

ADAMS GOLF INC  
Form 10-Q  
August 04, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2008

or

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from

\_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-33978

**ADAMS GOLF, INC.**

(Exact name of registrant as specified in its charter)

Delaware	75-2320087
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2801 E. Plano Pkwy, Plano, Texas	75074
(Address of principal executive offices)	(Zip Code)

(302) 427-5892  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

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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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐

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

☐ Yes ☒ No

The number of outstanding shares of the Registrant's common stock, par value \$.001 per share, was 6,453,318 on August 1, 2008.

### ADAMS GOLF, INC. AND SUBSIDIARIES

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Item 1.

ADAMS GOLF, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

ASSETS

	June 30, <u>2008</u>	December 31, <u>2007</u>
	(unaudited)	
Current assets:		
Cash and cash equivalents	\$ 2,106	\$ 11,265
Trade receivables, net of allowance for doubtful accounts of \$975		
(unaudited) and \$512 in 2008 and 2007, respectively	32,768	18,009
Inventories, net	27,691	28,745
Prepaid expenses	1,775	743
Other current assets	<u>1,389</u>	<u>1,432</u>
Total current assets	65,729	60,194
Property and equipment, net	1,225	1,046
Deferred tax asset - non current	8,877	8,877

Other assets, net	<u>710</u>	<u>1,069</u>
	\$ 76,541	\$ 71,186

## LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 10,964	\$ 9,205
Accrued expenses	9,861	8,682
Other current liabilities	<u>15</u>	<u>--</u>
Total current liabilities	20,840	17,887
Other liabilities	<u>23</u>	<u>--</u>
Total liabilities	20,863	17,887
Stockholders' equity:		
Preferred stock, \$0.01 par value; authorized 1,250,000 shares; none issued	--	--
Common stock, \$.001 par value; authorized 12,500,000 shares; 6,826,186 and 6,547,847 shares issued and 6,453,318 and 6,221,724 shares outstanding at June 30, 2008 (unaudited) and December 31, 2007, respectively	7	7
Additional paid-in capital	92,268	91,737
Accumulated other comprehensive income	2,303	2,555
Accumulated deficit	(34,395)	(36,746)
Treasury stock, 372,868 common shares at June 30, 2008 and 326,123 at December 31, 2007, at cost	<u>(4,505)</u>	<u>(4,254)</u>
Total stockholders' equity	<u>55,678</u>	<u>53,299</u>
	\$ 76,541	\$ 71,186

## Contingencies

See accompanying notes to unaudited condensed consolidated financial statements.

## ADAMS GOLF, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Net sales	\$ 33,260	\$ 30,403	\$ 61,261	\$ 58,211
Cost of goods sold	<u>19,524</u>	<u>17,101</u>	<u>35,414</u>	<u>32,714</u>
Gross profit	13,736	13,302	25,847	25,497

## Operating expenses:

Research and development expenses	793	818	1,879	1,629
Selling and marketing expenses	9,125	7,711	16,780	13,417
General and administrative expenses	<u>2,200</u>	<u>2,194</u>	<u>4,750</u>	<u>4,108</u>
Total operating expenses	<u>12,118</u>	<u>10,723</u>	<u>23,409</u>	<u>19,154</u>
Operating income	<u>1,618</u>	<u>2,579</u>	<u>2,438</u>	<u>6,343</u>

## Other income (expense):

Interest income (expense), net	(54)	20	(20)	44
Other income (expense), net	<u>(1)</u>	<u>(49)</u>	<u>(51)</u>	<u>(36)</u>

Income before income taxes	1,563	2,550	2,367	6,351
		<u>33</u>	<u>16</u>	
Income tax expense	<u>9</u>			<u>80</u>
Net income	\$ 1,554	\$ 2,517	\$ 2,351	\$ 6,271

Net income per common share - basic	\$ 0.24	\$ 0.42	\$ 0.37	\$ 1.04
diluted	\$ 0.21	\$ 0.33	\$ 0.32	\$ 0.82

See accompanying notes to unaudited condensed consolidated financial statements.

## ADAMS GOLF, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(in thousands, except share amounts)

Six Months Ended June 30, 2008  
(unaudited)

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Comprehensive Income	Cost of Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2007	6,547,847	\$ 7	\$ 91,737	\$ 2,555	\$ (36,746)		\$ (4,254)	\$ 53,299
Comprehensive income:								
Net income	--	--	--	--	2,351	\$ 2,351	--	2,351
	--	--	--	(252)	--	<u>(252)</u>	--	(252)

Foreign currency translation								
Comprehensive income	--	--	--	--	--	\$ 2,099	--	--
Issuance of restricted stock	161,365	--	--	--	--	--	--	--
Retired stock	(181)	--	--	--	--	--	--	--
Stock options exercised	117,155	--	5	--	--	--	--	5
Treasury stock purchase	--	--	--	--	--	(251)	(251)	
Amortization of deferred compensation	<u>--</u>	<u>--</u>	<u>526</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>526</u>	
Balance, June 30, 2008	6,826,186	\$ 7	\$ 92,268	\$ 2,303	\$ (34,395)	\$ (4,505)	\$ 55,678	

See accompanying notes to unaudited condensed consolidated financial statements.

#### ADAMS GOLF, INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

Six Months Ended  
June 30,

2008      2007

#### Cash flows from operating activities:

Net income      \$ 2,351      \$ 6,271

Adjustments to reconcile net income to net cash provided  
by (used in) operating activities:

Depreciation and amortization of property and  
equipment and intangible assets

285      213

Amortization of deferred compensation

526      525

Provision for doubtful accounts

682      297

Changes in assets and liabilities:

Trade receivables

(15,441)      (13,132)

Inventories

1,053      (538)

Prepaid expenses

(1,032)      (1,084)

Other current assets

44      (27)

Other assets

287      270

Accounts payable

1,759      4,337

Accrued expenses

1,179      1,675

Net cash provided by (used in) operating activities

(8,307)      (1,193)

#### Cash flows from investing activities:

Purchases of equipment

(348)      (192)

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Purchases of intangible assets	<u>--</u>	<u>(600)</u>
Net cash provided by (used in) investing activities	(348)	(792)
Cash flows from financing activities:		
Principal payments under capital lease obligation	(6)	(15)
Exercise of stock options	5	6
Treasury stock purchase	(251)	(344)
Debt financing costs	<u>--</u>	<u>(35)</u>
Net cash provided by (used in) financing activities	(252)	(388)
Effects of exchange rate changes	<u>(252)</u>	<u>707</u>
Net increase (decrease) in cash and cash equivalents	(9,159)	(1,666)
Cash and cash equivalents at beginning of period	<u>11,265</u>	<u>9,472</u>
Cash and cash equivalents at end of period	\$ 2,106	\$ 7,806
Supplemental disclosure of cash flow information		
Interest paid	\$ 82	\$ 1
Income taxes paid	\$ 9	\$ 27

See accompanying notes to unaudited condensed consolidated financial statements.

ADAMS GOLF, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Adams Golf, Inc. and its subsidiaries (the "Company", "Adams Golf", "we", "us", or "our") for the three and six month periods ended June 30, 2008 and 2007 have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The information included reflects all adjustments (consisting only of normal recurring accruals and adjustments) which are, in the opinion of management, necessary to fairly state the operating results for the respective periods. However, these operating results are not necessarily indicative of the results expected for the full fiscal year. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to SEC rules and regulations. The notes to the unaudited condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements contained in our 2007 Annual Report on Form 10-K filed with the SEC on March 11, 2008.

