GOLFSMITH INTERNATIONAL HOLDINGS INC
Form 10-Q
July 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 4, 2009

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 3195**
(Address of Principal Executive Offices)	(zip code)

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

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report: **Not Applicable**

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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 filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (check one):

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

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

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

Class of Common Stock	**Outstanding at July 30, 2009**
$.001 par value	15,777,185 Shares

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GOLFSMITH INTERNATIONAL HOLDINGS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JULY 4, 2009

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Golfsmith International Holdings, Inc.

Condensed Consolidated Balance Sheets

	July 4, 2009 (unaudited)	June 28, 2008 (unaudited)	January 3, 2009 (1)
ASSETS			
Current assets:			
Cash	$ 5,634,633	$ 5,664,315	$ 2,655,009
Receivables, net of allowances of $197,268 at July 4, 2009 $276,682 at June 28, 2008, and $131,065 at January 3, 2009	2,028,259	2,806,980	1,597,486
Inventories	93,096,713	101,052,822	90,499,949
Prepaid expenses and other current assets	13,072,353	11,383,530	9,288,142
Total current assets	113,831,958	120,907,647	104,040,586
Property and equipment:			
Land and buildings	22,348,498	22,066,559	22,263,200
Equipment, furniture and fixtures	42,939,613	33,270,579	34,437,845
Leasehold improvements and construction in progress	40,870,509	37,400,657	39,081,298
	106,158,620	92,737,795	95,782,343
Less: accumulated depreciation and amortization	(48,562,444)	(34,388,792)	(38,899,399)
Net property and equipment	57,596,176	58,349,003	56,882,944
Tradename	11,158,000	11,158,000	11,158,000
Trademarks	13,972,251	13,972,251	13,972,251
Customer database, net of accumulated amortization of $2,549,403 at July 4, 2009, $2,171,714 at June 28, 2008, and $2,360,559 at January 3, 2009	849,802	1,227,491	1,038,646
Debt issuance costs, net of accumulated amortization of $437,030 at July 4, 2009, $272,871 at June 28, 2008, and $354,951 at at January 3, 2009	328,316	492,476	410,396
Deferred tax assets, net	411,241	460,343	411,241
Other long-term assets	437,230	341,101	330,100
Total assets	**$ 198,584,974**	**$ 206,908,312**	**$ 188,244,164**
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 66,595,934	$ 67,735,614	$ 34,920,442
Accrued expenses and other current liabilities	16,197,309	18,039,179	19,015,839
Deferred tax liabilities, net	383,538	432,640	383,538
Total current liabilities	83,176,781	86,207,433	54,319,819
Deferred rent liabilities	15,020,545	11,879,477	12,209,786
Line of credit	27,967,000	34,603,152	51,708,222

Total liabilities		126,164,326		132,690,062		118,237,827
Stockholders Equity:						
Common stock $.001 par value; 100,000,000 shares authorized at each July 4, 2009, June 28, 2008, and January 3, 2009; 15,777,185 shares issued and outstanding at July 4, 2009, 15,777,145 at June 28, 2008, and 15,777,185 at January 3, 2009		15,778		15,778		15,778
Preferred stock $.001 par value; 10,000,000 shares authorized at each July 4, 2009, June 28, 2008, and January 3, 2009; no shares issued and outstanding						
Deferred Stock Units -$.001 par value; 314,998, 240,734 and 254,998 shares issued and outstanding at July 4, 2009, June 28, 2008, and January 3, 2009, respectively		315		241		255
Additional paid-in capital		123,640,366		122,974,708		123,245,789
Accumulated other comprehensive income (loss)		(126,564)		348,127		(490,847)
Accumulated deficit		(51,109,247)		(49,120,604)		(52,764,638)
Total stockholders equity		72,420,648		74,218,250		70,006,337
Total liabilities and stockholders equity	**$**	**198,584,974**	**$**	**206,908,312**	**$**	**188,244,164**

(1) Derived from audited financial statements.

