GOLFSMITH INTERNATIONAL HOLDINGS INC
Form 10-K/A
December 09, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K/A

(Amendment No. 1)

(Mark One)

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

For the fiscal year ended January 3, 2004 or

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 333-101117

Golfsmith International Holdings, Inc.

(Exact name of Registrant as Specified in Its Charter)

Delaware	**16-1634897**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

11000 N. IH-35

Austin, Texas 78753
(Address of Principal Executive Offices)

Registrant s telephone number, including area code:

(512) 837-8810

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

NONE

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

NONE

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

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

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

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

Class of Common Stock	Outstanding at March 24, 2004
$.001 par value	21,594,597 Shares

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GOLFSMITH INTERNATIONAL HOLDINGS, INC. INTRODUCTORY NOTE

Golfsmith International Holdings, Inc. (Holdings) (Successor to Golfsmith International, Inc. (Golfsmith) as a result of a merger transaction on October 15, 2002) is filing this Amendment No. 1 to Form 10-K (Amendment No. 1) for the fiscal year ended January 3, 2004 to reflect the restatement of its consolidated financial statements for the predecessor period from December 30, 2001 through October 15, 2002 included in its Annual Report on Form 10-K for the fiscal year ended January 3, 2004, which was originally filed on April 2, 2004. The restatement addresses accounting errors that overstated the extraordinary gain resulting from the repurchase of a minority interest previously held by a third party and repurchased by Golfsmith immediately prior to the merger transaction on October 15, 2002. Refer to Note 21 in the notes to the consolidated financial statements included in this Amendment No. 1 for a complete description and quantification of the restatement. The financial information for the predecessor period from December 30, 2001 through October 15, 2002 contained in this Amendment No. 1 has been revised to reflect the restatement items described in Note 21. No periods covered by Holdings consolidated financial statements other than the predecessor period from December 30, 2001 through October 15, 2002 are affected by the restatement.

The following items of the original Form 10-K are amended in this Amendment No. 1 in order to reflect the restatement and to conform to certain comments of the Securities and Exchange Commission staff:

Item 6. Selected Financial Data

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

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Item 8. Consolidated Financial Statements and Supplementary Data

Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

Except as set forth above and for such other changes as required by applicable law, no attempt has been made in this Amendment No. 1 to modify or update the disclosures as presented in the original Form 10-K and this Amendment No. 1 does not reflect events occurring after the original filing of the Form 10-K on April 2, 2004. You should read this Amendment No. 1 together with other periodic reports that Holdings has filed with the Securities and Exchange Commission subsequent to the filing of the original Form 10-K. Information contained in such reports updates and supersedes certain information contained in this Amendment No. 1.

GOLFSMITH INTERNATIONAL HOLDINGS, INC.

Form 10-K/ A (Amendment No. 1)

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CAUTIONARY NOTICE REGARDING

FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K/A contains forward-looking statements within the meaning of the federal securities laws. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include statements preceded by, followed by or that include the words may, could, would, should, believe, expect, anticipate, plan, target, project, intend, or similar expressions. These statements include, among others, statements regarding our expected business outlook, anticipated financial and operating results, our business strategy and means to implement the strategy, our objectives, the amount and timing of future store openings, store retrofits and capital expenditures, the likelihood of our success in expanding our business, financing plans, working capital needs and sources of liquidity.

Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management s beliefs and assumptions, which in turn are based on currently available information. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding demand for our products, the introduction of new product offerings, store opening costs, our ability to lease new sites on a timely basis, expected pricing levels, the timing and cost of planned capital expenditures, competitive conditions and general economic conditions. These assumptions could prove inaccurate. Forward-looking statements also involve risks and uncertainties, which could cause actual results that differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict.

We believe our forward-looking statements are reasonable; however, undue reliance should not be placed on any forward-looking statements, which are based on current expectations. Further, forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

PART I

Item 1. *Business*

Overview

Carl Paul founded our company in 1967 when he began providing clubmakers with the components necessary to offer custom-made golf clubs at a time when most golfers could only purchase ready-made, off-the-shelf equipment. In order to capitalize on this market opportunity, we helped pioneer the golf club components industry by designing and selling a line of components and supplies (principally golf clubheads, shafts, grips and tools) for custom clubmakers through our clubmakers catalog. Over the years we have complemented and expanded our operations by opening our first retail outlet in 1972, mailing our first general golf product catalog in 1975, opening our first superstore in 1992, opening the Harvey Penick Golf Academy in 1993 and launching golfsmith.com in 1997.

We are a multi-channel, specialty retailer of golf equipment and related accessories and a designer and marketer of golf equipment. We have a 37-year history as a retailer in the golf industry. We offer equipment from leading manufacturers, including Callaway®, Cobra®, FootJoy®, Nike®, Ping®, Taylor Made® and Titleist®. In addition, we offer our own proprietary brands, including Golfsmith®, Lynx®, Snake Eyes®, Killer Bee® and Zevo®. We market our products through 42 superstores as well as through our direct-to-consumer channel, which includes our clubmaking and accessory catalogs and our Internet site.

We offer a complete line of golf equipment and related accessories through multiple distribution channels:

Superstores. We opened our first golf superstore in 1992 and currently operate 42 superstores, four of which opened subsequent to January 3, 2004. These stores range in size from approximately 8,000 to

30,000 square feet. Our superstores feature a wide selection of golf equipment from major name brand manufacturers.

Direct-to-Consumer. Our principal publications are the Golfsmith Accessory Catalog and the Golfsmith Clubmaking Catalog. We also sell our products through our website,www.golfsmith.com. Through our direct-to-consumer distribution channels, we provide customers our offering of products, including equipment, apparel, accessories and clubmaking components and tools.

Harvey Penick Academy. In 1993, we partnered with Austin native and well-known golf instructor, the late Harvey Penick, to form the Harvey Penick Golf Academy. The academy has attracted over 17,000 students since its inception. We believe the academy helps contribute to sales at our adjacent Austin superstore.

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

The Merger

On October 15, 2002, BGA Acquisition Corp., our wholly owned subsidiary merged with and into Golfsmith International, Inc. Golfsmith International, Inc., or Golfsmith, is the surviving corporation and is our wholly owned subsidiary as a result of the merger. The aggregate purchase price for the merger was approximately $121.0 million. The components of this purchase price included the payment to the stockholders of Golfsmith prior to the merger of $101.5 million in cash and $12.8 million of our equity securities, and $6.7 million in fees and expenses incurred in connection with the merger. The cash portion of the purchase price for the merger was funded out of:

- the net proceeds from the offering of Golfsmith s 8.375% senior secured noted due 2009, of approximately $67.9 million;
- the cash contribution of $50.0 million described below; and
- existing cash.

The merger agreement required Golfsmith to repay and terminate all then existing indebtedness and also required us to put in place a new revolving credit facility as a condition to the closing of the merger. For more information about the purchase price and the other terms of the merger generally, you should read the description of the merger agreement contained in Item 13, Certain Relationships and Related Transactions .

We were formed by Atlantic Equity Partners III, L.P., a limited partnership operated by First Atlantic Capital Ltd. First Atlantic is a private equity investment firm. We were formed solely for the purpose of completing the merger and had no operations, assets or properties prior to the merger. In connection with the merger, Atlantic Equity Partners III contributed $50.0 million in return for approximately 79.7% of our common stock on a fully diluted basis. Some of Golfsmith s stockholders prior to the merger, including members of our current management, received shares of our common stock and restricted common stock units, which entitle the holders thereof to shares of our common stock, in the merger and currently own in the aggregate 17.3% of our common stock on a fully diluted basis, including outstanding stock options. In connection with the merger, we entered into a management consulting agreement with First Atlantic, and all of our stockholders, including members of our management, entered into a stockholders agreement and certain other contractual arrangements with First Atlantic as described in Item 13, Certain Relationships and Related Transactions .

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Products and Suppliers

We currently derive over 60% of our net revenues from clubs and components and a large portion of our club sales are of our own proprietary brands. Our products include golf clubs and club components, club bags, golf gloves, golf shoes, and golfing apparel.

Original Equipment Manufacturers

We offer a large selection of golf equipment from leading manufacturers, including, but not limited to, Callaway®, Cobra®, FootJoy®, Nike®, Ping®, Taylor Made® and Titleist®. We believe that we enjoy strong relationships with many of the major equipment vendors in the industry.

In fiscal 2002 and 2003, Callaway Golf supplied 12% and 11% of our consolidated purchases, respectively. No other single supplier accounted for more than 10% of our consolidated purchases during fiscal 2002 or 2003. Our top ten suppliers for fiscal 2003 were as follows:

TOP 10 SUPPLIERS

Callaway Golf
Eaton Corporation
Fortune Brands (Titleist/ Cobra Golf)
Nike
Ping
Roger Cleveland Golf
Taylor Made/ Adidas Golf
True Temper
Twin Lakes Co. Ltd.
Winn

Proprietary Brands

We are the registrant of over 80 trademarks and service marks in more than 25 countries including Golfsmith®, Lynx®, Snake Eyes®, Black Cat®, Killer Bee®, Predator®,Tigress® and Zevo®. Our trademarks are generally valid as long as they are properly in use in commerce. The registrations are valid as long as they are properly maintained and the registered marks have not become generic, abandoned nor the registrations obtained fraudulently. Our trademarks may cease to be valid, for example, if we:

- license our trademarks without quality control or fail to enforce quality control provisions in any licenses;
- fail to contest infringing uses;
- fail to use a U.S. trademark for three consecutive years;
- fail to use a foreign registered trademark within the time required after registration; and
- fail to maintain foreign registrations, in which case we may lose the presumption of ownership in the foreign country.

Our trademarks and domain names are considered to be indefinite lived assets under SFAS No. 142, Goodwill and Other Intangible Assets, and therefore are not amortized. Other definite lived intellectual property is amortized on a straight-line basis over nine years.

We focus on developing products that are high-quality and designed to increase the penetration of our private label offerings, fill a niche or gap in the premium brand product offerings, and appeal to custom clubmakers and enhance our status in equipment design. Three of these private labels were added in fiscal 1998 when we purchased assets of three golf companies: Lynx Golf Inc., Snake Eyes Golf Clubs Inc. and Black Rock Golf Corp., the manufacturer of the Killer Bee® line. We purchased an additional brand Zevo® in 2003. These companies equipment lines are now proprietary brands included in all of our retail

channels. We source over 70% of our proprietary products from contract manufacturers in Asia, and these suppliers manufacture our equipment according to our specifications.