We design, assemble, market and distribute premium quality, technologically innovative golf clubs for all skill levels, including Idea a3 and a3 OS irons, Idea a2 and a2 OS irons, Idea Tech OS irons, Idea Pro Gold Irons and Idea a3 and a3 OS, Idea a2 and a2 OS, Idea Tech OS and Idea Pro Gold I-woods, Insight XTD A3 & A3 OS drivers and fairway woods, RPM drivers and fairway woods, the Ovation family of drivers, fairway woods and irons, the Tight Lies family of fairway woods, the Redline family of fairway woods and drivers, Tight Lies GT500, the Tom Watson signature and Pugielli series of wedges, and certain accessories. In addition, under Women's Golf Unlimited we distribute the Lady Fairway and Square 2 brands.

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All significant intercompany accounts and transactions have been eliminated in consolidation.

2. Inventories

Inventories consisted of the following on the dates indicated (in thousands):

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	June 30, <u>2008</u> (unaudited)	December 31, <u>2007</u>
Finished goods	\$ 16,695	\$ 16,887
Component parts	<u>10,996</u>	<u>11,858</u>
Total inventory	\$ 27,691	\$ 28,745

Inventory is determined using the first-in, first-out method and is recorded at the lower of cost or market value. The inventory balance is comprised of the following: purchased raw materials or finished goods at their respective purchase costs; labor, assembly and other capitalizable overhead costs, which are then applied to each unit after work in process is completed; retained costs representing the excess of manufacturing and other overhead costs that are not yet applied to finished goods; and an estimated allowance for obsolete inventory. At June 30, 2008 and December 31, 2007, inventories included \$1,027,000 and \$865,000 of consigned inventory, respectively, and \$201,000 and \$189,000 of inventory obsolescence reserves, respectively.

ADAMS GOLF, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Accrued Expenses

Accrued expenses consisted of the following on the dates indicated (in thousands):

	June 30, <u>2008</u> (unaudited)	December 31, <u>2007</u>
Payroll and commissions	\$ 942	\$ 2,707
Advertising	872	--
Product warranty and sales returns allowances	2,866	1,611
Professional services	60	23
Accrued inventory	961	971
Accrued sales promotions	379	390
Deferred revenue	1,744	1,538
Other	<u>2,037</u>	<u>1,442</u>
Total accrued expenses	\$ 9,861	\$ 8,682

4. Income per Common Share

The weighted average common shares used for determining basic and diluted income per common share were

6,424,108 and 7,462,843, respectively, for the three months ended June 30, 2008, and 6,043,355 and 7,674,939, respectively, for the three months ended June 30, 2007.

The effect of all warrants and options to purchase shares of our common stock for the three months ended June 30, 2008 resulted in additional dilutive shares of 1,038,735. The effect of all warrants and options to purchase shares of our common stock for the three months ended June 30, 2007 resulted in additional dilutive shares of 1,631,584.

The weighted average common shares used for determining basic and diluted income per common share were 6,339,079 and 7,362,332, respectively, for the six months ended June 30, 2008, and 6,024,602 and 7,681,593, respectively, for the six months ended June 30, 2007.

The effect of all warrants and options to purchase shares of our common stock for the six months ended June 30, 2008 resulted in additional dilutive shares of 1,023,253. The effect of all warrants and options to purchase shares of our common stock for the six months ended June 30, 2007 resulted in additional dilutive shares of 1,656,991.

## ADAMS GOLF, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 5. Geographic Segment and Data

We generate substantially all revenues from the design, assembly, marketing and distribution of premium quality, technologically innovative golf clubs and accessories. Our products are distributed in both domestic and international markets. Net sales by customer for these markets consisted of the following during the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(unaudited)		(unaudited)	
United States	\$ 25,238	\$ 24,544	\$ 48,456	\$ 48,674
Rest of World	<u>8,022</u>	<u>5,859</u>	<u>12,805</u>	<u>9,537</u>
Total net sales	\$ 33,260	\$ 30,403	\$ 61,261	\$ 58,211

Foreign net sales are generated in various regions including, but not limited to, Canada (a majority of our foreign sales), Europe, Japan, Australia, South Africa, and South America. A change in our relationship with one or more of our customers or distributors could negatively impact the volume of foreign sales.

#### 6. Income Taxes

We account for income taxes in accordance with FAS No. 109, "Accounting for Income Taxes" ("FAS 109") as clarified by FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred income tax assets, we consider whether it is "more likely than not", according to the criteria of FAS 109, that some portion or all of the deferred income tax assets will be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. FIN 48 requires that we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority. Due to our historical operating results, management is unable to conclude on a more likely than not basis that all deferred income tax assets generated from net operating losses through December 31, 2002 and other deferred tax assets will be realized. However, due to

our recent earnings history, we have concluded that it is more likely than not that a portion of the deferred tax asset will be realized. We have recognized a valuation allowance equal to a portion of the deferred income tax asset for which realization is uncertain. Although we have carryforwards due to historical losses, current tax law for calculating Alternative Minimum Tax allows us to use carryforwards only up to 90% of the annual liability. Accordingly, AMT tax expense for the three months ended June 30, 2008 and 2007 was \$9,000 and \$33,000, respectively and for the six months ended June 30, 2008 and 2007 was \$16,000 and \$80,000, respectively.

## 7. Comprehensive Income

Comprehensive income for the six months ended June 30, 2008 was approximately \$2.1 million.

## ADAMS GOLF, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## 8. Stock-Based Compensation

We adopted the 2002 Equity Incentive Plan (the "Plan") for employees, outside directors and consultants. The Plan allows for the granting of up to 625,000 shares of our common stock at the inception of the Plan, plus all shares remaining available for issuance under all predecessor plans on the effective date of this Plan, and additional shares as defined in the Plan. In addition, the Plan automatically increases 250,000 shares available for granting on January 1 of each subsequent year for years 2003 through 2008. At June 30, 2008, 976,869 outstanding options had been granted with exercise prices from \$0.04 to \$4.80 per share. The requisite service periods for the options to vest vary from six months to four years and the options expire ten years from the date of grant. At June 30, 2008, 1,052,402 shares remain available for grant, including forfeitures.

During the three months ended June 30, 2008 no options were granted.

Operating expenses included in the consolidated statements of operations for the three months ended June 30, 2008 and 2007 include total compensation expense associated with stock options and restricted stock grants of \$318,000 and \$262,000, respectively and \$526,000 and \$525,000 for the six months ended June 30, 2008 and 2007, respectively.

	Number of Outstanding <u>Shares</u>	Weighted Average <u>Exercise price</u>	Aggregate Intrinsic <u>Value of</u> <u>options</u>
Options outstanding at December 31, 2007	1,100,274	\$ 0.16	\$ 9,725,455
Options granted	--	--	--
Options forfeited / expired	(6,250)	--	--
Options exercised			
			<u>(117,155)</u>
			<u>--</u>
			<u>--</u>

Options outstanding at June 30, 2008

976,869

0.18

5,190,936

Options exercisable at June 30, 2008

793,574

0.17

4,221,227

The weighted average remaining contractual life of the options outstanding at June 30, 2008 was 5.00 years and for options exercisable at June 30, 2008 was 4.63 years.

As of June 30, 2008, compensation costs related to non-vested awards totaled \$1.2 million, which is expected to be recognized over a weighted average period of 0.5 years.

