continues to be driven by the expansion of our store base while our direct-to-consumer revenue channel continues to decline as a percentage of total revenue as our retail base grows. The decline in our direct-to-consumer channel revenue is largely due to the decline of the club-component business.

Store revenues. Changes in revenues generated from our stores are driven primarily by the number of stores in operation and changes in comparable store sales. We consider sales by a new store to be comparable commencing in the fourteenth month after the store was opened or acquired. We consider sales by a relocated store to be comparable if the relocated store is expected to serve a comparable customer base and there is not more than a 30-day period from the close of the original store to the opening of the new or relocated store. We consider sales by retail stores with modified layouts to be comparable. We consider sales by stores that are closed to be comparable in the period leading up to closure if they meet the qualifications of a comparable store and do not meet the qualifications to be classified as discontinued operations under SFAS 146.

Branded compared to proprietary products. The majority of our sales are generated from premier-branded golf and tennis equipment, apparel and accessories from leading manufacturers and are sold through all of our channels. In addition, we sell proprietary-branded equipment, components, apparel and accessories under a variety of trademarked brand names. Sales of our proprietary-branded products accounted for $55.4 million of our net revenues in 2007, $53.3 million of our net revenues in 2006 and $50.8 million of our net revenues in 2005.

Seasonality. Our business is seasonal, and our sales leading up to and during the warm weather golf season and the December holiday gift-giving season have historically contributed a higher percentage of our annual net revenues and annual net operating income than other periods in our fiscal year. The months encompassing these seasons are responsible for the majority of our annual net revenues and substantially all of our annual operating income. See Quarterly Results of Operations and Seasonality.

Revenue Recognition. We recognize revenue from retail sales at the time the customer takes possession of the merchandise and purchases are paid for, primarily with either cash or by credit card. We recognize revenues from catalog and Internet sales upon shipment of merchandise. We recognize revenues from the Harvey Penick Golf Academy, our golf instructional school incorporating the techniques of the late Harvey Penick, at the time the services are performed.

We recognize revenue from the sale of gift cards and issuance of returns credits when (1) the cards or credits are redeemed by the customer, or (2) the likelihood of the cards or credits being redeemed by the customer is remote (breakage) and we determine that there is no legal obligation to remit the value of the unredeemed cards or credits to the relevant jurisdiction. Estimated breakage is calculated and recognized as revenue over a 48-month period following the card or credit issuance, in amounts based on the historical redemption patterns of the used cards or credits. Amounts in excess of the total estimated breakage, if any, are recognized as revenue at the end of the 48 months following the issuance of the card or credit, at which time we deem the likelihood of any further redemptions to be remote, and provided that such amounts are not required to be remitted to the relevant jurisdictions. Breakage income is included in net revenue in the consolidated statements of operations. In fiscal years 2007, 2006 and 2005, we recognized $0.3 million, $1.4 million and $0.9 million in breakage revenue, respectively.

For all merchandise sales, we reserve for sales returns in the period of sale using estimates based on our historical experience.

Cost of Products Sold

We capitalize inbound freight and vendor discounts into inventory upon receipt of inventory. These costs and discounts increase and decrease, respectively, the value of inventory recorded on our consolidated balance sheets. These costs and discounts are then subsequently reflected in cost of products sold upon the sale of that inventory. Because some retailers exclude these costs from cost of products sold and instead include them in a line item such as selling, general and administrative expenses, our gross profit may not be comparable to those of other retailers. Salary and facility expenses, such as depreciation and amortization, associated with our distribution and fulfillment center in Austin, Texas are included in cost of products sold. Income received from our vendors through our co-operative advertising program that does not pertain to incremental direct advertising costs is recorded as a reduction to cost of products sold when the related merchandise is sold.

Operating Expenses

Selling, general and administrative

Our selling, general and administrative expenses consist of all expenses associated with general operations for our stores and general operations for corporate and international expenses. This includes salary expenses, occupancy expenses, including rent and common area maintenance, advertising expenses and direct expenses, such as supplies for all retail and corporate facilities. A portion of our occupancy expenses are offset through our subleases to GolfTEC Learning Centers. Additionally, income received through our co-operative advertising program for reimbursement of incremental direct advertising costs is treated as a reduction to our selling, general and administrative expenses.