Sales and Distribution

SuperStores

We opened our first golf superstore in 1992 and currently operate 42 superstores, four of which opened subsequent to January 3, 2004. The locations of our superstores are more fully described in Item 2, Properties .

Our superstores range in size from approximately 8,000 to 30,000 square feet. Our superstores feature a wide selection of golf equipment from major name brand manufacturers and also serve as the primary retail outlet in the United States for our proprietary branded products. Our superstores also cater to golf and sports enthusiasts by providing golf simulators, indoor driving nets, computerized swing analyzers, putting greens, indoor lesson capabilities in certain locations and television monitors that display golf and major sporting events. In addition, the majority of our superstores offer components, clubmaking tools, supplies and on-site custom clubfitting and technical support.

We plan to modify selected larger superstores into a smaller, more productive layout that we believe will lower our operating costs and capital requirements and increase our profitability while providing customers with a superior shopping environment. In fiscal 2003, all six of the new stores opened were built in this mold of the smaller store layout.

We opened three stores during fiscal 2002 and six stores during fiscal 2003, and acquired six stores with our acquisition of Don Sherwood Golf Shop in July 2003.

We intend to selectively expand our existing store base in existing as well as new markets that fit our selection criteria. We plan to open six to eight additional superstores during fiscal 2004, four of which have been opened as of March 31, 2004. The criteria for the selection of new superstore locations include:

- demographic characteristics with a high number of avid golfers and above average annual household incomes;
- visibility from and access to highways or other major roadways;
- the ability to obtain favorable lease terms; and
- co-tenants that are likely to draw customers whom we would otherwise target within the site s relevant market.

After we have identified a potential site, we assess the cost of the site and carefully examine the projected profitability and returns generated from opening the additional store.

Our superstores accounted for approximately 54.8%, 56.7% and 62.9% of our net revenues for fiscal 2001, 2002 and 2003, respectively. The increase in the percentage of our net revenues derived from superstores correlates with our increased number of superstores from 26 superstores at December 29, 2001 to 38 superstores at January 3, 2004.

Direct-To-Consumer

Through our direct-to-consumer distribution channels, we provide customers our offering of products, including equipment, apparel, accessories, and clubmaking components and tools. Our direct-to-consumer channels accounted for approximately 41.7%, 40.3% and 34.5% of our net revenues for fiscal 2001, 2002 and 2003, respectively.

Catalogs. Our principal publications are the Golfsmith Accessory Catalog and the Golfsmith Clubmaking Catalog. We have developed a proprietary customer database largely through our catalog and online website order processing and to a lesser extent through contests and point-of-sale registers in our superstores. The names and associated sales information are merged periodically into our customer master file. This merge

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process provides a source of current information to help assess the effectiveness of the catalog and identifies new customers that can be added to our in-house mailing lists. We use statistical evaluation and selection techniques to determine which customer segments are likely to contribute the greatest revenue per mailing.

Our two catalog titles are designed and produced by our in-house staff of writers, photographers and graphic artists. The monthly production and distribution schedule of our accessory catalog permits frequent changes in the product selection and price.

Internet. We also sell our products through our e-commerce site,www.golfsmith.com. We have additional websites, www.Lynxgolf.com and www.golfandtennisworld.com, which link to www.golfsmith.com.

Our Internet business complements our superstore business by building customer awareness of our brand and acting as an effective advertising vehicle for new product introductions, unique product offerings, and our proprietary brands.

International

We work with a group of international distributors to offer golf club components and equipment to clubmakers and golfers in selected regions outside the United States. In the United Kingdom, we sell our proprietary branded equipment through a commissioned sales force directly to retailers. Throughout most of Europe and parts of Asia and other parts of the world, we sell our products through a network of distributors. Approximately 2.3%, 2.5% and 2.3% of our net revenues were derived from sales made through our international distributors and our distribution center near London in fiscal 2001, fiscal 2002 and fiscal 2003, respectively.

Harvey Penick Academy

In 1993, we partnered with Austin native and well-known golf instructor, the late Harvey Penick, to form the Harvey Penick Golf Academy. The academy has attracted over 17,000 students since its inception. We believe the academy helps contribute to sales at our adjacent Austin superstore. The academy accounted for approximately 0.5%, 0.5% and 0.3% of our net revenues for fiscal 2001, 2002 and 2003, respectively.

Marketing

We have a multi-faceted marketing strategy that combines direct marketing, local advertising and supplier marketing.

On the local level, we run newspaper ads to promote superstores and store events. Additional marketing activity occurs during key shopping periods, such as Father s Day and Christmas, and on specific sales and promotional events. On the national level, we participate in cooperative advertising arrangements with our vendors. Along with vendor buy-ins to sponsor events, these arrangements have reduced our advertising costs. Also, on the national level, we run printed advertisements in national magazines, such as Golf Digest. Historically, we have run national ads on the Golf Channel and local television ads in select markets to complement our direct marketing campaign. To contain costs and increase effectiveness, we have expanded the use of e-mail for direct marketing.

The catalogs that we distribute annually are also an important marketing tool. The Golfsmith Clubmaking Catalog is distributed to many of our clubmaking catalog customers and reinforces our place in the component market. In addition, we believe the magazine extends the Golfsmith® brand and encourages additional sales through the publicity of new product and promotional offerings.

Infrastructure

Our order fulfillment infrastructure includes:

a 100,000 square foot, direct-to-consumer shipping facility and associated warehouse which can handle over one million packages annually;

a 140,000 square foot distribution center with available capacity to handle all store inventory and order fulfillment requirements; and

management information systems that fully integrate all aspects of our business and enable us to quickly obtain key operating data.

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

Management Information Systems

Our management information systems provide us with a network and applications that are scalable and easy to use, maintain, and modify. These systems provide us with the infrastructure necessary to support continued growth. This infrastructure integrates all major aspects of our business, improves our back-office capabilities, enhances management reporting and analysis capabilities through rapid access to data, lowers operating costs and improves and expands our direct marketing capabilities.

The in-store, point-of-sale system tracks all sales by category, style and item and allows us to routinely compare current performance with historical and planned performance. The information gathered by this system supports automatic replenishment of inventory and is integrated into product buying decisions.

The majority of our hardware resides at our corporate headquarters. We have implemented redundant servers and communication lines to limit downtime in the event of power outages or other potential problems. System administrators and network managers monitor and operate our network operations and transactions-processing systems to ensure the continued uninterrupted operation of our website and transaction-processing systems.

Seasonality

Based on our experience, we believe that retailers in the golf industry experience a high degree of seasonality in their businesses during the spring and Christmas holiday selling seasons. As a consequence, retailers, including us, incur higher expenses related to building inventory in order to meet the higher demand during these seasons. In keeping with this trend, a substantial portion of our sales occur in our second fiscal quarter each year.

Employees

As of January 3, 2004, we employed 1,178 people. We believe we have strong relationships with our employees. None of our work force is unionized.

Competition

Our competitors currently include other specialty retailers, mass merchandise retailers, conventional sporting goods retailers, on-course pro shops, and online retailers of golf equipment. These businesses compete with us in one or more product categories. In addition, traditional and specialty golf retailers are expanding more aggressively in marketing brand-name golf equipment, thereby competing directly with us for products, customers and locations. Some of these potential competitors have been in business longer than us or have greater financial or marketing resources than we do and may be able to devote greater resources to sourcing, promoting and selling their products. Several of our key vendors have begun to operate retail stores or websites that sell directly to consumers and may compete with us and reduce our sales. In the specialty off-course segment, our primary competitors include retail chains such as Edwin Watts, Golf Galaxy, Pro Golf Discount, Dick s Sporting Goods, Galyan s and Nevada Bobs. Other competitors include on-course pro shops, direct marketers and sporting goods retailers. We compete on the basis of brand image, technology, quality and performance of our products, method of distribution, price, style and intellectual property protection.

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Environmental Matters

We are subject to various foreign, federal, state, and local environmental protection, chemical control, and health and safety laws and regulations, and we incur costs to comply with those laws. We own and lease real property, and some environmental laws hold current or previous owners or operators of businesses and real property liable for contamination on or originating from that property, even if they did not know of and were not responsible for the contamination. The presence of hazardous substances on any of our properties or the failure to meet environmental regulatory requirements may have a material adverse affect on our ability to use or to sell the property or to use the property as collateral for borrowing, and may cause us to incur substantial remediation or compliance costs. If hazardous substances are released from or located on any of our properties, we could incur substantial liabilities through a private party personal injury or property damage claim or a claim by a governmental entity for other damages. The liability may be imposed on us under environmental laws or common law principles. In addition, some of the products we sell contain regulated substances, such as solvents and lead. Environmental laws may impose liability on any person who disposes of hazardous substances, regardless of whether the disposal site is owned or operated by such person.

Although we do not currently anticipate that the costs of complying with environmental laws or otherwise satisfying any current liabilities under environmental laws will materially adversely affect us, we cannot assure you that we will not incur material costs or liabilities in the future, due to the discovery of new facts or conditions, acquisition of new properties, the occurrence of releases of hazardous substances, the filing of new claims, changes in operations, a change in existing environmental laws, adoption of new environmental laws, or new interpretations of existing environmental laws.

Additional Factors That May Affect Future Results

Our success depends on the continued popularity of golf and the growth of the market for golf-related products. If golf declines in popularity, our sales could materially decline.

We generate substantially all of our net revenues from the sale of golf-related equipment and accessories. The demand for our golf products is directly related to the popularity of golf, the number of golf participants and the number of rounds of golf being played by these participants. If golf participation decreases, sales of our products would be adversely affected. In addition, the popularity of golf organizations, such as the Professional Golfers Association, also affects the sales of our golf equipment and golf-related apparel. We depend on the exposure of our brands to increase brand recognition and reinforce the quality of our products. Any significant reduction in television coverage of PGA or other golf tournaments, or any other significant decreases in either attendance at golf tournaments or viewership of golf tournaments, will reduce the visibility of our brand and could adversely affect our sales.