See accompanying notes to unaudited condensed consolidated financial statements

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Golfsmith International Holdings, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 4, 2009	**June 28, 2008**	**July 4, 2009**	**June 28, 2008**
Net revenues	$ 114,796,870	$ 129,994,600	$ 183,589,774	$ 209,230,096
Cost of products sold	74,719,386	85,310,115	120,741,824	137,385,721
Gross profit	40,077,484	44,684,485	62,847,950	71,844,375
Selling, general and administrative	31,650,261	34,167,492	59,468,190	66,503,326
Store pre-opening / closing expenses	175,054	81,223	523,280	109,367
Total operating expenses	31,825,315	34,248,715	59,991,470	66,612,693
Operating income	8,252,169	10,435,770	2,856,480	5,231,682
Interest income (expense), net	(314,723)	(706,515)	(791,863)	(1,694,214)
Other income (expense), net	(10,387)	(5,089)	46,363	1,472
Income before income taxes	7,927,059	9,724,166	2,110,980	3,538,940
Income tax expense	(1,145,355)	(1,152,744)	(455,589)	(410,517)
Net income	$ 6,781,704	$ 8,571,422	$ 1,655,391	$ 3,128,423
Net income per common share - basic	$ 0.42	$ 0.54	$ 0.10	$ 0.20
Net income per common share - diluted	$ 0.42	$ 0.54	$ 0.10	$ 0.20
Basic weighted average common shares outstanding	16,061,194	15,973,033	16,046,689	15,906,124
Diluted weighted average common shares outstanding	16,126,393	15,973,033	16,046,890	15,951,852

See accompanying notes to unaudited condensed consolidated financial statements

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Golfsmith International Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended July 4, 2009	Six Months Ended June 28, 2008
Operating Activities		
Net income	$ 1,655,391	$ 3,128,423
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,681,356	4,411,775
Provision for bad debt expense	76,114	105,231
Amortization of intangible assets	188,845	188,845
Amortization of debt issue costs and debt discount	82,079	82,080
Stock-based compensation	394,637	849,343
Loss on disposal of assets		8,649
Change in operating assets and liabilities:		
Accounts receivable	(398,399)	(1,311,367)
Inventories	(4,408,697)	(1,746,037)
Prepaids and other current assets	(3,682,044)	(852,513)
Other assets	(107,448)	22,293
Accounts payable	33,690,054	17,929,884
Accrued expenses and other current liabilities	(2,754,231)	(3,277,668)
Deferred rent	2,810,759	108,434
Net cash provided by operating activities	32,228,416	19,647,372
Investing Activities		
Purchases of property and equipment	(5,553,159)	(1,875,750)
Net cash used in investing activities	(5,553,159)	(1,875,750)
Financing Activities		
Principal payments on line of credit	(77,883,249)	(93,872,918)
Proceeds from line of credit	54,142,026	77,739,834
Net cash used in financing activities	(23,741,223)	(16,133,084)
Effect of exchange rate changes on cash	45,590	478
Change in cash	2,979,624	1,639,016
Cash, beginning of period	2,655,009	4,025,299
Cash, end of period	$ 5,634,633	$ 5,664,315
Supplemental cash flow information:		
Interest payments	$ 1,163,106	$ 1,921,910
Income tax payments	261,043	345,825

See accompanying notes to unaudited condensed consolidated financial statements

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GOLFSMITH HOLDINGS INTERNATIONAL, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business and Basis of Presentation

Basis of Presentation and Principles of Consolidation

Golfsmith International Holdings, Inc. (the Company) is a multi-channel, specialty retailer of golf and tennis equipment and related apparel and accessories. The Company offers golf and tennis equipment from top national brands as well as its own proprietary brands. In addition, the Company provides services, including custom fitting and repair services. The Company markets and distributes its products and services through retail stores and through its direct-to-consumer channels, which include its Internet site and catalogs.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary Golfsmith International, Inc. (Golfsmith). The Company has neither operations nor any assets or liabilities other than its investment in Golfsmith. Accordingly, these unaudited condensed consolidated financial statements represent the operations of Golfsmith and its subsidiaries. All inter-company account balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. As information in this report relates to interim financial information, certain footnote disclosures required by GAAP for complete audited financial statements have been condensed or omitted. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments consisting of normal and recurring accruals considered necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the periods presented. Operating results for the three and six month periods ended July 4, 2009, are not necessarily indicative of the results that may be expected for the fiscal year ending January 2, 2010. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto for the year ended January 3, 2009, included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 3, 2009. The Company has evaluated subsequent events through the filing of these financial statements.

Revenue Subject to Seasonal Variations

The Company s business is seasonal and its sales leading up to and during the warm weather golf season and the December holiday gift-giving season have historically contributed a significantly higher percentage of the Company s annual net revenues and annual net operating income than in other periods in its fiscal year.