Selling, general and administrative expenses in the fiscal year ended December 30, 2006 also included the fees and other expenses we paid for services rendered to us pursuant to a management consulting agreement between us and First Atlantic Capital, Ltd. Under this agreement, we paid First Atlantic Capital fees and related expenses totaling $3.3 million in fiscal 2006 and $0.7 million in fiscal 2005. This contract was terminated in June 2006, and thus no amounts were paid under this agreement during the fiscal year ended December 29, 2007. The $3.3 million in payments to First Atlantic Capital, Ltd. included a payment of $3.0 million due to the termination of our management agreement. The $3.0 million payment was expensed at such time and included in selling, general and administrative expenses. We have agreed to reimburse First Atlantic Capital, Ltd. for expenses incurred in connection with meetings between representatives of First Atlantic Capital, Ltd. and us in connection with Atlantic Equity Partners III, L.P. s investment in us, and business matters that First Atlantic Capital, Ltd. attends to on our behalf for so long as Atlantic Equity Partners III, L.P. holds at least 20% of our outstanding shares of our common stock.

Store pre-opening expenses

Our store pre-opening expenses consist of costs associated with the opening of a new store and include costs of hiring and training personnel, supplies and certain occupancy and miscellaneous costs. Rent expense recorded after possession of the leased property but prior to the opening of a new retail store is recorded as store pre-opening expenses.

Impairment of goodwill and long-lived assets

In the fourth quarter of fiscal 2007, upon completion of our annual test for goodwill impairment, pursuant to SFAS 142, we determined that our goodwill was completely impaired and, accordingly, we recorded a goodwill impairment of approximately $41.6 million. Also in the fourth quarter of fiscal 2007, in compliance with our accounting policy for long-lived assets, under SFAS 144, we recorded a charge of $1.4 million for the impairment of fixed assets at certain stores (see Note 3 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report).

Non-operating Expenses

Interest expense. Our interest expense for fiscal 2007, consists of costs related to the First Amendment to the Amended and Restated Credit Agreement (the First Amendment) and the Amended and Restated Credit Agreement, (jointly, the Credit Facility). Our interest expense for fiscal 2006 consists of costs related to our Credit Facility and our Senior Secured Notes and Old Senior Secured Credit Facility. Our interest expense for fiscal 2005 consists of costs related to our Senior Secured Notes and Old Senior Secured Credit Facility.

Interest income. Our interest income consists of amounts earned from our cash balances, which were held in short-term money market accounts.

Other income. Other income consists primarily of transactions outside of our normal course of business and exchange rate variance gains.

Other expense. Other expense consists primarily of exchange rate variance expenses and penalties.

Extinguishment of debt

Extinguishment of debt consists of the loss incurred to retire all of our Senior Secured Notes and the write-off of debt issuance costs related to the Senior Secured Notes and the Old Senior Secured Credit Facility. We recorded a loss of $12.8 million on the extinguishment of this debt in the second fiscal quarter of 2006, as reported in continuing operations.

Income Taxes

Our income taxes consist of federal, state, local and foreign income taxes, based on the effective rates for the fiscal year.

Results of Operations

The following table sets forth selected consolidated statements of operations data for each of the periods indicated expressed as a percentage of total revenues:

	Fiscal Year Ended December 29, 2007	Fiscal Year Ended December 30, 2006	$ Change	% Change
	(in thousands)			
Net revenues	$ 388,157	$ 357,890	$ 30,267	8.5%
Cost of products sold	252,254	232,073	20,181	8.7%
Gross profit	$ 135,903	$ 125,817	10,086	8.0%
Selling, general and administrative	127,421	112,456	14,965	13.3%
Store pre-opening expenses	2,361	1,800	561	31.2%
Impairment of goodwill and long-lived assets	42,994		42,994	100.0%
Operating income	$ (36,873)	$ 11,561	$ (48,434)	-418.9%
As a percentage of net revenues				
Cost of products sold	65.0%	64.8%		
Gross profit	35.0%	35.2%		
Selling, general and administrative	32.8%	31.4%		
Store pre-opening expenses	0.6%	0.5%		
Operating income	-9.5%	3.2%		