In addition, we do not believe there has been any material increase in golf participation or the number of golf rounds played since 1999. The number of rounds played in the U.S. dropped to 502.4 million in 2002 from 518.4 million in 2000, perhaps reflecting the general decline in the U.S. economy**.**Additionally, the number of rounds played in the U.S. in 2003 dropped 2.6% from 2002 to 489.3 million rounds played. We can not assure you that the overall dollar volume of the worldwide market for golf-related products will grow, or that it will not decline, in the future.

We may not be able to borrow additional funds, if needed, to expand our business or compete effectively and, as a result, our net revenues and profitability may be materially adversely affected.

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

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

Our products are recreational in nature and are therefore discretionary purchases for consumers. Consumers are generally more willing to make discretionary purchases of golf products during favorable economic conditions. Discretionary spending is affected by many factors, including, among others, general business conditions, interest rates, the availability of consumer credit, taxation, and consumer confidence in future economic conditions. Our customers purchases of discretionary items, including our products, could decline during periods when disposable income is lower, or periods of actual or perceived unfavorable economic conditions. Any significant decline in these general economic conditions or uncertainties regarding future economic prospects that adversely affect discretionary consumer spending could lead to reduced sales of our products. In addition, our sales could be adversely affected by a downturn in the economic conditions in the markets in which our superstores operate. The general slowdown in the United States economy and the uncertain economic outlook have adversely affected consumer spending habits, which has adversely affected our net revenues. A prolonged economic downturn could have a material adverse effect on our business, financial condition, and results of operations.

Our sales and profits may be adversely affected if we and our suppliers fail to successfully develop and introduce new products.

Our future success will depend, in part, upon our and our suppliers continued ability to develop and introduce innovative products in the golf equipment market. The success of new products depends in part upon the various subjective preferences of golfers, including a golf club s look and feel, and the level of acceptance that a golf club has among professional and recreational golfers. The subjective preferences of golf club purchasers are difficult to predict and may be subject to rapid and unanticipated changes. If we or our suppliers fail to successfully develop and introduce innovative products on a timely basis, then our sales and profits may suffer.

In addition, if we or our suppliers introduce new golf clubs too rapidly, it could result in close-outs of existing inventories. Close-outs can result in reduced margins on the sale of older products, as well as reduced sales of new products given the availability of older products at lower prices. These reduced margins and sales may adversely affect our results of operations.

Our sales and profitability may be adversely affected if new competitors enter the golf products industry.

Increased competition in our markets due to the entry of new competitors, including companies which currently supply us with products that we sell, could reduce our net revenues. Our competitors currently include other specialty retailers, mass merchandise retailers, conventional sporting goods retailers, on-course pro shops, and online retailers of golf equipment. These businesses compete with us in one or more product categories. In addition, traditional and specialty golf retailers are expanding more aggressively in marketing brand-name golf equipment, thereby competing directly with us for products, customers and locations. Some of these potential competitors have been in business longer than us and/or have greater financial or marketing resources than we do and may be able to devote greater resources to sourcing, promoting and selling their products. Several of our key vendors have begun to operate retail stores or websites that sell directly to consumers and may compete with us and reduce our sales. As a result of this competition, we may experience lower sales or greater operating costs, such as marketing costs, which would have an adverse effect on our profitability.

New superstores that we may open may divert our limited capital resources away from other areas of our business and may not be profitable which could adversely affect the profitability of our company as a whole.

Our strategy involves opening additional superstores in new and existing markets. During the year ended January 3, 2004, not including stores that we acquired through our acquisition of Don Sherwood Golf Shop, we opened six new stores, incurring $0.6 million in pre-opening expenses and $3.9 million in capital expenditures. We plan to open six to eight additional stores during fiscal 2004, four of which have been opened as of March 31, 2004. Based on our experience, we expect to spend $1.3 million to open each additional superstore. This amount is an estimate and actual store opening costs may vary. We intend to fund new store openings through cash flow from operations. Our senior credit facility and the indenture governing our senior secured notes significantly restrict our ability to incur indebtedness and to make capital expenditures. We may not have or be able to obtain sufficient funds to fund our planned expansion.

Our ability to open new stores on a timely and profitable basis is subject to various contingencies, some of which are beyond our control. These contingencies include our ability to locate suitable store sites, negotiate acceptable lease terms, build-out or refurbish sites on a timely and cost-effective basis, hire, train and retain skilled managers and personnel, obtain adequate capital resources and successfully integrate new stores into existing operations. We can not assure you that our new stores will be a profitable deployment of our limited capital resources. If any of our new stores are not profitable, then the profitability of our company as a whole may be adversely affected.

Our expansion in new and existing markets, if unsuccessful, could cause our net revenues to decrease.

Our expansion in new and existing markets may present competitive, distribution, and merchandising challenges that differ from our current challenges, including competition among our stores clustered in a single market, diminished novelty of our store design and concept, added strain on our distribution center and management information systems and diversion of management attention from existing operations. To the extent that we are not able to meet these new challenges, our net revenues could decrease.

If we do not accurately predict our sales during our peak seasons and they are lower than we expect, our profitability may be materially adversely affected.

Our business is highly seasonal. Our sales during our second fiscal quarter of each year, which includes the Father s Day selling season, and during the fourth fiscal quarter, which includes the Christmas holiday selling season, have historically contributed a disproportionate percentage of our net revenues and most of our net income for the entire year. We make decisions regarding merchandise well in advance of the season in which it will be sold, particularly for the Father s Day and Christmas holiday selling seasons. We incur significant additional expenses leading up to and during our second fiscal quarter and the month of December in anticipation of higher sales in those periods, including acquiring additional inventory, preparing and mailing our catalogs, advertising, creating in-store promotions and hiring additional employees. If our sales during our peak seasons are lower than we expect for any reason, we may not be able to adjust our expenses in a timely fashion. As a result, our profitability may be materially adversely affected.

If the products we sell do not satisfy the standards of the United States Golf Association and the Royal and Ancient Golf Club of St. Andrews in the future, our net revenues attributable to those products and our profitability may be reduced.

We and our suppliers generally seek to satisfy the standards established by the United States Golf Association and the Royal and Ancient Golf Club of St. Andrews in the design of golf clubs because these standards are generally followed by golfers within their respective geographic areas. We believe that all of the products we sell conform to these standards, except where expressly marketed as non-conforming. However, we cannot assure you that our products will satisfy these standards in the future or that the standards of these organizations will not be changed in a way that makes our products non-conforming. If our products that are intended to conform are determined to be non-conforming, our net revenues attributable to those products and, as a result, our profitability may be reduced.

We lease most of our superstore locations. If we are unable to maintain those leases or locate alternative sites for our superstores on terms that are acceptable us, our net revenues and profitability could be reduced.

We lease 41 of our 42 current superstores, and 37 of our 38 superstores as of January 3, 2004. As of January 3, 2004, none of our superstores operated under a lease with a term that expires in less than one year.

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We cannot assure you that we will be able to maintain our existing store locations as leases expire, or that we will be able to locate alternative sites on favorable terms. If we cannot maintain our existing store locations or locate alternative sites on favorable or acceptable terms, our net revenues and profitability could be reduced.

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

Our comparable store sales are affected by a variety of factors, including, among others:

- customer demand in different geographic regions;
- our ability to efficiently source and distribute products;
- changes in our product mix;
- promotional events;
- effects of competition;
- our ability to effectively execute our business strategy; and
- general economic conditions.

Our comparable store sales have fluctuated significantly in the past and we believe that such fluctuations may continue. Our historic results are not necessarily indicative of our future results, and we cannot assure you that our comparable store sales will not decrease again in the future. Any reduction in or failure to increase our comparable store sales could negatively impact our future operating performance.

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

Our results of operations depend in part on the success of our catalog operations. We believe that the success of our catalog operations depends on our ability to:

- achieve adequate response rates to our mailings;
- continue to offer a merchandise mix that is attractive to our mail order customers;
- cost-effectively add new customers;
- cost-effectively design and produce appealing catalogs; and
- timely deliver products ordered through our catalogs to our customers.

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

If we are unable to meet our labor needs, our performance will suffer.

Many of our employees are in entry-level or part-time positions that historically have high rates of turnover. We may be unable to meet our labor needs and control our costs due to external factors such as unemployment levels, minimum wage legislation, and wage inflation. If we cannot attract and retain quality employees, our performance will suffer and we may not be able to successfully execute our strategy to open new superstores.

If we lose the services of key members of our management, we may not be able to manage our operations and implement our growth strategy effectively.

Our future success depends, in large part, on the continued service of James Thompson, our chief executive officer, and some of our other key executive officers and managers who possess significant expertise and knowledge of our business and markets. We do not maintain key person insurance on any of our officers or managers. Any loss or interruption of the services of these individuals could significantly reduce our ability to effectively manage our operations and implement our growth strategy because we cannot assure you that we would be able to find appropriate replacements for our key executives and managers should the need arise.

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

Atlantic Equity Partners III, L.P. owns approximately 75.1% of our common stock on a fully diluted basis, including outstanding stock options. All of our stockholders are parties to a stockholders agreement that contains voting arrangements that give Atlantic Equity Partners III voting control over the election of all but one of our directors. As a result, Atlantic Equity Partners III controls us and effectively has the power to approve any action requiring the approval of the holders of our stock, including adopting certain amendments to our certificate of incorporation and approving mergers or sales of all of our assets. In addition, as a result of Atlantic Equity Partners III s ownership interest, conflicts of interest could arise with respect to transactions involving business dealings between us and Atlantic Equity Partners III or First Atlantic Capital Ltd., which operates Atlantic Equity Partners III, potential acquisitions of businesses or properties, the issuance of additional securities, the payment of dividends by us and other matters.

If we are unable to enforce our intellectual property rights, or if we are accused of infringing on a third party s intellectual property rights, our net revenues and profits may decline.

We currently hold a substantial number of industrial designs and trademarks. The exclusive right to use these designs and trademarks has helped establish our market share. The loss or reduction of any of our significant proprietary rights could hurt our ability to distinguish our products from competitors products and retain our market share. In addition, our proprietary products generate substantially higher margins than products we sell that are produced by other manufacturers. If we are unable to effectively protect our proprietary rights and less of our sales come from our proprietary products, our net revenues and profits may decline.