As of June 30, 2008, there was \$1.2 million of unrecognized compensation costs related for the non-vested share-based compensation of restricted stock grants awarded. The fair value was determined based on the fair value of our common stock on the date of grant of \$8.50 for the 150,000 shares granted and \$8.60 for the 11,365 shares granted. Compensation expense recognized during the three and six months ended June 30, 2008 related to the restricted stock grants was \$0.1 million and \$0.2 million, respectively.

## ADAMS GOLF, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 8. Stock-Based Compensation (continued)

Due to the passage of The American Jobs Creation Act and the subsequent IRS Section 409A rules, stock options that were issued at a strike price less than market value at the date of grant will now be considered deferred compensation by the Internal Revenue Service and the individual who was granted the options will incur adverse tax consequences, including, but not limited to excise taxes, unless the individual deemed a future exercise date of the unvested stock options at December 31, 2004 and made this election before December 31, 2005. As a result of the compliance with the American Job Creation Act, a summary of the elected future exercise dates is as follows:

<u>Period of Exercise</u>	<u>Total Options to be exercised</u>
---------------------------	--

2008	83,764
2009	
	90,000
2010	
	15,000
2011	
	27,500
Beyond 2012	
	60,771
Total options	<hr/>
	277,035
	=====

#### 9. New Accounting Pronouncements

There have been no new material accounting pronouncements that are applicable to our business for this period.

#### 10. Liquidity

In November 2007, we signed a revolving credit agreement with Wachovia Bank, National Association to provide up to \$15.0 million in short term debt with the option to increase to \$30 million. The agreement is collateralized by all of our assets and requires, among other things, us to maintain certain financial performance levels relative to the fixed charge coverage ratio, but only when we have an outstanding balance on the facility. Interest on outstanding balances accrues at a rate of Libor plus 1.75% payable monthly. As of June 30, 2008 and August 1, 2008, we have no outstanding borrowings, respectively, on our credit facility.

Our anticipated sources of liquidity over the next twelve months are expected to be cash reserves, projected cash flows from operations, and available borrowings under our credit facility. We anticipate that operating cash flows and current cash reserves will also fund capital expenditure programs. These capital expenditure programs can be suspended or delayed at any time with minimal disruption to our operations if cash is needed in other areas of our operations. In addition, cash flows from operations and cash reserves will be used to support ongoing purchases of component parts for our current and future product lines. The expected operating cash flow, current cash reserves and borrowings available under our credit facility are expected to allow us to meet working capital requirements during periods of low cash flows resulting from the seasonality of the industry.

If adequate funds are not available or not available on acceptable terms, we may be unable to continue operations; develop, enhance and market products; retain qualified personnel; take advantage of future opportunities; or respond to competitive pressures, any of which could have a material adverse effect on our business, operating results, financial condition and/or liquidity.

### ADAMS GOLF, INC. AND SUBSIDIARIES

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 11. Contingencies

Beginning in June 1999, the first of seven class action lawsuits was filed against us, certain of our current and former officers and directors, and the three underwriters of our initial public offering ("IPO") in the United States District Court of the District of Delaware. The complaints alleged violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, as amended, in connection with our IPO. In particular, the complaints alleged that our prospectus, which became effective July 9, 1998, was materially false and misleading. The operative complaint was filed on January 24, 2006, and it alleges that the prospectus failed to disclose that unauthorized distribution of our products (gray market sales) threatened our long-term profits and that we engaged in questionable sales practices (including double shipping and unlimited rights of return), which threatened post-IPO financial results. Discovery closed on August 11, 2006. On November 21, 2006, all summary-judgment briefing was completed. On December 13, 2006, we learned that the Delaware District Court judge whom the case was set before was elevated to the United States Court of Appeals for the Third Circuit. On December 15, 2006, we were notified that our case was assigned to the vacant judicial position and that all proceedings had been postponed until a new judge was confirmed, and there was no trial date set at this time. On February 7, 2008, we were notified that our case has been reassigned to Chief Judge Gregory M. Sleet. There has been no scheduling conference set yet, and there is no trial date currently set. The parties participated in a mediation on April 8, 2008, but no resolution has been reached at this time.

We maintain directors' and officers' ("D&O") and corporate liability insurance to cover certain risks associated with these securities claims filed against us or our directors and officers. During the period covering the class action lawsuit, we maintained insurance from multiple carriers, each insuring a different layer of exposure, up to a total of \$50 million. In addition, we have met the financial deductible of our directors' and officers' insurance policy for the period covering the time the class action lawsuit was filed. On March 30, 2006, Zurich American Insurance Company, which provided insurance coverage totaling \$5 million for the layer of exposure between \$15 million and \$20 million, notified us that it was denying coverage due to the fact that it was allegedly not timely notified of the class action lawsuit. On October 11, 2007, we filed a suit against our former insurance broker, Thilman & Filipini, LLC ("T&F"), for various claims related to T&F's alleged failure to notify Zurich of the class action lawsuit. Depending on the outcome of this proceeding, based on the previously disclosed agreement with Chubb & Son ("Chubb"), a division of Federal Insurance Company ("Federal"), which is described below, we could be required to pay Zurich's \$5 million limit of liability in cash before the layers of insurance coverage excess to the Zurich layer attach. We previously disclosed that Chubb had notified us that coverage under the Federal policy, which provided insurance coverage totaling \$10 million for the layer of exposure between \$20 million and \$30 million, and the Executive Risk Indemnity Inc. ("ERII") policy, which provided insurance coverage totaling \$10 million for the layer of exposure between \$40 million and \$50 million, would attach only if the underlying limits are exhausted by payment from the underlying insurance carriers. On June 18, 2007, Chubb notified us that Federal and ERII will not require that Zurich pay the full amount of its limit of liability before the Federal and ERII policies attach, and it confirmed that Chubb will accept payment in cash by our Company of Zurich's limit of liability to satisfy this requirement, so long as such payment is for covered loss. All of the excess insurance carriers (other than Zurich, which has denied coverage) have reserved their rights to deny coverage on various grounds. At this point in the legal proceedings, we cannot predict with any certainty the outcome of the matter, per the guidance in SFAS 5, and thus can not reasonably estimate future liability on the conclusion of the events, if any.

## ADAMS GOLF, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 11. Contingencies (continued)

The underwriters for the IPO are also defendants in the securities class action. The underwriting agreement that we entered into with the underwriters in connection with the IPO contains an indemnification clause, providing for

indemnification against any loss, including defense costs, arising out of the IPO. After the first lawsuit was filed, the underwriters requested indemnification under the agreement. Our D&O insurance policy included an endorsement providing \$1 million to cover indemnification of the underwriters. Our D&O insurer has notified the underwriters of the exhaustion of the \$1 million sublimit. We believe that we have no current obligation to pay the underwriters' defense costs. We believe that the applicable case law provides that the earliest possible time that an obligation to indemnify might exist is after a court has decided conclusively that the underwriters are without fault under the federal securities laws. The litigation is not at that stage yet. As of August 7, 2008, the total amount of outstanding underwriter defense costs was just less than \$1.4 million. At this time, the underwriters are not able to predict with certainty the amount of defense costs they expect to incur going forward, but it is likely they will incur additional costs before this matter is concluded. At this time, we cannot predict with any certainty the outcome of this indemnification issue, per the guidance in SFAS 5, and thus cannot reasonably estimate future liability on the conclusion of the events, if any.