Comparison of Fiscal 2007 to Fiscal 2006

Net Revenues

(dollars in thousands)	Fiscal Year Ended December 29, 2007	Fiscal Year Ended December 30, 2006	$ Change	% Change
Net revenues	$388,157	$357,890	$30,267	8.5%

Comparable stores	247,851	257,374	(9,523)	-3.7%
Non-comparable stores	52,682	7,417	45,265	610.3%

Net revenues increased 8.5% for fiscal year 2007 compared with fiscal 2006. The increase was due to a $35.7 million increase from our store revenues partially offset by a decrease of $5.3 million in our direct-to-consumer revenue channel. The increase in our store revenues was due to an increase in our non-comparable store revenues resulting from the opening of 23 new stores in fiscal years 2006 and 2007.

Eight stores entered our comparable store base during fiscal 2007. Our comparable store revenues declined by 3.7% in fiscal 2007 in comparison with fiscal 2006. Comparable store revenues continue to be negatively impacted by increased competition in select geographic markets as well as declines in our retail club component business. In addition to these competitive and product mix factors, golf rounds played in the United States, a leading indicator of golf participation tracked by the NGF, decreased 0.5% in fiscal 2007 compared to fiscal 2006. Non-comparable store net revenues primarily comprise revenues from 13 stores that were opened in fiscal 2007 and revenue from 10 stores that were opened prior to 2007 but became comparative stores for a portion of fiscal 2007.

Gross Profit

	Fiscal Year Ended			
	December 29,	**December 30,**		**%**
(dollars in thousands)	**2007**	**2006**	**$ Change**	**Change**
Cost of products sold	$252,254	$232,073	$20,181	8.7%
As a percentage of net revenues	65.0%	64.8%		
Gross profit	$135,903	$125,817	$10,086	8.0%
Gross profit as a percentage of net revenues	35.0%	35.2%	-0.2%	

Increased revenues led to higher gross profit for fiscal 2007 compared to fiscal 2006. However, gross margin decreased slightly, primarily due to the continued decline in our higher margin club component business, in turn primarily due to decreased club head sales. In addition, increased freight costs, net of earned discounts, and increased inventory valuation expenses resulted in decreases in gross profit of $1.4 million. The factors causing declines in gross profit were partially offset by an increase in our co-operative vendor program income of $1.7 million.

Selling, General and Administrative

	Fiscal Year Ended			
	December 29,	**December 30,**		**%**
(dollars in thousands)	**2007**	**2006**	**$ Change**	**Change**
Selling, general and administrative expenses	$127,421	$112,456	$14,965	13.3%
As a percentage of net revenues	32.8%	31.4%		

Selling, general and administrative expenses increased by 13.3% for the year ended December 29, 2007 compared with the year ended December 30, 2006. The increase in selling, general and administrative expenses was primarily due to an increase of $16.3 million related to non-comparable stores and an increase of $0.8 million related to corporate and international operations. These increases were partially offset by a decrease of $1.2 million related to our direct-to-consumer channel and a decrease of $1.0 million related to our comparable stores.

The increase in our non-comparable store expenses of $16.3 million was mainly related to increases in occupancy and personnel costs of $12.2 million due to the opening of thirteen stores subsequent to December 30, 2006. The increase of $0.8 million in corporate and international support expenses was primarily due to an increase in payroll costs and professional service fees. These expenses include amounts necessary to continue to build the infrastructure to support our store opening plan and the costs of being a public company. In addition, we incurred consulting fees for assistance in developing our three-year strategic initiative plan and our new larger concept store format. These increases in corporate and international support expenses were offset by a reduction in non-recurring management fees which were zero in fiscal 2007 and $3.3 million in fiscal 2006, which included a $3.0 million fee related to the early termination of our management consulting agreement with First Atlantic Capital Ltd. The decrease of $2.2 million related to our direct-to-consumer channel and our comparable stores was primarily due to a reduction in our advertising expenses across both channels and a reduction of payroll expenses in our comparable stores.

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Store Pre-Opening Expenses

	Fiscal Year Ended			
	December 29,	December 30,	$	%
(dollars in thousands)	2007	2006	Change	Change
Store pre-opening expenses	$2,361	$ 1,800	$561	31.2%
As a percentage of net revenues	0.6%	0.5%		

During the year ended December 29, 2007, we incurred $2.4 million of expenses related to the opening of thirteen new retail locations. During the year ended December 30, 2006, we incurred $1.8 million of expenses related to the opening of ten new retail locations.