Additionally, third parties may assert claims against us alleging infringement, misappropriation or other violations of patent, trademark or other proprietary rights, whether or not such claims have merit. Such claims can be time consuming and expensive to defend and could require us to cease using and selling the allegedly infringing products, which may have a significant impact on our net revenues and cause us to incur significant litigation costs and expenses.

Self-insured benefits plan claims could materially impact our results of operations.

We administer self-insured, voluntary employee benefits plans that provide, among other benefits, health care benefits to participating employees. The plans are designed to provide specified levels of coverage up to $75,000 per covered employee, with excess insurance coverage provided by a commercial insurer. Costs of health care have risen significantly in recent years, and we expect this trend to continue. Our expenses and, consequently, our results of operations, could be materially impacted by claims and other expenses related to such plans.

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

The efficient operation of our business is dependent on our management information systems. We rely on our management information systems to effectively manage order entry, order fulfillment, point-of-sale, and inventory replenishment processes. The failure of our management information systems to perform as we anticipate, as we experienced when we implemented our current system in 2000, could disrupt our business and could result in decreased sales, increased overhead costs, excess inventory and product shortages, causing our business and results of operations to suffer.

In addition, our management information systems are vulnerable to damage or interruption from:

- earthquake, fire, flood and other natural disasters; and
- power loss, computer systems failure, Internet and telecommunications or data network failure.

Any such interruption could have a material adverse effect on our business.

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

We operate a centralized call center and distribution center in Austin, Texas. We receive most of our catalog orders and receive and ship a substantial portion of our merchandise at our Austin facility. Any natural disaster or other serious disruption to this facility due to fire, tornado or any other cause would substantially disrupt our sales and would damage a portion of our inventory, impairing our ability to adequately stock our stores. In addition, we could incur significantly higher costs and longer lead times associated with fulfilling our direct-to-consumer orders and distributing our products to our stores during the time it takes for us to reopen or replace our Austin facility. As a result, disruption at our Austin facility would adversely affect our profitability.

If our suppliers fail to deliver products on a timely basis and in sufficient quantities, such failure could have a material adverse effect on our operations.

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

We import substantially all of our proprietary products from Asia, and a significant amount of the products we buy from vendors to resell through our distribution channels is shipped to us from Asia. If a disruption occurs in the operations of ports through which our products are imported, we may begin to ship some of our products from Asia by air freight, and many of our suppliers may also begin to ship their products by air freight. Shipping by airfreight is more expensive than shipping by boat, and if we cannot pass these increased shipping costs on to our customers, our profitability will be reduced. A disruption at ports through which our products are imported would have a material adverse effect on our results of operations.

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

We may be subject to risks associated with our products, including product liability. Our existing or future products may contain design or materials defects, which could subject us to product liability claims and product recalls. Although we maintain limited product liability insurance, if any successful product liability claim or product recall is not covered by or exceeds our insurance coverage, our business, results of operation and financial condition would be harmed. In addition, product recalls could adversely affect our reputation in the marketplace. In May 2002, we learned that some of our private label products sold in the last two years were not manufactured in accordance with their design specifications. Upon discovery of this discrepancy, we offered our customers refunds, replacements or gift certificates. As a result, in fiscal, 2002, we recognized $0.3 million in product return and replacement expenses. In fiscal 2003, we did not recognize any product-return and replacement expenses.

An increase in the costs of mailing, paper, and printing our catalogs would decrease our net income.

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

A disruption in the service of our primary delivery service for our direct-to-consumer sales may decrease our profitability.

During fiscal 2003, we generated approximately 34.5% of our net revenues through our direct-to-consumer sales. We use UPS for substantially all of our ground shipments of products sold through our catalogs and Internet site to our customers in the United States. Any significant interruption in UPS s services would impede our ability to deliver our products to our direct-to-consumer channel, which could cause us to lose sales and/or customers. In the event of an interruption in UPS s services, we may not be able to engage alternative carriers to deliver our products in a timely manner on equally favorable terms. If we incur higher shipping costs, we may be unable to pass these costs on to our customers, which could decrease our profitability.

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

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

If we do not anticipate and respond to the changing preferences of our customers, our revenues could significantly decline and we could be required to take significant markdowns in inventory.

Our success depends, in large part, on our ability to identify and anticipate the changing preferences of our customers and stock our stores with a wide selection of quality merchandise that appeals to their preferences. Our customers preferences for merchandise and particular brands vary from location to location, and may vary significantly over time. We cannot guarantee that we will accurately identify or anticipate the changing preferences of our customers or stock our stores with merchandise that appeals to them. If we do not accurately identify and anticipate our customers preferences, we may lose sales or we may overstock merchandise, which may require us to take significant markdowns on our inventory. In either case, our revenues could significantly decline and our business and financial results may suffer.

We may incur material costs or liabilities under environmental laws, which may materially adversely affect our results of operations.

We are subject to various foreign, federal, state, and local environmental protection, chemical control, and health and safety laws and regulations. We own and lease real property, and some environmental laws hold current or previous owners or operators of businesses and real property liable for contamination on or originating from that property, even if they did not know of and were not responsible for the contamination. The presence of hazardous substances on any of our properties or the failure to meet environmental regulatory requirements may materially adversely affect our ability to use or to sell the property or to use the property as collateral for borrowing, and may cause us to incur substantial remediation or compliance costs. If hazardous substances are released from or located on any of our properties, we could incur substantial liabilities through a private party personal injury or property damage claim or a claim by a governmental entity for other damages.

In addition, some of the products we sell contain hazardous or regulated substances, such as solvents and lead. Environmental laws may impose liability on any person who disposes of hazardous substances, regardless of whether the disposal site is owned or operated by such person.

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If we incur material costs or liabilities in the future under environmental laws for any reason, our results of operations may be materially adversely affected.

Our sales could decline if we are unable to process increased traffic to our website or to prevent unauthorized security breaches.

A key element of our strategy is to generate a high volume of traffic on, and use of, our website. Accordingly, the satisfactory performance, reliability and availability of our website, transaction processing systems and network infrastructure are critical to our reputation and our ability to attract and retain customers, as well as maintain adequate customer service levels. Our Internet revenues will depend on the number of visitors who shop on our website and the volume of orders we can fill on a timely basis. Problems with our website or order fulfillment performance would reduce the volume of goods sold and the attractiveness of our merchandise and could also adversely affect consumer perception of our brand name. We may experience periodic system interruptions from time to time. If there is a substantial increase in the volume of traffic on our website or the number of orders placed by customers, we may be required to expand and upgrade further our technology, transaction processing systems and network infrastructure. There can be no assurance that we will be able to accurately project the rate or timing of increases, if any, in the use of our website, or that we will be able to expand and upgrade our systems and infrastructure to accommodate such increases on a timely basis.

The success of our website depends on the secure transmission of confidential information over public networks. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of confidential information, such as customer credit card numbers. In addition, we maintain an extensive confidential database of customer profiles and transaction information. There can be no assurance that advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments will not result in a compromise or breach of the algorithms we use to protect customer transaction and personal data contained in our customer database. If any such compromise of our security were to occur, it could have a material adverse effect on our reputation, business, operating results and financial condition. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches.

Our acquisition of Don Sherwood Golf Shop, and any future acquisitions, could negatively affect our results of operations if unanticipated liabilities are discovered or if we fail to successfully integrate the acquired businesses into our existing operations.

We completed our acquisition of Don Sherwood Golf Shop in July 2003. Our failure to successfully address the risks associated with this acquisition could harm our ability to fully integrate and market products. We may discover liabilities and risks associated with this acquisition that were not discovered in our due diligence prior to completing the acquisition. Although a portion of the purchase price was placed in escrow to cover such liabilities, it is possible that the actual amounts required to cover such liabilities will exceed the escrow amount. Additionally, we may acquire other businesses in the future, which would complicate our management tasks. We may need to integrate widely dispersed operations that have different and unfamiliar corporate cultures. These integration efforts may not succeed or may distract management s attention from existing business operations. Our failure to successfully integrate Don Sherwood Golf Shop and future acquisitions into our existing operations could materially harm our business.

Item 2. ***Properties***

At January 3, 2004, we operated 38 stores in 12 states. We own our 41-acre Austin, Texas campus, which is home to our general offices, distribution center, call center, clubmaker training facility and Harvey Penick Golf Academy. The Austin campus also includes a golf testing and practice area. With the exception of the Austin superstore at our corporate headquarters, we lease all of our superstores. All leased premises are held under long-term leases with differing provisions and expiration dates. Leases provide for monthly rentals, typically computed on the basis of a fixed amount. Most leases contain provisions permitting us to renew for one or more specified terms. Details of our non-superstore properties and facilities are as follows:

Location	Size (sq.ft.)	Facility Type	Year Opened	Owned/ Leased
Austin, Texas	60,000	Office	1992	Owned
Austin, Texas	50,000	Warehouse	1994	Owned
Austin, Texas	140,000	Distribution Center	1999	Owned
Austin, Texas	50,000	Shipping Facility	1994	Owned
Austin, Texas	17 Acres	Driving Range and Training Facility	1992	Owned
Toronto, Canada	3,906	Direct-to-Consumer Order Fulfillment Facility	2001	Leased
St. Ives, Cambridgeshire, England	15,900	Office, Warehouse and Shipping Facility	2001	Leased

The following table shows the number of our stores by state as of January 3, 2004:

Location	Number of Stores
Arizona	2
California	11
Colorado	2
Connecticut	1
Georgia	3
Illinois	4
Michigan	3
Minnesota	1
New Jersey	1
New York	2
Ohio	1
Texas	7

Item 3. ***Legal Proceedings***

We are a party to a number of claims and lawsuits incidental to our business. We believe that the ultimate outcome of such matters, in the aggregate, will not have a material adverse impact on our financial position, liquidity or results of operations.

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

None.

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PART II

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

As of March 31, 2004, there were approximately four holders of record of our common stock and approximately 24 holders of record of our restricted common stock units, which entitle the holder thereof to shares of our common stock. Neither our common stock nor our restricted common stock units has an established public trading market.

Since the merger transaction on October 15, 2002 between us and Golfsmith, no dividends have been declared. We do not anticipate paying cash dividends on our common stock in the foreseeable future. We expect to retain all available earnings generated by our operations for the development and growth of our business. Any future determination as to the payment of dividends will be made at the discretion of our board of directors and will depend upon the general business conditions and such other factors as the board of directors deems relevant. The agreements governing our debt include provisions that restrict in most instances the payment of cash dividends on our common stock.