Beginning April 2008, we received communications from the Estate of Anthony Antonious that our products infringed an Anthony Antonious patent concerning an aerodynamic metal wood golf club head. In May 2008, we filed a declaratory judgment lawsuit against the Anthony Antonious Trust, alleging non-infringement of the Antonious patent. In June 2008, the Estate of Anthony Antonious filed a lawsuit against us alleging infringement of the patent. At this point in the legal proceedings, we cannot predict the outcome of the matter with any certainty, per the guidance in SFAS 5, and thus cannot reasonably estimate future liability on the conclusion of the events, if any.

From time to time, we are engaged in various other legal proceedings in the normal course of business. The ultimate liability, if any, for the aggregate amounts claimed cannot be determined at this time.

## **12. Reclassifications**

Certain prior period amounts have been reclassified to conform to current period presentation.

## **13. Business and Credit Concentrations**

We were dependent on four customers, which collectively comprised approximately 26% of net sales for the three months ended June 30, 2008. Two customers individually represented greater than 5% but less than 10% of net sales, and one customer represented greater than 10% but less than 15% of net sales. For the three months ended June 30, 2007, four customers collectively comprised approximately 24% of net sales. All four customers individually represented greater than 5% but less than 10% of net sales, and no customers represented greater than 10% of net sales.

For the six months ended June 30, 2008, we were dependent on three customers, which collectively comprised approximately 24% of net sales. Of these, two customers individually represented greater than 5% but less than 10% of net sales for the period, and one customer represented greater than 10% but less than 15% of net sales and no customers represented greater than 15% of net sales. For the six months ended June 30, 2007, four customers comprised approximately 26% of net sales while three customers individually represented greater than 5% but less than 10% of net sales and one customer individually represented greater than 10% of net sales, but no customers represented greater than 15% of net sales. Should these customers or our other customers fail to meet their obligations to us, our results of operations and cash flows would be adversely impacted.

## **ADAMS GOLF, INC. AND SUBSIDIARIES**

### **NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

13.

**Business and Credit Concentrations (continued)**

A significant portion of our inventory purchases are from one supplier in China. We purchased approximately 44% and 38% of our total inventory purchased for the six months ended June 30, 2008 and 2007, respectively, from this one Chinese supplier. This supplier and many other industry suppliers are located in China. We do not anticipate any changes in the relationships with our suppliers. However, if such change were to occur, we have alternative sources available. Supply from these alternative sources, however, may not be immediately available or available in the quantities necessary to meet customer demand.

**14. Product Warranty Reserve**

Our golf equipment is sold under warranty against defects in material and workmanship for a period of one year. An allowance for estimated future warranty costs is recorded in the period products are sold. In estimating our future warranty obligations, we consider various relevant factors, including our stated warranty policies, the historical frequency of claims, and the cost to replace or repair the product. Accounting for product warranty reserve could be adversely affected if one or more of our products were to fail (i.e broken shaft, broken head, etc) to a significant degree above and beyond our historical product failure rates, which determine the product warranty accruals.

	Beginning Balance	Charges for Warranty claims	Estimated accruals	Ending Balance
Quarter ended December 31, 2007	\$ 350	(79)	66	\$ 337
Quarter ended March 31, 2008	\$ 337	(86)	59	\$ 310
Quarter ended June 30, 2008	\$ 310	(219)	324	\$ 415

Item 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with (i) the attached unaudited condensed consolidated financial statements and notes thereto for the three and six months ended June 30, 2008, and with our consolidated financial statements and notes thereto for the year ended December 31, 2007 included in our Annual Report on Form 10-K filed with the SEC on March 11, 2008 and (ii) the discussion under the caption "Risk Factors" in our Annual Report on Form 10-K filed with the SEC on March 11, 2008 and any material changes from risk factors as previously disclosed in the Annual Report set forth herein.

***Forward Looking Statements***

This Quarterly Report contains "forward-looking statements" made under the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, including, without limitation, in the notes to the consolidated financial statements included in this Quarterly Report and under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Quarterly Report. Any and all statements

contained in this Quarterly Report that are not statements of historical fact may be deemed forward-looking statements. The statements include, but are not limited to: statements regarding pending litigation, statements regarding liquidity and our ability to increase revenues or achieve satisfactory operational performance, statements regarding our ability to satisfy our cash requirements and our ability to satisfy our capital needs, including cash requirements during the next twelve months, statements regarding our ability to produce products commercially acceptable to consumers and statements using terminology such as "may," "might," "will," "would," "should," "could," "project," "pro forma," "predict," "potential," "strategy," "attempt," "develop," "continue," "future," "expect," "intend," "estimate," "anticipate," "plan," "seek" or "believe." Such statements reflect our current view with respect to future events and are subject to certain risks, uncertainties and assumptions related to certain factors including, without limitation, the following:

- The ability to maintain historical growth in revenue and profitability;
- Product development difficulties;
- Product approval and conformity to governing body regulations;
- Assembly difficulties;
- Product introductions;
- Patent infringement risks;
- Uncertainty of the ability to protect intellectual property rights;
- Market demand and acceptance of products;
- The impact of changing economic conditions;
- The future market for our capital stock;
- The uncertainty in the debt markets;
- The success of our marketing strategy;
- The success of our tour strategy;
- Our dependence on one supplier for a majority of our inventory products;
- Our dependence on suppliers who are concentrated in one geographic region;
- Our dependence on a limited number of customers;
- Business conditions in the golf industry;
- Reliance on third parties, including suppliers, and freight transporters;
- The actions of competitors, including pricing, advertising and product development risks concerning future technology;
- Investor audience, interest or valuation;
- The management of sales channels and re-distribution;
- The uncertainty of the results of pending litigation;
- The adequacy of the allowance for doubtful accounts, obsolete inventory and warranty reserves;
- The risk associated with events that may prove unrecoverable under existing insurance policies; and
- The impact of operational restructuring on operating results and liquidity and one-time events and other factors detailed under "Risk Factors" in our Securities and Exchange Commission filings.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Based upon changing conditions, should any one or more of these risks or uncertainties materialize, or should any underlying assumptions prove incorrect, actual results may vary materially from those described herein. Except as required by federal securities laws, we undertake no obligation to publicly update or revise any written or oral forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Quarterly Report. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements.

## Overview

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We design, assemble, market and distribute premium quality, technologically innovative golf clubs for all skill levels, including Idea a3 and a3 OS irons, Idea a2 and a2 OS irons, Idea Tech OS irons, Idea Pro Gold Irons and Idea a3 and a3 OS, Idea a2 and a2 OS, Idea Tech OS and Idea Pro Gold I-woods, Insight XTD A3 & A3 OS drivers and fairway woods, RPM drivers and fairway woods, the Ovation family of drivers, fairway woods and irons, the Tight Lies family of fairway woods, the Redline family of fairway woods and drivers, Tight Lies GT500, the Tom Watson signature and Poglielli series of wedges, and certain accessories. In addition, under Women's Golf Unlimited we distribute the Lady Fairway and Square 2 brands.

Our net sales are primarily derived from sales to on- and off- course golf shops, sporting goods retailers, mass merchants and, to a lesser extent, international distributors. No assurances can be given that demand for our current products or the introduction of new products will allow us to achieve historical levels of sales in the future.

Our net sales are typically driven by product lifecycles. Several factors affect a product's life, including but not limited to, customer acceptance, competition and technology. As a result, each product family's life cycles generally range from one to three years.