Impairment of goodwill and long-lived assets. Upon completion of our annual test for goodwill impairment in fiscal 2007, performed pursuant to SFAS 142, we determined that our goodwill was completely impaired and, accordingly, we recorded a goodwill impairment of approximately $41.6 million. In addition, in the fourth quarter of fiscal 2007, in compliance with our accounting policy for long-lived assets under SFAS 144, we recorded a charge $1.4 million for the impairment of fixed assets at certain stores (see Note 3 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report).

Interest expense. Interest expense decreased by $3.9 million to $3.8 million in fiscal 2007 from fiscal 2006. The decline in interest expense is due to the retirement of our Senior Secured Notes in June 2006.

Interest income. Interest income decreased by $0.3 million in fiscal 2007 from fiscal 2006. The decrease in interest income is due to the escrow utilized for the retirement of our Senior Secured Notes in fiscal 2006.

Other income. Other income was $0.7 million for both fiscal 2007 compared to fiscal 2006. In fiscal 2007, other income included a gain of $0.5 million for the sale of rights to certain intellectual property. In fiscal 2006, other income included a one-time gain in fiscal 2006 of $0.3 million for declared settlement income resulting from the Visa Check / MasterMoney Antitrust Litigation class action lawsuit, in which we were a claimant.

Other expense. Other expense increased to $0.3 million in fiscal 2007 from $0.2 million in fiscal 2006.

Extinguishment of debt. Upon the closing of the initial public offering on June 20, 2006, we remitted payment of $94.4 million to the trustee to retire our Senior Secured Notes. We recorded a loss of $12.8 million on the extinguishment of this debt as reported in our statement of operations. This loss was the result of: (1) the contractually obligated amounts to retire the debt being larger than the accreted value of the Senior Secured Notes on our balance sheet at the time of settlement of $86.2 million, including accrued interest; (2) the write-off of debt issuance costs related to the Senior Secured Notes of $4.2 million; and (3) transaction fees associated with the retirement of the Senior Secured Notes of $0.3 million.

Income Taxes. Income taxes increased by $0.5 million in fiscal 2007 to $0.7 million. As in fiscal 2006, income tax expense primarily consisted of income taxes incurred by our foreign subsidiaries and state income taxes incurred in the United States. During 2007, we used a significant portion of our net operating loss carry-forward deductions and incurred a small amount of United States federal income tax. This amount was largely offset by relief of a small portion of the valuation allowance against the deferred tax assets in the United States. The deferred tax assets grew significantly in 2007 due to the impairment of assets. The valuation allowance increased proportionately to the increase in the deferred tax assets.

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Comparison of Fiscal 2006 to Fiscal 2005

	Twelve Months Ended December 30, 2006	December 31, 2005	$ Change	% Change
	(in thousands)			
Net revenues	$ 357,890	$ 323,794	$ 34,096	10.5%
Cost of products sold	232,073	208,044	24,029	11.5%
Gross profit	$ 125,817	$ 115,750	10,067	8.7%
Selling, general and administrative	112,456	99,310	13,146	13.2%
Store pre-opening expenses	1,800	1,765	35	2.0%
Operating income	$ 11,561	$ 14,675	$ (3,114)	-21.2%
As a percentage of net revenues				
Cost of products sold	64.8%	64.3%		
Gross profit	35.2%	35.7%		
Selling, general and administrative	31.4%	30.7%		
Store pre-opening expenses	0.5%	0.5%		
Operating income	3.2%	4.5%		

Net Revenues

(dollars in thousands)	Twelve Months Ended December 30, 2006	December 31, 2005	$ Change	% Change
Net revenues	$357,890	$323,794	$34,096	10.5%
Comparable stores	234,355	229,681	4,674	2.0%
Non-comparable stores	30,436	4,578	25,858	564.8%

Net revenues increased by 10.5% in fiscal 2006 compared to fiscal 2005. The majority of this increase was comprised of a $25.9 million increase in non-comparable store revenues, mainly d