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Item 6. ***Selected Consolidated Financial Data***

The following selected consolidated financial data as of and for fiscal 1999, 2000, 2001 and for the period from December 30, 2001 through October 15, 2002 have been derived from the audited consolidated financial statements of Golfsmith International, Inc., and for the period from October 16, 2002 through December 28, 2002 and as of and for fiscal 2003 have been derived from the audited consolidated financial statements of Golfsmith International Holdings, Inc., all periods of which have been audited by Ernst & Young LLP. Golfsmith International Holdings, Inc. was formed on September 4, 2002 and became the parent company of Golfsmith International, Inc. on October 15, 2002 as a result of the merger. Holdings is a holding company and had no material assets or operations prior to acquiring all of the capital stock of Golfsmith International, Inc. in the merger. As a result of applying the required purchase accounting rules, the financial statements of Golfsmith International Holdings, Inc. are significantly affected. The application of purchase accounting rules results in different accounting bases and hence different financial information for the periods beginning on October 16, 2002. We refer to Golfsmith International Holdings, Inc. and all of its subsidiaries, including Golfsmith International, Inc. following the acquisition on October 15, 2002, as the successor for purposes of the presentation of financial information below. We refer to Golfsmith International, Inc. prior to being acquired by Golfsmith International Holdings, Inc. as the predecessor for purposes of the presentation of financial information below. References to any fiscal year of our company refer to the fiscal year of us or our predecessor ended or ending on the Saturday closest to December 31 of such year.

You should read the information set forth below in conjunction with our Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited consolidated financial statements and related notes included in Item 8, Consolidated Financial Statements and Supplementary Data.

As discussed in the note 21 to the accompanying consolidated financial statements, the accompanying consolidated financial statements have been restated to correct an error arising since the date of the original filing. Please read the note 21 to the accompanying consolidated financial statements for additional information about these restatements. The selected financial data that follows has been adjusted to reflect these restatements.

	Predecessor				Successor	
	Fiscal Year			Period from December 30, 2001 through October 15, 2002	Period from October 16, 2002 through December 28, 2002	Fiscal Year 2003
	1999	2000	2001	2002	2002	
				(Restated)		
	(in thousands)					
Results of Operations:						
Net revenues	$267,946	$232,080	$221,439	$180,315	$37,831	$257,745
Cost of products sold	175,600	153,630	143,118	117,206	25,147	171,083
Gross profit	92,346	78,450	78,321	63,109	12,684	86,662
Selling, general and administrative	78,360	76,352	64,081	48,308	13,581	73,400
Store pre-opening/closing expenses	493	1,592		122	93	600
Amortization of deferred compensation(1)			458	6,033		
Total operating expenses	78,853	77,944	64,539	54,463	13,674	74,000
Operating income	13,493	506	13,782	8,646	(990)	12,662
Interest expense	(5,775)	(6,905)	(6,825)	(5,206)	(2,210)	(11,157)
Interest income	22	82	597	331	7	40
Other income, net	275	449	1,031	2,365	14	164
Minority interest	(583)	454	(581)	(844)		
Loss on debt extinguishment(1)				(8,047)		

Income (loss) from continuing operations before income taxes	7,432	(5,414)	8,004	(2,755)	(3,179)	1,709
Income tax benefit (expense)	(289)	190	(251)	(709)	633	(645)

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	Predecessor				Successor	
	Fiscal Year			Period from December 30, 2001 through October 15, 2002	Period from October 16, 2002 through December 28, 2002	Fiscal Year
	1999	2000	2001	2002	2002	2003
				(Restated)		
			(in thousands)			
Income (loss) from continued operations	7,143	(5,224)	7,753	(3,464)	(2,546)	1,064
Income (loss) from discontinued operations	52	(380)	(590)	(230)	(40)	
Income (loss) before extraordinary items	7,195	(5,604)	7,163	(3,694)	(2,586)	1,064
Extraordinary items(1)				2,022		
Net income (loss)	$ 7,195	$ (5,604)	$ 7,163	$ (1,672)	$ (2,586)	$ 1,064
Other Financial Data:						
Depreciation and amortization(2)	$ 5,601	$ 9,118	$ 6,717	$ 4,808	$ 1,349	$ 5,228
Capital expenditures(3)	9,740	2,107	1,345	2,086	1,127	5,759
Balance Sheet Data (at period end):						
Cash and cash equivalents	$ 3,023	$ 11,149	$ 39,550	$ 3,788	$ 11,412	$ 2,928
Total assets	105,882	106,902	111,500	151,035	160,011	179,327
Long-term debt	23,540	37,145	33,720	75,000	75,380	77,488
Total stockholders equity	33,004	24,921	32,519	56,011	53,473	58,976

(1) As described elsewhere in this report, the consolidated financial statements contained herein have been restated to correct an error arising since the date of the original filing of our Annual Report on Form 10-K. For the period from December 30, 2001 through October 15, 2002, refer to the Introductory Note for a discussion of the restatement, to note 5 and note 14 in our consolidated financial statements for a discussion of the extraordinary items, loss on debt extinguishment and amortization of deferred compensation and note 21 for a discussion of the restatement.

(2) Excludes the amortization of the debt discount and deferred charges associated with our 12% senior subordinated notes which were outstanding prior to the merger, the deferred charges associated with our credit facility in effect prior to the merger, the amortization of the debt discount and deferred charges associated with our 8.375% senior secured notes and deferred charges associated with our senior credit facility in effect subsequent to the merger.

(3) Capital expenditures consist of total capital expenditures, including capital costs associated with opening new stores.

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

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and related notes contained in Item 8, Consolidated Financial Statements and Supplementary Data. These consolidated financial statements and the other financial information contained in this report have been restated for the predecessor period from December 30, 2001 through October 15, 2002, as discussed in Golfsmith International Holdings, Inc. Introductory Note to this Amendment No. 1 to Form 10-K and in Note 21 to our consolidated financial statements. No periods covered by our consolidated financial statements other than the predecessor period from December 30, 2001 through October 15, 2002 are affected by the restatement.

Overview

We became the parent company of Golfsmith International, Inc., or Golfsmith, on October 15, 2002 as a result of a purchase business combination, which we refer to as the merger. We have no assets or liabilities other than our investment in our wholly owned subsidiary Golfsmith and did not have assets or operations prior to our acquisition of Golfsmith. The following discussion and analysis of historical financial condition and results of operations is therefore based on the financial condition and results of operations of Golfsmith International, Inc. with respect to periods prior to the merger. The discussion for periods following the merger is based on the financial condition and results of operations of Golfsmith International Holdings, Inc.

We sell brand name golf equipment from the industry s leading manufacturers including Callaway®, FootJoy®, Ping®, Nike®, Taylor Made® and Titleist® as well as our own proprietary brands, Golfsmith®, Lynx®, Snake Eyes®, Killer Bee® and Zevo®. We sell through multiple distribution channels consisting of:

- 42 golf superstores, four of which opened subsequent to January 3, 2004;
- regular mailings of our clubmakers catalogs, which offer golf club components, and our accessory catalogs, which offer golf accessories, clothing and equipment; and
- golfsmith.com, our online e-commerce website.

We also operate a clubmaker training program and are the exclusive operator of the Harvey Penick Golf Academy, an instructional school incorporating the techniques of the well-known golf instructor, the late Harvey Penick.

Industry Trends

Sales of our products are affected by increases and declines in the golf industry as a whole. According to national publications, the golf industry is a greater than $62 billion industry, has a base of over 26 million participants in the United States and is characterized by favorable demographic trends. During 2002, total consumer golf equipment spending grew by a moderate 2% according to a national publication. We believe that since 1997, the overall worldwide premium golf club market has experienced only moderate growth in dollar volume from year to year and that from 1999 to 2003 there was no material increase in the number of rounds played. Golf Datatech has reported that during 2003, the number of golf rounds played in the United States declined 2.6% as compared to the same period in 2002. Declines in the number of rounds played in 2003 have been attributed to bad weather, the uncertainty in the U.S. economy, and golfers spending more time at work and with their families. While we are optimistic about the potential for increased rounds in 2004 that could spur increased consumer spending, we cannot assure you that declines in the U.S. economy or a reduction in discretionary consumer spending will not impede growth in the worldwide market for golf-related products, including our products.

Superstores

Our superstores range in size from 8,000 to 30,000 square feet and average approximately 18,000 square feet. Our superstores feature a wide selection of golf equipment from major brand manufacturers and also serve as the primary outlet in the United States for our proprietary branded products. Our superstores

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accounted for approximately 54.8%, 56.7% and 62.9% of our net revenues for fiscal 2001, 2002 and 2003, respectively. The revenues that we generate from our superstores are driven primarily by the number of stores in operation and changes in comparable store sales. We had 25, 26 and 38 superstores in operation as of the end of fiscal 2001, 2002 and 2003, respectively. Comparable store sales increased 7.4% and 0.1% in fiscal 2003 compared to fiscal 2002 and in fiscal 2002 compared to fiscal 2001, respectively, as discussed below in Results of Operations. We consider sales of a new store to be comparable commencing in the fourteenth month after the store was opened or acquired. We consider sales of a relocated store to be comparable if the relocated store is expected to serve a comparable customer base. We consider sales of superstores with modified layouts to be comparable. We consider sales of stores that are closed to be comparable in the period leading up to closure if they have met the qualifications of a comparable store and do not meet the qualifications to be classified as discontinued operations under Statement of Financial Accounting Standards (SFAS) No. 144.

We intend to selectively expand our existing store base in existing as well as new markets that fit our selection criteria. In fiscal 2003 we opened six stores and acquired six stores in the acquisition of Don Sherwood Golf Shop. We also plan to continue modifying selected larger superstores into a smaller, more productive layout that we believe will lower our operating costs and capital requirements while providing customers with a superior shopping environment. In fiscal 2003 all six of the new stores we opened were built in this mold of the smaller store layout. Based on our experience, we expect to spend approximately $1.3 million to open each additional superstore, which includes pre-opening expenses, capital expenditures and inventory costs, and between $0.3 million and $0.5 million to retrofit selected superstores to the smaller store layout.