Our business, financial condition, cash flows and results of operations are subject to seasonality resulting from factors such as weather and spending patterns. Due to the seasonality of our business, one quarter's financial results are not indicative of the full fiscal year's expected financial results. A majority of our revenue is earned in the first and second quarters of the year and revenues generally decline in the third and fourth quarters.

We manage all stages of manufacturing, from sourcing to assembly, in order to maintain a high level of product quality and consistency. We establish product specifications, select the material used to produce the components, and test the specifications of components we receive.

As part of our quality control program, we review the quality assurance programs at the manufacturing facilities of our component part suppliers to monitor adherence to design specifications. In addition to the quality assurance conducted by the suppliers at their facilities, we also conduct random sampling and perform testing of products received from the suppliers or produced at our facility to ensure consistency with our design specifications. Golf clubs are then built by our assembly personnel using the appropriate component parts.

We have put into place a purchasing procedure that strives to negotiate effective terms with various vendors while continuing to ensure the quality of our components. We are frequently re-evaluating existing vendors while testing potential new vendors for all the various product lines we offer. At any time, we may purchase a substantial majority of our volume of a specific component part from a single vendor, but we continually strive to maintain primary and secondary suppliers. Substantially all of our fairway wood, driver, iron, i-wood, wedge and putter component parts are manufactured in China. A significant portion of our inventory purchases are from one supplier in China; we purchased approximately 44% and 38% of our total inventory purchased for the six months ended June 30, 2008 and 2007, respectively, from this one Chinese supplier. This supplier and many other industry suppliers are located in China. We do not anticipate any changes in the relationships with our suppliers; however, if such change were to occur, we have alternative sources available. Supply from these sources, however, may not be immediately available or available in the quantities necessary to meet customer demand.

Costs of our clubs consist primarily of component parts, including the head, shaft and grip. To a lesser extent, our cost of goods sold includes labor, occupancy and shipping costs in connection with the inspection, testing, assembly and distribution of our products and certain promotional and advertising costs given in the form of additional merchandise as consideration to customers.

### Key Performance Indicators

Our management team has defined and tracks performance against several key sales, operational and balance sheet performance indicators. Key sales performance indicators include, but are not limited to, the following:

- Daily sales by product group
- Daily sales by geography
- Sales by customer channel
- Gross margin performance
- Market share by product at retail

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--Inventory share by product at retail

Tracking these sales performance indicators on a regular basis allows us to understand whether we are on target to achieve our internal sales plans.

Key operational performance indicators include, but are not limited to, the following:

- Product returns (dollars and percentage of sales)
- Product credits (dollars and percentage of sales)
- Units shipped per man-hour worked
- Orders shipped on time
- Expenses by department
- Inbound and outbound freight cost by mode (dollars and dollars per unit)

--Inbound freight utilization by mode (ocean vs air)

--Vendor purchase order cycle time

Tracking these operational performance indicators on a regular basis allows us to understand whether we are on target to achieve our expense targets and efficiently satisfy customer demand.

Key balance sheet performance indicators include, but are not limited to, the following:

- Days of sales outstanding
- Days of inventory (at cost)
- Days of payables outstanding

Tracking these balance sheet performance indicators on a regular basis allows us to understand our working capital performance and forecast cash flow and liquidity.

### Results of Operations

The following table sets forth operating results expressed as a percentage of net sales for the periods indicated. All information is derived from the accompanying unaudited condensed consolidated financial statements. Results for any one or more periods are not necessarily indicative of annual results or continuing trends.

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(unaudited)		(unaudited)	
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold	<u>58.7</u>	<u>56.2</u>	<u>57.8</u>	<u>56.2</u>
Gross profit	41.3	43.8	42.2	43.8
Operating expenses:				
Research and development expenses	2.4	2.7	3.1	2.8
Sales and marketing expenses	27.4	25.4	27.4	23.0
General and administrative expenses	<u>6.6</u>	<u>7.2</u>	<u>7.7</u>	<u>7.1</u>
Total operating expenses	<u>36.4</u>	<u>35.3</u>	<u>38.2</u>	<u>32.9</u>

Interest income				
(expense), net	(0.2)	0.1	0.0	0.1
Other income (expense),				
net	<u>(0.0)</u>	<u>(0.2)</u>	<u>(0.1)</u>	<u>(0.1)</u>
Income before income				
taxes	4.7	8.4	3.9	10.9
Income tax expense	<u>0.0</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Net income	4.7%	8.3%	3.8%	10.8%

### Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007

Total net sales increased to \$33.3 million for the three months ended June 30, 2008 from \$30.4 million for the comparable period of 2007 primarily driven by the product sales of the Insight XTD drivers and hybrid-fairway woods and the Idea a3 and a3 OS Irons. Several factors affect a product's life, including but not limited to, customer acceptance, competition and technology. As a result, each product family's life cycles generally range from one to three years. Due to the seasonality of our business, one quarter's financial results are not indicative of the full fiscal year's expected financial results.

Net sales of irons increased to \$22.2 million, or 66.7% of total net sales for the three months ended June 30, 2008 from \$21.5 million, or 70.6% of total net sales, for the comparable period of 2007. The increase was primarily generated from the a3 and a3 OS iron product family. Current period iron net sales primarily resulted from the recently launched Idea a3 and a3 OS irons coupled with a smaller portion of sales resulting from Tech OS irons and integrated iron sets while the prior period net sales primarily resulted from the Idea a2 and a2 OS irons, Tech OS irons and integrated iron sets.

Net sales of drivers increased to \$3.5 million, or 10.6% of total net sales, for the three months ended June 30, 2008 from \$2.3 million, or 7.5% of total net sales, for the comparable period of 2007. A large portion of the driver net sales for the three months ended June 30, 2008 was generated by the Insight XTD driver, which was introduced in the first quarter of 2008, while prior period net sales were driven by the Insight driver, which was launched in the first quarter of 2007.

Net sales of fairway woods increased to \$8.5 million, or 25.6% of total net sales, for the three months ended June 30, 2008, from \$6.6 million, or 21.6% of total net sales, for the comparable period of 2007. Net sales for the three months ended June 30, 2008 were generated from Insight XTD hybrid-fairway woods and Idea a3 and a3 OS, Idea a2 and a2 OS, Idea Pro Gold and Tech OS I-woods. Net sales for the three months ended June 30, 2007 were generated from Insight fairway woods and Idea a2 and a2 OS, Idea Pro and Tech OS I-woods.

We were dependent on four customers, which collectively comprised approximately 26% of net sales for the three months ended June 30, 2008. Of these, two customers individually represented greater than 5% but less than 10% of net sales and one customer represented greater than 10% but less than 15% of net sales. No customer represented greater than 15% of net sales for this period. Should these customers or our other customers fail to meet their obligations to us, our results of operations and cash flows would be adversely impacted.

Net sales of our products outside the U.S. increased to \$8.0 million, or 24.1% of total net sales, from \$5.9 million, or 19.3% of total net sales, for the three months ended June 30, 2008 and 2007, respectively. Net sales resulting from countries outside the U.S. and Canada increased to 7.2% of total net sales for the three months ended June 30, 2008 from 6.8% for the comparable period of 2007.

Cost of goods sold increased to \$19.5 million, or 58.7% of total net sales, for the three months ended June 30, 2008

from \$17.1 million, or 56.2% of total net sales, for the comparable period of 2007. The increase as a percentage of total net sales is primarily due to changes in the product mix and increases in some component pricing as well as increases in inbound raw material freight costs driven by increasing fuel costs.