Fiscal Year

The Company s fiscal year ends on the Saturday closest to December 31. The three month periods ended July 4, 2009 and June 28, 2008 both consisted of 13 weeks. The six month periods ended July 4, 2009 and June 28, 2008 both consisted of 26 weeks.

Foreign Currency Translation

The financial statements of our international operations, where the local currency is the functional currency, are translated into U.S. dollars using period-end exchange rates for assets and liabilities and average exchange rates during the period for revenues and expenses. Cumulative translation gains and losses are excluded from results of operations and recorded as a separate component of consolidated stockholders equity. Gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the entity s local currency) are included in the unaudited condensed consolidated statements of operations as either a component of costs of products sold or other income or expense, depending on the nature of the transaction.

Comprehensive Income (Loss)

Comprehensive income (loss) is computed as net income (loss) plus certain other items that are recorded directly to stockholders equity. In addition to net income (loss), the components of comprehensive income (loss) also include foreign currency translation adjustments. There were no material changes to comprehensive income (loss) during the three and six month periods ended July 4, 2009 and June 28, 2008.

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GOLFSMITH HOLDINGS INTERNATIONAL, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Reclassification

The condensed consolidated financial statements and accompanying footnotes reflect the reclassification of the following items for the period ended June 28, 2008. Deferred taxes were reclassified from other long-term assets to deferred tax assets, net and deferred tax liabilities, net in the amount of $0.5 million and $0.4 million, respectively. Also, the Amended and Restated Credit Facility was reclassified from current to non-current liabilities consistent with the terms of the credit agreement (see Note 5). These reclassifications have been made to prior year consolidated financial statements to conform to the current year presentation. The effect of these reclassifications is not material. These reclassifications did not affect the Company s reported net income or cash flows.

Recent Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 165, Subsequent Events (SFAS No. 165). SFAS No. 165 establishes principles and standards related to the accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 requires an entity to recognize, in the financial statements, subsequent events that provide additional information regarding conditions that existed at the balance sheet date. Subsequent events that provide information about conditions that did not exist at the balance sheet date shall not be recognized in the financial statements under SFAS No. 165. SFAS No. 165 is effective for interim reporting periods ending after June 15, 2009. The Company adopted SFAS No. 165 as of the quarter ended July 4, 2009.

In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have significantly decreased in relation to normal market activity. Additionally, FSP FAS 157-4 provides guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 requires interim disclosures of the inputs and valuation techniques used to measure fair value reflecting changes in the valuation techniques and related inputs. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and is to be applied prospectively. The adoption of FSP FAS 157-4 did not have a material impact on the Company s results of operations or financial position.

In April 2009, the FASB issued FSP FAS No. 107-1 and APB No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1). This FSP amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* and APB Opinion No. 28, *Interim Financial Reporting* , to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair value for these assets and liabilities was only disclosed annually. FSP FAS 107-1 and APB 28-1 applies to all financial instruments within the scope of SFAS No. 107 and requires all entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments. FSP FAS 107-1 and APB 28-1 is effective for interim periods ending after June 15, 2009. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption. The adoption of FSP FAS 107-1 and APB 28-1 did not have a material impact on the Company s results of operations or financial position.

In April 2008, the FASB issued FSP FAS No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3) to improve the consistency between the useful life of a recognized intangible asset (under SFAS No. 142) and the period of expected cash flows used to measure the fair value of the intangible asset (under SFAS No. 141(R)). FSP FAS 142-3 amends the factors to be considered when developing renewal or extension assumptions that are used to estimate an intangible asset s useful life under SFAS No. 142. The guidance in the new staff position is to be applied prospectively to intangible assets acquired after December 31, 2008. In addition, FSP FAS 142-3 increases the disclosure requirements related to renewal or extension assumptions. The adoption of FSP FAS 142-3 has had no effect on the Company s results of operations or financial condition.

On January 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157) as amended by FASB Staff Position (FSP) FAS 157-1 and FSP FAS 157-2. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and enhances fair value measurement disclosure. FSP FAS 157-2 delayed, until the first quarter of fiscal year 2009, the

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NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

effective date for SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS No. 157 did not have a material impact on the Company s results of operations or financial position.

2. Basic and Diluted Net Income Per Common Share

The calculation for basic net income per common share is based on the weighted average number of common shares outstanding, including outstanding deferred common stock units (DSUs). Diluted net income per common share is computed based on the weighted average number of common shares outstanding, including outstanding DSUs, adjusted by the number of additional shares that would have been outstanding had the potentially dilutive common shares been issued. Potentially dilutive shares of common stock include outstanding stock options.