Specialty Services

Over the past few years we have implemented a number of initiatives to improve our competitive position and financial performance, including closing under-performing stores, updating and remodeling existing stores, narrowing product assortments and upgrading our technology and infrastructure. While some of these initiatives have reduced sales, we believe that these actions have contributed to improved cash flow, earnings and asset management. We continue to implement new initiatives surrounding product offerings such as our Playability Guarantee program designed to insure complete customer satisfaction with our customers purchase of golf clubs; our Club Vantage program that provides the customer with separately-priced repair service on any club purchase; and the Golfsmith credit card which offers flexible payment options on any purchase. We believe our continued market expansion combined with these new initiatives have contributed to increased market presence and brand recognition, as evidenced by our comparable store sales in fiscal 2003 compared to fiscal 2002 (see discussion of comparable store sales below in Results of Operations.)

Products

The majority of our sales are comprised of golf equipment from leading manufacturers, including Callaway®, Cobra®, FootJoy®, Nike®, Ping®, Taylor Made® and Titleist®. We also sell proprietary brand equipment, component and apparel products under the Golfsmith®, Lynx®, Snake Eyes®, Black Cat®, Killer Bee®, Predator®, Tigress® and Zevo® product lines. These private label equipment lines are included in all of our sales distribution channels and generate higher gross profit margins than products we sell that are produced by other manufacturers. Sales of our proprietary brands constituted approximately 23.8, 21.9% and 17.5%, of our net revenues in fiscal 2001, 2002 and 2003, respectively.

We recognize revenue for retail sales at the time the customer takes possession of the merchandise and purchases are paid for, primarily with either cash or credit card. Catalog and e-commerce sales are recorded upon shipment of merchandise. Revenue from the Harvey Penick Golf Academy instructional school is recognized at the time the services are performed. Revenues from the sale of gift certificates are recorded upon the redemption of the gift certificate for the purchase of tangible products at the time the customer takes possession of the merchandise.

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Our business is seasonal. Our sales during the Christmas holiday selling season and during and leading up to the Father s Day selling season have historically contributed a higher percentage of our annual net revenues and annual operating income than other periods in our fiscal year. During fiscal 2003, the fiscal months of June and December, which together consisted of 11 weeks of our 53-week fiscal year and included the Father s Day and Christmas holiday selling seasons, contributed over one-quarter of our annual net revenues and over one-half of our annual operating income.

We capitalize inbound freight and vendor discounts into inventory upon receipt of inventory. These costs are then subsequently included in cost of goods sold upon the sale of that inventory. Because some retailers exclude these costs from cost of goods sold, and instead include them in a line item like selling and administrative expenses, our gross margins may not be comparable to those of these other retailers.

Our fiscal year ends on the last Saturday closest to December 31 and generally consists of 52 weeks, though occasionally our fiscal years will consist of 53 weeks. This occurred in fiscal 2003. References to fiscal 2002 refer to the combined financial results of our predecessor from December 30, 2001 through October 15, 2002 and of Holdings from October 16, 2002 through December 28, 2002. The presentation of combined fiscal 2002 financial results is not in accordance with generally accepted accounting principles and is presented only for comparison purposes. Fiscal 2002 consisted of 52 weeks. Each quarter of each fiscal year generally consists of 13 weeks.

Impact of Merger

On October 15, 2002, BGA Acquisition Corp., a wholly owned subsidiary of Golfsmith International Holdings, Inc., merged with and into Golfsmith International, Inc. We accounted for the merger under the purchase method of accounting for business combinations. In accordance with the purchase method of accounting, in connection with the merger, we allocated the excess purchase price over the fair value of our net assets between a write-up of certain of our assets, which reflect an adjustment to the fair values of these assets, and goodwill. The assets that have had their fair values adjusted include inventory, property and equipment, and certain intangible assets.

As a result of applying the required purchase accounting rules, our financial statements are significantly affected. The application of purchase accounting rules results in different accounting bases and hence financial information for the periods beginning on October 16, 2002. The term successor refers to Golfsmith International Holdings, Inc. and all of its subsidiaries, including Golfsmith International, Inc. following the acquisition on October 15, 2002. The term predecessor refers to Golfsmith International, Inc. prior to being acquired by Holdings.

Immediately prior to the merger, we repaid in full our 12% senior subordinated notes for $34.4 million and terminated our then existing revolving credit facility. Deferred debt financing costs of $1.6 million were written-off in connection with the termination of these agreements. We sold 8.375% senior secured notes due 2009 with an aggregate principal amount at maturity of $93.75 million for gross proceeds of $75.0 million in a private placement offering to finance part of the cash portion of the merger consideration, and entered into a new senior credit facility to fund our future working capital requirements and for general corporate purposes as described below in Liquidity and Capital Resources Credit Facility.

As a result of the merger and the offering of the notes, we currently have total debt in amounts substantially greater than our historical levels. This amount of debt and associated debt service costs will lower our net income and cash provided by operating activities and will limit our ability to obtain additional debt financing, fund capital expenditures or operating requirements, open new or retrofit existing stores, and make acquisitions.

Historically, we operated as a Subchapter S corporation under the Internal Revenue Code. Consequently, we were not generally subject to federal income taxes because our stockholders included our income in their personal income tax returns. Simultaneously with the completion of the merger, we converted from a Subchapter S corporation to a Subchapter C corporation and consequently became subject to federal income taxes from that date. This conversion will lower our future net income and cash provided by operating activities.

In connection with the merger, all stock options held by our employees vested and were either canceled in exchange for the right to receive cash or surrendered in exchange for stock units. As a result, we incurred a non-cash compensation charge of $4.6 million which was equal to the difference between the market value of its common stock and the exercise price of these options at that vesting date. Total non-cash compensation expense for fiscal 2002 and fiscal 2003 was $6.0 million and $0, respectively. As all options were either canceled in exchange for the right to receive cash or surrendered in exchange for stock units concurrent with the merger, there is no future amortization expense associated with these pre-merger options. For further information about our stock-based compensation, see Note 1 and Note 14 to our audited consolidated financial statements included in this Amendment No. 1 to Form 10-K.

Business Combinations Don Sherwood Golf Shop

On July 24, 2003, we acquired all of the issued and outstanding shares of Don Sherwood Golf Shop, which we refer to as Sherwood, for a total purchase price of $9.2 million, including related acquisition costs of $0.4 million. We believe that the Sherwood acquisition supports our goal of expanding our national presence while gaining exposure to one of the country s top golf markets in San Francisco, California. We acquired all six Sherwood retail stores as part of the acquisition. The operations of Sherwood stores are included in our statements of operations and cash flows as of July 25, 2003 and do not result in any new segments for us.

In conjunction with the acquisition of Sherwood, Holdings issued 1,433,333 shares of its common stock to existing stockholders, including its majority stockholder, for consideration of $4.3 million. The proceeds from the issuance of common stock were used to fund a portion of the purchase price of the acquisition of Sherwood. The issuance of these additional shares increased Holdings majority stockholder s 79.7% controlling interest to an 80.9% controlling interest, including issued restricted common stock units, which entitle the holders to shares of common stock of Holdings, and excluding outstanding stock options. At January 3, 2004, our majority stockholder held a majority interest of 75.1% of our common stock on a fully diluted basis, including outstanding stock options.

The total purchase consideration has been allocated to the assets acquired and liabilities assumed, including property and equipment, inventory and identifiable intangible assets, based on their respective fair values at the date of acquisition. This allocation resulted in goodwill of $6.4 million. Goodwill is assigned at the reporting unit level and is not deductible for income tax purposes.

Contingent consideration of $1.3 million was placed in an escrow account by us to secure certain indemnification obligations of the selling shareholder. The escrow funds will be released upon the earlier of one year from the acquisition date or 90 days after our audited financial statements for fiscal 2003 are completed.

Critical Accounting Policies and Estimates

Management s discussion and analysis of financial condition and results of operations is based on 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, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. The estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and other various factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

We believe the following critical accounting policies, as have been discussed with our audit committee, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

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Inventory Valuation

Inventory value is presented as a current asset on our balance sheet and is a component of cost of products sold in our statement of operations. It therefore has a significant impact on the amount of net income reported in any period. Merchandise inventories are carried at the lower of cost or market. Cost is the sum of expenditures, both direct and indirect, incurred to bring inventory to its existing condition and location. Cost is determined using the weighted-average method. We estimate a reserve for damaged, obsolete, excess and slow-moving inventory and for inventory shrinkage due to anticipated book-to-physical adjustments. We periodically review these reserves by comparing them to on-hand quantities, historical and projected rates of sale, changes in selling price and inventory cycle counts. Based on our historical results, using various methods of disposition, we estimate the price at which we expect to sell this inventory to determine the potential loss if those items are later sold below cost. The carrying value for inventories that are not expected to be sold at or above costs are then written down. A significant adjustment in these estimates or in actual sales may have a material adverse impact on our net income. Shrink reserves are booked on a monthly basis at 0.5% to 1.0% of net revenues depending on the distribution channel (direct-to-consumer channel or retail channel) in which the sales occur. Inventory shrink expense recorded in the statements of operations in fiscal 2002 and 2003 was 0.55% and 0.66% of net revenues, respectively. Inventory shrink expense recorded is a result of physical inventory counts made during these respective periods and reserve amounts recorded for periods outside of the physical inventory count dates. These reserve amounts are based on management s estimates of shrink expense using historical experience.

Long-lived Assets, Including Goodwill and Identifiable Intangible Assets

We evaluate the impairment of the book value of our indefinite lived intangibles and related goodwill in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. We evaluate impairment annually, as well as whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be recoverable based on a combination of our projection of estimated future discounted cash flows and other valuation methodologies. We evaluate the impairment of the book value of our long-lived assets including intangible assets subject to amortization in accordance with SFAS No. 144, *Impairment of Long-Lived Assets*, based on our projection of estimated future undiscounted cash flows whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be recoverable. Factors that are considered by management in performing this assessment include, but are not limited to, our performance relative to our projected or historical results, our intended use of acquired assets and our strategy for our overall business, as well as industry and economic trends. In the event that the book value of intangibles, long-lived assets and related goodwill is determined to be impaired, such impairments are measured using a combination of a discounted cash flow valuation, with a discount rate determined to be commensurate with the risk inherent in our current business model, and other valuation methodologies. To the extent these future projections or our strategies change, our estimates regarding impairment may differ from our current estimates. In accordance with SFAS No. 142, we determined that our recorded tradename and trademarks have indefinite useful lives and therefore are not amortized. Based on our analyses, no impairment of long-lived assets, including goodwill and identifiable intangible assets, was recorded in either fiscal 2002 or fiscal 2003.