Selling and marketing expenses increased to \$9.1 million for the three months ended June 30, 2008 from \$7.7 million for the comparable period in 2007. The increase is primarily the result of an increase in marketing expense of \$0.6 million, tour player expenses of \$0.6 million and commission expense of \$0.6 million.

General and administrative expenses remained flat at \$2.2 million for the three months ended June 30, 2008 and 2007.

Research and development expenses, primarily consisting of costs associated with development of new products, remained flat at \$0.8 million for the three months ended June 30, 2008 and 2007.

### **Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007**

Total net sales increased to \$61.3 million for the six months ended June 30, 2008 from \$58.2 million for the comparable period of 2007 primarily driven by the product launches of the Insight XTD drivers and hybrid-fairway woods and the Idea a3 and a3 OS Irons. Several factors affect a product's life, including but not limited to, customer acceptance, competition and technology. As a result, each product family's life cycles generally range from one to three years. Due to the seasonality of our business, one quarter's financial results are not indicative of the full fiscal year's expected financial results.

Net sales of irons decreased to \$38.9 million, or 63.5% of total net sales for the six months ended June 30, 2008 from \$39.0 million, or 67.1% of total net sales, for the comparable period of 2007. The decrease was primarily generated from the decline in year over year net sales of the Tech OS irons. Current period iron net sales primarily resulted from the recently launched Idea a3 and a3 OS irons coupled with a smaller portion of sales resulting from Tech OS irons and integrated iron sets while the prior period net sales primarily resulted from the Idea a2 and a2 OS irons, Tech OS irons and integrated iron sets.

Net sales of drivers increased to \$8.2 million, or 13.5% of total net sales, for the six months ended June 30, 2008 from \$6.8 million, or 11.6% of total net sales, for the comparable period of 2007. A large portion of the driver net sales for the six months ended June 30, 2008 was generated by the Insight XTD driver, which was introduced in the first quarter of 2008, while prior period net sales were driven by the Insight driver, which was launched in the first quarter of 2007.

Net sales of fairway woods increased to \$14.7 million, or 24.1% of total net sales, for the six months ended June 30, 2008, from \$11.8 million, or 20.3% of total net sales, for the comparable period of 2007. Net sales for the six months ended June 30, 2008 were generated from Insight XTD hybrid-fairway woods and Idea a3 and a3 OS, Idea a2 and a2 OS, Idea Pro Gold and Tech OS I-woods. Net sales for the six months ended June 30, 2007 were generated from Insight fairway woods and Idea a2 and a2 OS, Idea Pro and Tech OS I-woods.

We were dependent on three customers, which collectively comprised approximately 24% of net sales for the six months ended June 30, 2008. Of these, two customers individually represented greater than 5% but less than 10% of net sales and one customer represented greater than 10% but less than 15% of net sales. No customer represented greater than 15% of net sales. Should these customers or our other customers fail to meet their obligations to us, our results of operations and cash flows would be adversely impacted.

Net sales of our products outside the U.S. increased to \$12.8 million, or 20.9% of total net sales, from \$9.5 million, or 16.4% of total net sales, for the six months ended June 30, 2008 and 2007, respectively. Net sales resulting from countries outside the U.S. and Canada increased to 5.9% of total net sales for the six months ended June 30, 2008 from 5.2% for the comparable period of 2007.

Cost of goods sold increased to \$35.4 million, or 57.8% of total net sales, for the six months ended June 30, 2008 from \$32.7 million, or 56.2% of total net sales, for the comparable period of 2007. The increase as a percentage of total net sales is primarily due to changes in the product mix and increases in some component pricing as well as increases in inbound raw material freight costs driven by increasing fuel costs.

Selling and marketing expenses increased to \$16.8 million for the six months ended June 30, 2008 from \$13.4 million for the comparable period in 2007. The increase is primarily the result of an increase in marketing expense of \$1.2 million, tour player expenses of \$1.3 million and commission expense of \$0.8 million.

General and administrative expenses increased to \$4.8 million for the six months ended June 30, 2008 from \$4.1 million for the comparable period in 2007 primarily related to increases in public company expenses, compensation expenses and bad debt expenses.

Research and development expenses, primarily consisting of costs associated with development of new products, increased to \$1.9 million for the six months ended June 30, 2008 from \$1.6 million for the comparable period in 2007 primarily related to compensation expenses resulting from increased staffing efforts.

Our inventory balances were approximately \$27.7 million and \$28.7 million at June 30, 2008 and December 31, 2007, respectively. The decrease in inventory levels is primarily due to the seasonality of our business where purchases are stronger in the fourth and first quarters of the year, while sales begin to deplete inventory levels in the first and second quarters of the year.

Our net accounts receivable balances were approximately \$32.8 million and \$18.0 million at June 30, 2008 and December 31, 2007, respectively. The increase is primarily due to the seasonality of our business as sales are historically stronger in the first half of the year as compared to the second half of the year.

Our accounts payable balances were approximately \$11.0 million and \$9.2 million at June 30, 2008 and December 31, 2007, respectively. The increase in accounts payable is primarily associated with increases in inventory purchases associated with the seasonality of our product launch cycles.

Our accrued liabilities balances were approximately \$9.9 million and \$8.7 million at June 30, 2008 and December 31, 2007, respectively. The increase in accrued liabilities is primarily associated with the seasonality of the business where our advertising accruals, sales reserve accruals and deferred revenues are larger during this time of the year.

### Liquidity and Capital Resources

Our principal sources of liquidity are cash reserves, cash flows provided by operations and our credit facilities in effect from time to time. Cash inflows from operations are generally driven by collections of accounts receivables from customers, which generally increase in our second quarter and continue into the third quarter and then begin to decrease during the fourth quarter. As necessary we could use our credit facility to supplement our cash inflows from operations as well as other investing activities such as potential future acquisitions. Cash outflows are primarily tied to procurement of inventory which typically begins to build during the fourth quarter and continues heavily into the first and second quarters in order to meet demands during the height of the golf season.

Cash and cash equivalents decreased to \$2.1 million at June 30, 2008 compared to \$11.3 million at December 31, 2007. During the period, accounts receivable increased \$14.8 million and prepaids increased \$1.0 million. These increases were partially offset with an increase in accrued expenses and accounts payable of \$2.9 million and a decrease in inventory of \$1.0 million.

In November 2007, we signed a revolving credit agreement with Wachovia Bank, National Association to provide up to \$15.0 million in short term debt with the option to increase to \$30 million. The agreement is collateralized by all of our assets and requires us, among other things, to maintain certain financial performance levels relative to the fixed charge coverage ratio, but only when we have an outstanding balance on the facility. Interest on outstanding balances accrues at a rate of Libor plus 1.75% and is payable monthly. As of August 1, 2008, we had no

outstanding borrowings on our credit facility.

Working capital increased at June 30, 2008 to \$44.9 million compared to \$42.3 million at December 31, 2007. Approximately 50% of our current assets were comprised of accounts receivable at June 30, 2008. Due to industry sensitivity to consumer buying trends and available disposable income, we have in the past extended payment terms for specific purchase transactions. Issuance of these terms (i.e. greater than 30 days or specific dating) is dependent on our relationship with the customer and the customer's payment history. Payment terms are extended to selected customers typically during off-peak times in the year in order to promote our brand name and to assure adequate product availability and to coincide with planned promotions or advertising campaigns. Although a significant amount of our sales are not affected by these terms, the extended terms do have a negative impact on our financial position and liquidity. We expect to continue to selectively offer extended payment terms in the future, depending upon known industry trends and our financial condition. We generate cash flow from operations primarily by collecting outstanding trade receivables. Because we have limited cash reserves, if collections of a significant portion of trade receivables are unexpectedly delayed, we would have a limited amount of funds available to further expand production until such time as we could collect a significant portion of the trade receivables. If our cash needs in the near term exceed the available cash and cash equivalents on hand and the available borrowing under our credit facility, we would be required to obtain additional financing or limit expenditures to the extent of available cash on hand, all of which could adversely effect our current growth plans and result in a material adverse effect on our results of operations, financial condition and/or liquidity.