The following table sets forth the computation of basic and diluted net income per common share:

	Three Months Ended		Six Months Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Net income	$ 6,781,704	$ 8,571,422	$ 1,655,391	$ 3,128,423
Basic:				
Weighted-average shares of common stock outstanding	15,777,185	15,777,145	15,777,185	15,777,145
Weighted-average shares of deferred common stock units outstanding	284,009	195,888	269,504	128,979
Shares used in computing basic net income per common share	16,061,194	15,973,033	16,046,689	15,906,124
Effect of dilutive securities:				
Stock options and awards	65,199		201	45,728
Shares used in computing diluted net income per common share	16,126,393	15,973,033	16,046,890	15,951,852
Basic net income per common share	$ 0.42	$ 0.54	$ 0.10	$ 0.20
Diluted net income per common share	$ 0.42	$ 0.54	$ 0.10	$ 0.20

3. Stock-Based Compensation

2006 Incentive Compensation Plan

In June 2006, the Company adopted the 2006 Incentive Compensation Plan (the 2006 Plan). Under the 2006 Plan, certain employees, members of the Board of Directors and third-party consultants may be granted options, stock appreciation rights and restricted stock grants. The total number of shares of common stock that could originally be issued under the 2006 Plan was 1,800,000. On May 5, 2009, the stockholders of the Company approved the First Amendment to the 2006 Plan (the Amendment), which increased the number of shares of common stock that may be issued under the 2006 Plan from 1,800,000 to 3,300,000. The exercise price of options granted is equal to the value of the Company s common stock on the date of grant, options generally vest over a period of five years, and the term of each option is no more than ten years from the date of grant. There were 3.0 million options outstanding under the 2006 Plan at July 4, 2009.

The Company calculates the fair value of option awards on the date of grant using the Black-Scholes option pricing model in accordance with SFAS No. 123(R), *Share-Based Payment* (SFAS 123(R)). This model incorporates various subjective assumptions including expected volatility, expected term, risk-free interest rate and expected dividend yield. In calculating fair value for options issued, expected volatility is based on an equal 50% combination of the Company s historical volatility and the historical volatility for a comparable industry peer group over periods of time equivalent to the expected life of the awards granted. The Company believes the calculated basis for expected volatility provides a more reasonable measurement of its expected future volatility rate than using solely the three years of historic trading value of the Company s own stock. The expected term utilized is calculated based on the average of the remaining vesting term and the remaining contractual life of each award consistent with the guidance provided by the SEC in Staff Accounting Bulletin No. 107 and No. 110. The Company bases the estimate of risk-free interest rate on the U.S. Treasury yield curve in effect at the time of grant. The Company has never paid cash dividends and does not currently intend

GOLFSMITH HOLDINGS INTERNATIONAL, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

to pay cash dividends, and thus has assumed a 0% dividend yield. In the case of service based awards, the resulting calculated fair values are reported as non-cash compensation expense in the unaudited condensed statements of operations and amortized over the vesting period. The assumptions used to calculate the fair value of stock options granted are periodically evaluated and revised, as necessary, to reflect market conditions and experience.

In May 2009, the Company s Board of Directors approved a grant of 270,750 options to purchase shares of the Company s common stock at a weighted-average exercise price of $1.43 per share to certain employees. In addition, on May 15, 2009, the Company issued 100,000 options to purchase shares of the Company s common stock to Sue Gove, the Company s Chief Operating Officer and Chief Financial Officer, pursuant to the terms of her employment agreement dated September 29, 2008 at an exercise price of $1.13 per share. The weighted average grant date calculated fair value of options issued during the three month period ended July 4, 2009 and June 28, 2008 was $0.88 and $1.51 per share, respectively, based on the following assumptions:

	2009	**2008**
Expected dividend yield	0%	0%
Expected stock price volatility	68.4%	68.6%
Risk-free interest rate	2.6%	3.3% - 4.0%
Expected option life (in years)	6.5	6.5

For the three and six month periods ended July 4, 2009, the Company recorded non-cash compensation expense of $0.2 million and $0.3 million in selling, general and administrative expense, respectively. For the three and six month periods ended June 28, 2008, the Company recorded non-cash compensation expense of $0.2 million and $0.4 million in selling, general and administrative expense, respectively. As of July 4, 2009, there was $3.0 million of unamortized non-cash compensation expense, net of expected forfeitures, related to non-vested stock options which are expected to be amortized over a weighted-average period of approximately 4 years.