Product Return Reserves

We reserve for product returns based on estimates of future sales returns related to our current period sales. We analyze historical returns, current economic trends and changes in customer acceptance of our products when evaluating the adequacy of the reserve for sales returns. Any significant increase in merchandise returns that exceeds our estimates could adversely affect our operating results. In addition, we may be subject to risks associated with defective products, including product liability. Our current and future products may contain defects, which could subject us to higher defective product returns, product liability claims and product recalls. Because our allowances are based on historical return rates, we cannot assure you that the introduction of new merchandise in our stores or catalogs, the opening of new stores, the introduction of new catalogs, increased sales over the Internet, changes in the merchandise mix or other factors will not cause actual returns to exceed return allowances. We book reserves on a monthly basis at 2% to 10% of net revenues depending on the distribution channel in which the sales occur. We routinely compare actual experience to current reserves and make any necessary adjustments.

Store Closure Costs

When we decide to close a store and meet the applicable accounting guidance criteria, we recognize an expense related to the future net lease obligation, non-recoverable investments in related fixed assets and other expenses directly related to the discontinuance of operations in accordance with SFAS No. 146, *Accounting For Costs Associated With Exit or Disposal Activities*. These charges require us to make judgments about exit costs to be incurred for employee severance, lease terminations, inventory to be disposed of, and other liabilities. The ability to obtain agreements with lessors, to terminate leases or to assign leases to third parties can materially affect the accuracy of these estimates.

We closed two stores in fiscal 2000, one store in fiscal 2001 and two stores in fiscal 2002. These stores were selected for closure by evaluating the historical and projected financial performance of all of our stores in accordance with our store strategy. In each case, the stores that have been closed were our only store in that market, had a sub-lessor or assignee available to take over use and payments of the leased property and were substantially larger in size than our current store prototype, which we put into service in fiscal 2002. We did not close any stores in fiscal 2003. We do not currently have any plans to close any additional stores, although we regularly evaluate our stores and the necessity to record expenses under SFAS No. 146.

Deferred Tax Assets

Current income tax expense is the amount of income taxes expected to be payable for the current year. A deferred income tax asset or liability is established for the expected future consequences resulting from temporary differences in the financial reporting and tax bases of assets and liabilities. We provide a valuation allowance for our deferred tax assets when, in the opinion of management, it is more likely than not that such assets will not be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax asset in the future as a result of net losses, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Recently Issued Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), which was revised in December 2003 (FIN 46(R)). FIN 46(R) requires that companies consolidate a variable interest entity if they are subject to a majority of the risk of loss from the variable interest entity s activities or are entitled to receive a majority of the entity s residual returns, or both. The provisions of FIN 46(R) currently are required to be applied no later than the first reporting period ending after March 15, 2004 for variable interest entities. We have no special purpose entities, nor have we acquired a variable interest in an entity where we are the primary beneficiary. The adoption of FIN 46(R) did not have a material impact on our financial condition, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.* SFAS No. 150 establishes standards on the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The provisions of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003 and to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material impact on our financial condition, results of operations or cash flows.

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Results of Operations

Successor Fiscal 2003 Compared to Combined Fiscal 2002

References to fiscal 2002 refer to the combined financial results of our predecessor from December 30, 2001 through October 15, 2002 and of Holdings from October 16, 2002 through December 28, 2002. The presentation of combined fiscal 2002 financial results is not in accordance with generally accepted accounting principles and is presented only for comparison purposes. In conjunction with the acquisition of Golfsmith, Golfsmith, being the surviving wholly owned subsidiary of Holdings, issued the 8.375% senior secured notes at a 20% discount off of face value for gross proceeds of $75.0 million.

We had net revenues of $257.7 million, operating income of $12.7 million and net income of $1.1 million in fiscal 2003 compared to net revenues of $218.1 million, operating income of $7.7 million and a net loss of $4.3 million in fiscal 2002.

The $39.6 million increase in net revenues from fiscal 2002 to fiscal 2003 was mostly comprised of a $9.1 million increase, or 7.4%, in comparable store revenues and a $29.4 million increase in non-comparable store revenues from twelve additional retail stores in operation in fiscal 2003, including six stores acquired in the acquisition of Don Sherwood Golf Shop. Direct-to-consumer channel revenues increased $0.9 million, or 1.0%, from fiscal 2002 to fiscal 2003. International revenues increased $0.2 million, or 4.0%, from fiscal 2002 to fiscal 2003.

For fiscal 2003, gross profit was $86.7 million, or 33.7% of net revenues, compared to $75.8 million, or 34.8% of net revenues, for fiscal 2002. Increased net revenues in fiscal 2003 compared to fiscal 2002 led to higher gross profits for fiscal 2003. The decline in gross profit percentage resulted principally from higher sales in lower margin merchandise categories such as equipment. In addition, shipping costs increased and shipping income did not materially change from fiscal 2002 to fiscal 2003 as a result of multiple sales promotions during fiscal 2003 which were designed to drive revenues, resulting in a $0.9 million decrease in gross profit. We also incurred approximately $0.7 million of non-recurring costs included in cost of goods sold resulting from the fair value adjustment made to inventory as part of the merger transaction in October 2002.

Selling, general and administrative expenses increased $11.5 million to $73.4 million for fiscal 2003 from $61.9 million for fiscal 2002. We had twelve additional retail stores in operation during fiscal 2003 compared to fiscal 2002, including six stores acquired in the acquisition of Don Sherwood Golf Shop on July 24, 2003, resulting in an increase in selling, general and administrative expenses of $7.3 million. In fiscal 2003, we also incurred increased costs relating to and resulting from the merger transaction on October 15, 2002, including a $0.6 million increase in depreciation and amortization resulting from the fair value adjustments made as part of the merger transaction. Additionally, in fiscal 2003 we incurred increased expenses of $0.9 million related to professional fees associated with our filings with the Securities and Exchange Commission and other company initiatives, $0.5 million related to management fees paid to our majority stockholder, $2.2 million related to salaries and benefits, $1.5 million related to occupancy costs such as rent and utilities, and $0.3 million related to advertising expenses. These increases were offset by a $1.8 million decrease in depreciation expense in fiscal 2003 compared to fiscal 2002.

During fiscal 2003, we incurred approximately $0.6 million in pre-opening expenses related to the opening of six new retail locations in fiscal 2003. During fiscal 2002, we closed two stores and opened three stores. The two closed stores accounted for $2.0 million in net revenues and $0.3 million in operating losses in fiscal 2002. Store closure expenses were $0.3 million in fiscal 2002. Store closure expenses for stores closed in 2002 are reflected in discontinued operations in accordance with SFAS No. 144, *Impairment of Long-Lived Assets*. We incurred approximately $0.2 million in store pre-opening expenses in fiscal 2002.

Amortization of deferred compensation was approximately $6.0 million for fiscal 2002. Deferred compensation is related to the accounting for stock options under variable plan accounting guidance. These non-cash charges did not exist in fiscal 2003 due to all remaining outstanding options becoming vested and being either canceled in exchange for the right to receive cash or surrendered in exchange for stock units on the merger date of October 15, 2002. See Impact of Merger above for further discussion.

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For fiscal 2002, interest expense consisted of costs related to our 12% senior subordinated notes, a mortgage note and a bank line of credit. Immediately prior to the merger in October 2002, we repaid the senior subordinated notes and other pre-existing debt and a new line of credit was put in place. Interest expense was $11.2 million and $7.4 million in fiscal 2003 and 2002, respectively. Interest expense increased as debt balances during fiscal 2003 were almost three times higher than during most of fiscal 2002. Approximately $0.9 million of amortization of debt issuance costs resulting from the new senior secured notes and senior credit facility during fiscal 2003 as compared to approximately $0.6 million of amortization of debt issuance costs related to the senior subordinated notes and prior credit facility during fiscal 2002 also contributed to the increase in interest expense. For further discussion, see Liquidity and Capital Resources Senior Secured Notes and Liquidity and Capital Resources Credit Facility below. Interest income was approximately $40,000 and $0.3 million in fiscal 2003 and 2002, respectively. The decrease in interest income was the result of overall lower cash and cash equivalent balances combined with lower interest rates.

Other income, net of other expenses was approximately $164,000 for fiscal 2003, compared to other income, net of other expenses of $2.4 million for fiscal 2002. In March 2002, the rights to certain intellectual property were sold for gross proceeds of $3.3 million, resulting in a $2.2 million gain which accounts for most of the difference.

On October 15, 2002, immediately prior to the merger, we repaid in full our 12% senior subordinated notes. We recorded a loss of $8.0 million on the extinguishment of this debt, as reported in continuing operations.

We recognized a loss of $0.3 million in fiscal 2002 from discontinued operations related to the operations and final closing costs associated with closing two retail locations during fiscal 2002 due to poor operating performance and the lack of market penetration being derived from these single-store markets. Store closure costs include writedowns of remaining leasehold improvements and store equipment to estimated fair values and lease termination costs. We recorded a loss on the disposal of these assets in fiscal 2002 of $0.3 million, which is reported in discontinued operations under the accounting guidance of SFAS No. 144, *Impairment of Long-Lived Assets*. All related assets and liabilities for this location have been eliminated from each of the consolidated balance sheets included in this prospectus. We did not close or determine any stores to be discontinued during fiscal 2003.

Minority interest expense during fiscal 2002 of $0.8 million relates to an obligation that was associated with partnership interests issued in 1998. Immediately prior to the merger, we repurchased this minority interest obligation. The minority interest obligation had a carrying value of $13.1 million and was repurchased for $9.0 million, resulting in a $2.1 million write-down of long term assets associated with the minority interest and the recording of $2.0 million in negative goodwill during the fourth quarter of fiscal 2002.

Historically, we elected to be treated as a Subchapter S Corporation under the Internal Revenue Code. Consequently, we were not generally subject to federal income taxes because our stockholders included our income in their personal income tax returns. Concurrently with the completion of the merger, we converted from a Subchapter S corporation to a Subchapter C corporation and consequently became subject to federal income taxes from that date. For fiscal 2003, our income tax expense was $0.6 million, which consisted of federal, state and foreign taxes for a consolidated 38% tax rate, compared to income tax expense of $0.1 million for fiscal 2002 which related to our European and Canadian operations as well as certain state income taxes.