Our anticipated sources of liquidity over the next twelve months are expected to be cash reserves, projected cash flows from operations, and available borrowings under our credit facility. We anticipate that operating cash flows, current cash reserves, and available borrowings will also fund capital expenditure programs. These capital expenditure programs can be suspended or delayed at any time with minimal disruption to our operations if cash is needed in other areas of our operations. In addition, cash flows from operations and cash reserves will be used to support ongoing purchases of component parts for our current and future product lines. The expected operating cash flow, current cash reserves and borrowings available under our credit facility are expected to allow us to meet working capital requirements during periods of low cash flows resulting from the seasonality of the industry.

If adequate funds are not available or not available on acceptable terms, we may be unable to continue operations; develop, enhance and market products; retain qualified personnel; take advantage of future opportunities; or respond to competitive pressures, any of which could have a material adverse effect on our business, operating results, financial condition and/or liquidity.

## Critical Accounting Policies and Estimates

Our discussion and analysis of our results of operations, financial condition and liquidity are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an on-going basis, we review our estimates to ensure that the estimates appropriately reflect changes in our business.

### Inventories

Inventories are valued at the lower of cost or market and primarily consist of finished golf clubs and component parts. Cost is determined using the first-in, first-out method. The inventory balance, which includes material, labor and assembly overhead costs, is recorded net of an estimated allowance for obsolete inventory. The estimated allowance for obsolete inventory is based upon management's understanding of market conditions and forecasts of future product demand. Accounting for inventories could result in material adjustments if market conditions and future demand estimates are significantly different than original assumptions, causing the reserve for obsolescence to be materially adversely affected.

### *Revenue Recognition*

We recognize revenue when the product is shipped. At that time, the title and risk of loss transfer to the customer and collectability is reasonably assured. Collectability is evaluated on an individual customer basis taking into consideration historical payment trends, current financial position, results of independent credit evaluations and payment terms. Additionally, an estimate of product returns and warranty costs are recorded when revenue is recognized. Estimates are based on historical trends taking into consideration current market conditions, customer demands and product sell through. We also record estimated reductions in revenue for sales programs such as co-op advertising and spiff incentives. Estimates in the sales program accruals are based on program participation and forecast of future product demand. If actual sales returns and sales programs significantly exceed the recorded estimated allowances, our sales would be adversely affected. We recognize deferred revenue as a result of sales that have extended terms and a right of return of the product under a specified program. Once the product is paid for and all revenue recognition criteria have been met, we record revenue.

### ***Allowance for Doubtful Accounts***

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. An estimate of uncollectable amounts is made by management using an evaluation methodology involving both overall and specific identification. We evaluate each individual customer and measure various key aspects of the customer such as, but not limited to, their overall credit risk (via Dun and Bradstreet reports), payment history, track record for meeting payment plans, industry communications, the portion of the customer's balance that is past due and other various items. From an overall perspective, we also look at the aging of the receivables in total and aging relative to prior periods to determine the appropriate reserve requirements. Fluctuations in the reserve requirements will occur from period to period as the change in customer mix or strength of the customers could affect the reserve disproportionately compared to the total change in the accounts receivable balance. Based on management's assessment, we provide for estimated uncollectable amounts through a charge to earnings and a credit to the valuation allowance. Balances which remain outstanding after we have used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. We generally do not require collateral. Accounting for an allowance for doubtful accounts could be significantly affected as a result of a deviation in our assessment of any one or more customers' financial strength. While only two customers represent greater than 5% but less than 10% of net sales and one customer represents greater than 10% but less than 15% of net sales for the six months ended June 30, 2008, if a combination of customers were to become financially impaired, our financial results could be severely affected.

### **Product Warranty**

Our golf equipment is sold under warranty against defects in material and workmanship for a period of one year. An allowance for estimated future warranty costs is recorded in the period products are sold. In estimating our future warranty obligations, we consider various relevant factors, including our stated warranty policies, the historical frequency of claims, and the cost to replace or repair the product. Accounting for product warranty reserve could be adversely affected if one or more of our products were to fail (i.e broken shaft, broken head, etc) to a significant degree above and beyond our historical product failure rates, which determine the product warranty accruals.

### **Income Taxes**

We account for income taxes in accordance with FAS No. 109, "Accounting for Income Taxes" ("FAS 109") as clarified by FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred income tax assets, we consider whether it is "more likely than not," according to the criteria of FAS 109, that some portion or all of the deferred income tax assets will be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. FIN 48 requires that we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority. Due to our historical operating results, management is unable to conclude on a more likely than not basis that all deferred income tax assets generated from net operating losses through December 31, 2002 and other deferred tax assets will be realized. However, due to our recent earnings history, we have concluded that it is more likely than not that a portion of the deferred tax asset will be realized. We have recognized a valuation allowance equal to a portion of the deferred income tax asset for which realization is uncertain.

### ***Impairment of Long-Lived Assets***

We have reviewed long-lived assets and certain identifiable intangibles according to the guidance in SFAS ("Statement of Financial Accounting Standards") 144 for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. During the three and six months ended June 30, 2008 and 2007, there were no impairments of long-lived assets.

### **Item 4. Controls and Procedures**

*Introduction*

"Disclosure Controls and Procedures" are defined in Exchange Act Rules 13a -15(e) and 15d -15 (e) as the controls and procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time period specified by the SEC's rules and forms. Disclosure Controls and Procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding disclosure.

"Internal Control Over Financial Reporting" is defined in Exchange Act Rules 13a -15(f) and 15d -15(f) as a process designed by, or under the supervision of, an issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by an issuer's board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. It includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and disposition of an issuer; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the issuer's assets that could have a material adverse effect on the financial statements.

We have endeavored to design our Disclosure Controls and Procedures and Internal Controls Over Financial Reporting to provide reasonable assurances that our objectives will be met. All control systems are subject to inherent limitations, such as resource constraints, the possibility of human error, lack of knowledge or awareness, and the possibility of intentional circumvention of these controls. Furthermore, the design of any control system is based, in part, upon assumptions about the likelihood of future events, which assumptions may ultimately prove to be incorrect. As a result, no assurances can be made that our control system will detect every error or instance of fraudulent conduct, including an error or instance of fraudulent conduct, which could have a material adverse impact on our operations or results.

*Evaluation of Internal Controls over Financial Reporting and Disclosure Controls and Procedures*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Under the supervision of our Chief Executive Officer and Chief Financial Officer, our management conducted an assessment of our internal controls over financial reporting as of December 31, 2007, based on the framework and criteria established in *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

Based on the results of the assessment, management concluded that as of December 31, 2007, our internal controls over financial reporting were effective. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our Disclosure Controls and Procedures as of the end of the period covered by this report and have concluded that our Disclosure Controls and Procedures as of the end of the period covered by this report were designed to ensure that material information relating to us is made known to the Chief Executive Officer and Chief Financial Officer by others within our Company, and, based on their evaluations, our controls and procedures were effective as of the end of the period covered by this report. There were no material changes to our Internal Controls Over Financial Reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the last fiscal quarter that have materially affected or are reasonably likely to materially affect our Internal Controls Over Financial Reporting.