There were no options granted during the three month periods ended April 4, 2009 and March 29, 2008. There were no stock option exercises during the three and six month periods ended July 4, 2009 and June 28, 2008.

Non-Employee Director Compensation Plan

In August 2006, the Company s Board of Directors approved the Non-Employee Director Compensation Plan. In addition to cash compensation, the Non-Employee Director Compensation Plan authorizes an annual grant of DSUs to members of the Company s Board of Directors. Each DSU represents the equivalent of one share of the Company s common stock, vests immediately on the date of grant, and is exercisable upon a Director s completion of Board service. DSUs granted are issuable from and included in the total number of shares reserved for issuance under the 2006 Plan.

On May 21, 2009, the Company s Board of Directors approved an amendment to the Non-Employee Director Compensation Plan providing changes in the annual retainer and annual grant of DSU s. The complete text of the amendment is included as Exhibit 10.19 to this Quarterly Report on Form 10-Q.

During the three month period ended March 29, 2008, 100,000 shares were issued to the Company s Chief Executive Officer and the Company recorded $0.3 million of related stock-based compensation expense. During the three month period ended July 4, 2009 and June 28, 2008, 60,000 and 99,548 DSU s, respectively, were issued to non-employee Directors and the Company recorded $0.07 million and $0.2 million of related non-cash stock-based compensation expense, respectively.

4. Income Taxes

Income taxes for the interim periods in fiscal 2008 have been included in the accompanying unaudited condensed consolidated financial statements on the basis of an estimated annual effective tax rate, adjusted for discrete items. In fiscal 2009, the Company s tax provision is based on actual operating results for the six months ended July 4, 2009 due to the relative proximity to breakeven of the Company s expected annual results before taxes and the sensitivity to the Company s estimated annual effective tax rate. For the three month periods ended July 4, 2009 and June 28, 2008, the Company s provision for income taxes reflects an effective tax rate of approximately 14.4% and 11.9%, respectively. For the six month periods ended July 4, 2009 and June 28, 2008, the Company s provision for income taxes reflects an effective tax rate of approximately 21.6% and 11.6%, respectively. For both the three and six month periods ended July 4, 2009 and June 28, 2008, the Company s effective tax rate was lower than the U.S. federal statutory rate

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GOLFSMITH HOLDINGS INTERNATIONAL, INC.

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

primarily due to changes to its valuation allowances. Due to the utilization of deferred tax assets relating to net operating losses, the Company does not anticipate paying a material amount of U.S. federal income taxes in fiscal 2009, however, the Company s actual results of operations could accelerate or defer the utilization of its deferred tax assets.

In the three month periods ended July 4, 2009 and June 28, 2008, the Company recorded approximately $1.1 million and $1.2 million of income tax expense, respectively, on pre-tax income of approximately $7.9 million and $9.7 million, respectively. In the six month periods ended July 4, 2009 and June 28, 2008, the Company recorded approximately $0.5 million and $0.4 million of income tax expense, respectively, on pre-tax income of approximately $2.1 million and $3.5 million, respectively.

In July 2006, the FASB issued FASB Interpretation 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an interpretation of SFAS 109.* FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The Company had $0.09 million of unrecognized tax benefits at July 4, 2009, which would have a slight impact to the Company s effective income tax rate if recognized. As of July 4, 2009, the Company does not expect to recognize any tax benefits in the next twelve months due to the closing of open tax years. Unrecognized income tax benefits relate to the uncertainty regarding deductions taken on returns that have not been examined by the applicable tax authority. The Company recognized no material adjustments to the liability for unrecognized income tax benefits from the balance recorded as of January 3, 2009. The tax years 2005 through 2008 remain open to examination by the major taxing jurisdictions to which we are subject.

5. Debt

Amended and Restated Credit Facility

On June 20, 2006, the Company entered into an Amended and Restated Credit Facility by and among Golfsmith International, L.P., Golfsmith NU, L.L.C., and Golfsmith USA, L.L.C., as borrowers (the Borrowers), the Company and the other subsidiaries of the Company identified therein as credit parties (the Credit Parties), General Electric Capital Corporation, as Administrative Agent , Swing Line Lender and L/C Issuer, GE Capital Markets, Inc., as Sole Lead Arranger and Bookrunner, and the financial institutions from time to time parties thereto (the Amended and Restated Credit Facility). The Amended and Restated Credit Facility was further amended in September 2007 and consists of a $90.0 million asset-based revolving credit facility (the Revolver), including a $5.0 million letter of credit sub facility, and a $10.0 million swing line sub facility. On an ongoing basis, loans incurred under the Amended and Restated Credit Facility will be used for working capital and general corporate purposes of the Borrowers and their subsidiaries (the Loans). The Credit Facility has a term of five years and expires in June 2011.