Combined Fiscal 2002 Compared to Predecessor Fiscal 2001

References to fiscal 2002 refer to the combined financial results of our predecessor from December 30, 2001 through October 15, 2002 and of Holdings from October 16, 2002 through December 28, 2002. The presentation of combined fiscal 2002 financial results is not in accordance with generally accepted accounting principles and is presented only for comparison purposes.

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We had net revenues of $218.1 million, operating income of $7.7 million and a net loss of $4.3 million in fiscal 2002 compared to net revenues of $221.4 million, operating income of $13.8 million and net income of $7.2 million in fiscal 2001.

The $3.3 million decline in net revenues from fiscal 2001 to fiscal 2002 was due to one store that closed in July 2001 and therefore did not contribute to 2002 revenues, accounting for a reduction in revenues of $1.3 million, combined with a $4.7 million reduction in revenues in our direct-to-consumer channels. We believe that the decline in our revenues in our direct-to-consumer channels from fiscal 2001 to fiscal 2002 was related to the timing and circulation levels of our catalog mailings. These revenue declines were partially offset by the opening of three new stores in fiscal 2002, resulting in $2.2 million in revenues, as well as an increase in international revenues of $0.5 million. Revenues from comparable stores remained consistent with a 0.1% increase from fiscal 2001 to fiscal 2002.

In fiscal 2002, gross profit was $75.8 million, or 34.8% of net revenues, compared to $78.3 million, or 35.4% of net revenues, in fiscal 2001. Gross profit declined due to the lower net revenues and lower gross profit margins resulting principally from higher sales in lower margin merchandise categories such as equipment.

Selling, general and administrative expenses, excluding store pre-opening/closing expenses, decreased $2.2 million to $61.9 million in fiscal 2002 from $64.1 million in fiscal 2001. The decrease was the result of improvements in management of administrative expenses, which decreased by $2.6 million, as well as a reduction in store payroll, which decreased by $0.2 million. Those reductions were partially offset by a $0.6 million increase in advertising expense.

During fiscal 2002, we closed two stores, one in January and one in May, opened one store in June and opened two stores in November. The two closed stores accounted for $2.0 million and $7.8 million in net revenues and $0.3 million and $0.6 million in operating loses in fiscal 2002 and 2001, respectively. Store closure expenses were $0.3 million and $0.7 million in fiscal 2002 and 2001, respectively. Store closure expenses for stores closed in 2002 are reflected in discontinued operations in accordance with SFAS No. 144, *Impairment of Long-Lived Assets*. We incurred approximately $0.2 million in store pre-opening expenses in fiscal 2002.

Amortization of deferred compensation increased $5.5 million to $6.0 million in fiscal 2002 compared to $0.5 million in 2001. Deferred compensation is related to the accounting for stock options under variable plan accounting guidance. These non-cash charges increased over the prior year due to all remaining outstanding options becoming vested on the merger date of October 15, 2002. See Impact of Merger above for further discussion.

For all of fiscal 2001 and a majority of fiscal 2002, interest expense consisted of costs related to our 12% senior subordinated notes, a mortgage note and our prior credit facility. Immediately prior to the merger in October 2002, we repaid our senior subordinated notes and other pre-existing debt with the net proceeds from our senior secured notes, which were $67.9 million. Interest expense was $7.4 million and $6.8 million for fiscal 2002 and fiscal 2001, respectively. Interest expense increased as a result of increased borrowings in fiscal 2002 compared to fiscal 2001. The senior subordinated notes and borrowings under our prior credit facility were repaid in connection with the merger in October 2002 and a new line of credit and the senior secured notes were put in place. For further discussion, see Liquidity and Capital Resources Senior Secured Notes and Liquidity and Capital Resources Credit Facility below. In fiscal 2002 and fiscal 2001, interest income was $0.3 million and $0.6 million, respectively.

Other income, net of other expenses was $2.4 million in fiscal 2002, compared to other income, net of other expenses of $1.0 million for fiscal 2001. The increase is due primarily to a gain on the sale of assets. In March 2002, the rights to certain intellectual property were sold for gross proceeds of $3.3 million, resulting in a $2.2 million gain. In March 2001, unutilized real estate adjacent to our Austin facilities was sold, which resulted in a $1.1 million gain.

On October 15, 2002, immediately prior to the merger, we repaid in full our 12% senior subordinated notes. We recorded a loss of $8.0 million on the extinguishment of this debt, as reported in continuing operations.

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We recognized a loss of $0.3 million and $0.6 million in fiscal 2002 and 2001, respectively, from discontinued operations related to the operations and final closing costs associated with closing two retail locations in fiscal 2002 due to poor operating performance and the lack of market penetration being derived from these single-market stores. We recorded a loss on the disposal of these assets in fiscal 2002 of $0.3 million, which is reported in discontinued operations under the accounting guidance of SFAS No. 144, *Impairment of Long-Lived Assets*. All related assets and liabilities for these two locations have been eliminated from the consolidated balance sheets included in this prospectus.

Minority interest expense during fiscal 2002 of $0.8 million and during fiscal 2001 of $0.6 million relates to an obligation that was associated with partnership interests issued in 1998. Immediately prior to the merger, we repurchased this minority interest obligation. The minority interest obligation had a carrying value of $13.1 million and was repurchased for $9.0 million, resulting in a $2.1 million write-down of long term assets associated with the minority interest and the recording of $2.0 million in negative goodwill during the fourth quarter of fiscal 2002. In accordance with SFAS No. 141, *Business Combinations*, this gain was recorded on the statement of operations as an extraordinary item in fiscal 2002.

Historically, we elected to be treated as a Subchapter S Corporation under the Internal Revenue Code. Consequently, we were not generally subject to federal income taxes because our stockholders included our income in their personal income tax returns. For fiscal 2002, income tax expense was $0.1 million compared to income tax expense of $0.3 million for fiscal 2001, related to our European and Canadian operations as well as certain state income taxes.

Liquidity and Capital Resources

Cash Flows

As of January 3, 2004, we had $2.9 million in cash and cash equivalents, working capital of $18.3 million and outstanding debt obligations of $78.9 million. We had $8.6 million in borrowing availability under our credit facility as of January 3, 2004.

Operating Activities

Net cash provided by operating activities was $1.1 million for fiscal 2003, compared to $20.2 million in net cash provided by operating activities for fiscal 2002. This decrease in net cash provided by operations during fiscal 2003 as compared to fiscal 2002 is primarily attributable to additional cash of $13.4 million used to fund working capital requirements during fiscal 2003 as compared to fiscal 2002 as we utilized cash to grow and expand operations. Additional cash of approximately $16.5 million was used during fiscal 2003 as compared to fiscal 2002 to fund normal inventory requirements. These requirements were primarily the result of having twelve additional retail stores in operation subsequent to fiscal 2002 combined with an increased effort to be better stocked in all retail stores during fiscal 2003. The cash used to fund inventory requirements was offset by an increase of $3.1 million in cash generated from working capital accounts during fiscal 2003 as compared to fiscal 2002. In addition, in fiscal 2002 we recognized certain non-recurring non-cash expenses, net of gains, totaling $10.7 million that were additive to the fiscal 2002 net loss in determining fiscal 2002 net cash provided by operating activities. These combined decreases in net cash provided by operating activities in fiscal 2003 compared to fiscal 2002 were offset by the fact that we generated net income of $1.1 million in fiscal 2003 compared to a net loss of $4.3 million in fiscal 2002.

Investing Activities

Net cash used in investing activities was $15.3 million for fiscal 2003, compared to net cash provided by investing activities of $0.1 million for fiscal 2002. Net cash used in investing activities for fiscal 2003 of $15.3 million was the result of capital expenditures of $5.8 million, $0.9 million related to asset purchases, and $8.6 million related to our acquisition of Don Sherwood Golf Shop. In fiscal 2003, capital expenditures were comprised of $5.2 million for new and existing stores and $0.6 million for corporate projects. Net cash provided by investing activities for fiscal 2002 of $0.1 million was the result of proceeds from the sale of certain intellectual property of $3.3 million, which was partially offset by $3.2 million in capital expenditures. In fiscal

2002, capital expenditures were comprised of $2.7 million for new and existing stores and $0.5 million for corporate projects.

Financing Activities

Net cash provided by financing activities was $5.6 million for fiscal 2003, compared to net cash used in financing activities of $48.5 million for fiscal 2002. Net cash provided by financing activities for fiscal 2003 of $5.6 million was comprised of proceeds from a line of credit of $1.4 million, net of payments, $4.3 million in proceeds from the issuance of common stock primarily related to the purchase of Don Sherwood Golf Shop, offset by $0.1 million relating to payments of debt issuance costs and notes payable. Net cash used in financing activities in fiscal 2002 of $48.5 million was comprised of principal payments on long-term debt of $41.7 million, payments to satisfy debt and minority interest obligations of $10.6 million, distributions to stockholders of $35.9 million as a result of the merger in October 2002 discussed above and dividends paid to stockholders of $3.5 million. We received proceeds of $43.2 million from the issuance of common stock associated with the merger.

Senior Secured Notes

On October 15, 2002, we completed a private placement of $93.75 million aggregate principal amount at maturity of our 8.375% senior secured notes due 2009 for gross proceeds of $75.0 million. In July 2003, we conducted an exchange offer in which we offered to exchange new senior secured notes registered under the Securities Act of 1933 for all of our eligible existing senior secured notes. The terms of the new notes are substantially identical as those issued in the private placement, except the new notes are freely tradable. Holdings fully and unconditionally guarantees the notes. As a result of the covenants in the indenture governing the notes, our ability to borrow under the credit facility described below is restricted to a maximum of $12.5 million and the payment of dividends or repurchases of stock are limited. The proceeds from the sale of the notes were used to pay part of the cash portion of the merger consideration and for fees and expenses of the offering and merger.

Within 120 days after the end of each fiscal year, we are required by the indenture governing the notes to offer to repurchase the maximum principal amount of notes that may be purchased with 50% of our excess cash flow from our previous fiscal year at a purchase price of 100% of the accreted value of the notes to be purchased. The indenture governing the notes defines excess cash flow as consolidated