In addition, it is our policy to not participate in off-balance sheet transactions, including but not limited to special purpose entities.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Beginning in June 1999, the first of seven class action lawsuits was filed against us, certain of our current and former officers and directors, and the three underwriters of our initial public offering ("IPO") in the United States District Court of the District of Delaware. The complaints alleged violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, as amended, in connection with our IPO. In particular, the complaints alleged that our prospectus, which became effective July 9, 1998, was materially false and misleading. The operative complaint was filed on January 24, 2006, and it alleges that the prospectus failed to disclose that unauthorized distribution of our products (gray market sales) threatened our long-term profits and that we engaged in questionable sales practices (including double shipping and unlimited rights of return), which threatened post-IPO financial results. Discovery closed on August 11, 2006. On November 21, 2006, all summary-judgment briefing was completed. On December 13, 2006, we learned that the Delaware District Court judge whom the case was set before was elevated to the United States Court of Appeals for the Third Circuit. On December 15, 2006, we were notified that our case was assigned to the vacant judicial position and that all proceedings had been postponed until a new judge was confirmed, and there was no trial date set at this time. On February 7, 2008, we were notified that our case has been reassigned to Chief Judge Gregory M. Sleet. There has been no scheduling conference set yet, and there is no trial date currently set. The parties participated in a mediation on April 8, 2008, but no resolution has been reached at this time.

We maintain directors' and officers' ("D&O") and corporate liability insurance to cover certain risks associated with these securities claims filed against us or our directors and officers. During the period covering the class action lawsuit, we maintained insurance from multiple carriers, each insuring a different layer of exposure, up to a total of \$50 million. In addition, we have met the financial deductible of our directors' and officers' insurance policy for the period covering the time the class action lawsuit was filed. On March 30, 2006, Zurich American Insurance Company, which provided insurance coverage totaling \$5 million for the layer of exposure between \$15 million and \$20 million, notified us that it was denying coverage due to the fact that it was allegedly not timely notified of the class action lawsuit. On October 11, 2007, we filed a suit against our former insurance broker, Thilman & Filipini, LLC ("T&F"), for various claims related to T&F's alleged failure to notify Zurich of the class action lawsuit. Depending on the outcome of this proceeding, based on the previously disclosed agreement with Chubb & Son ("Chubb"), a division of Federal Insurance Company ("Federal"), which is described below, we could be required to pay Zurich's \$5 million limit of liability in cash before the layers of insurance coverage excess to the Zurich layer attach. We previously disclosed that Chubb had notified us that coverage under the Federal policy, which provided insurance coverage totaling \$10 million for the layer of exposure between \$20 million and \$30 million, and the Executive Risk Indemnity Inc. ("ERII") policy, which provided insurance coverage totaling \$10 million for the layer of exposure between \$40 million and \$50 million, would attach only if the underlying limits are exhausted by payment from the underlying insurance carriers. On June 18, 2007, Chubb notified us that Federal and ERII will not require that Zurich pay the full amount of its limit of liability before the Federal and ERII policies attach, and it confirmed that Chubb will accept payment in cash by our Company of Zurich's limit of liability to satisfy this requirement, so long as such payment is for covered loss. All of the excess insurance carriers (other than Zurich, which has denied coverage) have reserved their rights to deny coverage on various grounds. At this point in the legal proceedings, we cannot predict with any certainty the outcome of the matter, per the guidance in SFAS 5, and thus can not reasonably estimate future liability on the conclusion of the events, if any.

The underwriters for the IPO are also defendants in the securities class action. The underwriting agreement that we entered into with the underwriters in connection with the IPO contains an indemnification clause, providing for indemnification against any loss, including defense costs, arising out of the IPO. After the first lawsuit was filed, the underwriters requested indemnification under the agreement. Our D&O insurance policy included an endorsement providing \$1 million to cover indemnification of the underwriters. Our D&O insurer has notified the underwriters of the exhaustion of the \$1 million sublimit. We believe that we have no current obligation to pay the underwriters'

defense costs. We believe that the applicable case law provides that the earliest possible time that an obligation to indemnify might exist is after a court has decided conclusively that the underwriters are without fault under the federal securities laws. The litigation is not at that stage yet. As of August 7, 2008, the total amount of outstanding underwriter defense costs was just less than \$1.4 million. At this time, the underwriters are not able to predict with certainty the amount of defense costs they expect to incur going forward, but it is likely they will incur additional costs before this matter is concluded. At this time, we cannot predict with any certainty the outcome of this indemnification issue, per the guidance in SFAS 5, and thus cannot reasonably estimate future liability on the conclusion of the events, if any.

Beginning April 2008, we received communications from the Estate of Anthony Antonious that our products infringed an Anthony Antonious patent concerning an aerodynamic metal wood golf club head. In May 2008, we filed a declaratory judgment lawsuit against the Anthony Antonious Trust, alleging non-infringement of the Antonious patent. In June 2008, the Estate of Anthony Antonious filed a lawsuit against us alleging infringement of the patent. At this point in the legal proceedings, we cannot predict the outcome of the matter with any certainty, per the guidance in SFAS 5, and thus cannot reasonably estimate future liability on the conclusion of the events, if any.

From time to time, we are engaged in various other legal proceedings in the normal course of business. The ultimate liability, if any, for the aggregate amounts claimed cannot be determined at this time.

#### Item 1A. Risk Factors

We have included in our filings with the SEC, including Part I, 1A of our Annual Report on Form 10-K for the year ended December 31, 2007, a description of certain risks and uncertainties that could have an affect on our business, future performance, or financial condition. There are no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007.

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

At our Annual Meeting of Stockholders held on May 20, 2008, the following proposals were adopted by the margin indicated.

1. To elect the following nominees as director to serve until the 2011 Annual Meeting of Stockholders and until his successor is elected and qualified.

	Number of Shares	
	<u>Vote For</u>	<u>Withheld</u>
Robert D. Rogers	5,779,065	143,791
John M. Gregory	5,774,903	147,953

The following directors' terms of office continued after the Annual meeting of Stockholders: Oliver G. Brewer, III, B. H. (Barney) Adams, Russell L. Fleischer, Mark R. Mulvoy, and Joseph Gregory.

2. To ratify the appointment of KBA Group LLP as the independent auditors of the Company for the year ending December 31, 2008.

	Number of Shares		
	<u>Vote For</u>	<u>Vote Against</u>	<u>Abstained</u>
	5,915,999	6,207	650

Item 6. Exhibits

See exhibit index on pages 28-29.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ADAMS GOLF, INC.

Date: August 4, 2008

By: /S/ OLIVER G. BREWER  
III  
Oliver G. Brewer, III  
Chief Executive Officer and  
President  
(Principal Executive Officer)

Date: August 4, 2008

By: /S/ ERIC  
LOGAN  
Eric Logan  
Chief Financial Officer  
(Principal Financial Officer)

Date: August 4, 2008

By: /S/ PAMELA  
HIGH  
Pamela J. High  
Controller  
(Principal Accounting Officer)

EXHIBIT INDEX

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\* The SEC has granted our request for confidential treatment of certain portions of these agreements.

\*\* We have requested confidential treatment for certain portions of this agreement.