Interest Rate and Fees. Loans outstanding under the Amended and Restated Credit Facility bear interest per annum at (1) LIBOR plus two percent (2.0%), or (2) the Base Rate, which is equal to the higher of (i) the Federal Funds Rate plus 50 basis points and (ii) the publicly quoted rate as published by The Wall Street Journal on corporate loans posted by at least 75% of the nation s largest 30 banks.

Covenants and Events of Default. The Amended and Restated Credit Facility contains customary affirmative covenants regarding, among other things, the delivery of financial and other information to the lenders, maintenance of records, compliance with law, maintenance of property and insurance and conduct of our existing business. The Amended and Restated Credit Facility also contains certain customary negative covenants that limit the ability of the Credit Parties to, among other things, create liens, make investments, enter into transactions with affiliates, incur debt, acquire or dispose of assets, including merging with another entity, enter into sale-leaseback transactions, and make certain restricted payments. The foregoing restrictions are subject to certain customary exceptions for facilities of this type. The Amended and Restated Credit Facility includes events of default (and related remedies, including acceleration of the Loans made thereunder) usual for a facility of this type, including payment default, covenant default (including breaches of the covenants described above), cross-default to other indebtedness, material inaccuracy of representations and warranties, bankruptcy and involuntary proceedings, change of control, and judgment default. Many of the defaults are subject to certain materiality thresholds and grace periods usual for a facility of this type. As of July 4, 2009, the Company was in compliance with all applicable covenants.

Borrowing Capacity. Available amounts under the Amended and Restated Credit Facility are calculated against a borrowing base. The borrowing base is limited to (i) 85% of the net amount of eligible receivables, as defined in the credit agreement, plus (ii) the lesser of (x) 70% of the value of eligible inventory or (y) up to 90% of the net orderly liquidation value of eligible inventory, plus (iii) the lesser of (x) $17,500,000 or (y) 70% of the fair market value of eligible real estate, and minus (iv) any reserves except to the extent already deducted there from. The Administrative Agent has the right to establish, modify, or eliminate reserves against eligible inventory and receivables from time to time in its reasonable credit judgment. At July 4, 2009, the Company had $28.0 million of outstanding borrowings under the Amended and Restated Credit Facility and $38.7 million of borrowing availability after giving

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GOLFSMITH HOLDINGS INTERNATIONAL, INC.

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effect to all reserves. At January 3, 2009, the Company had $51.7 million of outstanding borrowings under its Amended and Restated Credit Facility and $5.9 million of borrowing availability after giving effect to all reserves.

Guarantees and Collateral. Borrowings under the Amended and Restated Credit Facility are jointly and severally guaranteed by the Credit Parties, and are secured by a security interest granted in favor of the Administrative Agent, for itself and for the benefit of the lenders, in all of the personal and owned real property of the Credit Parties, including a lien on all of the equity securities of the Borrowers and each of the Borrower s current and future domestic subsidiaries.

The Company has no operations or any assets or liabilities other than its investment in its wholly-owned subsidiary Golfsmith, including its liability under the Amended and Restated Credit Facility. Domestic subsidiaries of Golfsmith comprise all of Golfsmith s assets, liabilities and operations and include its liability under the Amended and Restated Credit Facility. There are no restrictions on the transfer of funds between the Company, Golfsmith and any of Golfsmith s domestic subsidiaries.

6. Commitments and Contingencies

Lease Commitments

The Company leases all but one of its store locations under operating leases that provide for annual payments that, in most cases, increase over the life of the lease. The aggregate of the minimum annual payments is expensed on a straight-line basis over the term of the related lease without consideration of renewal option periods and escalating rents. The lease agreements generally contain provisions that require the Company to pay for normal repairs and maintenance, property taxes and insurance. In addition, the Company has entered into certain sublease agreements with third parties to sublease retail space currently or previously occupied by the Company.

At July 4, 2009, future minimum lease payments and sublease rental income under non-cancelable operating leases, excluding repairs and maintenance, property taxes and insurance, with initial terms of one year or more, are presented in the table below for each of the 12-month periods ending at the end of our second fiscal quarter for each year presented below.

	Operating Lease	Sublease