

CALLAWAY GOLF CO
Form 10-K
February 28, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .

Commission file number 1-10962

Callaway Golf Company

(Exact name of registrant as specified in its charter)

Delaware

95-3797580

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(State or other jurisdiction of
incorporation or organization)

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

2180 Rutherford Road
Carlsbad, CA 92008
(760) 931-1771

(Address, including zip code, and telephone number, including area code, of principal executive offices)

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

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value per share	New York Stock Exchange

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

None

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

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

(Do not check if a smaller reporting company)

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

As of June 29, 2007, the aggregate market value of the Registrant's Common Stock held by nonaffiliates of the Registrant was \$1,227,008,320 based on the closing sales price of the Registrant's Common Stock as reported on the New York Stock Exchange. Such amount was calculated by excluding all shares held by directors and executive officers, shares held in treasury, and shares held by the Company's grantor stock trust without conceding that any of the excluded parties are affiliates of the Registrant for purposes of the federal securities laws.

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As of January 31, 2008, the number of shares of the Registrant's Common Stock outstanding was 66,279,762, and there were no shares of the Registrant's Preferred Stock outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the Registrant's 2008 Annual Meeting of Shareholders, which is scheduled to be held on May 20, 2008. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the Registrant's fiscal year ended December 31, 2007.

Important Notice to Investors: *Statements made in this report that relate to future plans, events, liquidity, financial results or performance including statements relating to future dividends, cash flows and liquidity, as well as estimated unrecognized compensation expense, projected capital expenditures, and future contractual obligations, are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are based upon current information and expectations. Actual results may differ materially from those anticipated if the information on which those estimates was based ultimately proves to be incorrect or as a result of certain risks and uncertainties, including delays, difficulties, changed strategies, or unanticipated factors including those affecting the implementation of the Company's gross margin initiatives, as well as the general risks and uncertainties applicable to the Company and its business. For details concerning these and other risks and uncertainties, see Part I, Item 1A, Risk Factors contained in this report, as well as the Company's other reports on Forms 10-K, 10-Q and 8-K subsequently filed with the Securities and Exchange Commission from time to time. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Investors should also be aware that while the Company from time to time does communicate with securities analysts, it is against the Company's policy to disclose to them any material non-public information or other confidential commercial information. Furthermore, the Company has a policy against distributing or confirming financial forecasts or projections issued by analysts and any reports issued by such analysts are not the responsibility of the Company. Investors should not assume that the Company agrees with any report issued by any analyst or with any statements, projections, forecasts or opinions contained in any such report.*

Callaway Golf Company Trademarks: *The following marks and phrases, among others, are trademarks of Callaway Golf Company: A Better Game By Design A Passion For Excellence Apex Ben Hogan BH Big Bertha Black Series Callaway Callaway Collection Callaway Golf Callaway Golf Drysport Chev Chevron Device Complete Demonstrably Superior and Pleasingly Different Dimple-in-Dimple Dual Force ERC Explosive Distance.Amazing Soft Feel Flying Lady Ft-i FTi-brid FT-3 FT-5 Freak-Fusion Game Series Gems Great Big Bertha Heavenwood Hogan HX Hot Hx Hot Bite HX Pearl HX Tour Hyper X-IMIX Little Ben Marksman Molitor Number One Putter in Golf Odyssey OptiFit-ORG.14 Rossie S2H2 Sabertooth SRT SenSert Speed Slot Squareway Steelhead Strata Stronomic Sure-Out TF design T Series Top-Flite Top-Flite D2 Top-Flite XL Tour Authentic Tour Deep Tour i Tour iX Trade In! Trade Up! TriBall Tru Bore Tunité VFT War Bird Warbird WarmSport White Hot White Hot Tour White Hot XG White Steel Windsport World's Friendliest X-20 X-20 Tour X460 XL 3000 Series XL Extreme X-Forged X Hot X-Series X-Sole X-SPANN Xtra Traction Technology X-Tour XTT Xtra Width Technology XWT.*

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PART I

Item 1. Business

Callaway Golf Company (the Company or Callaway Golf) was incorporated in California in 1982 and reincorporated in Delaware on July 1, 1999. In 1997, the Company acquired substantially all of the assets of Odyssey Sports, Inc., which manufactured and marketed the Odyssey brand of putters and wedges. In 1998, the Company began a reorganization of its international operations by acquiring the distribution rights in certain key international markets. As a result, during 1998 through 2001, the Company acquired distribution rights and substantially all of the assets from its distributors in Japan, France, Belgium, Norway, Denmark, Germany, Japan, Ireland, Spain, Canada, Korea and Australia. In 2000, the Company entered the golf ball business with the release of its first golf ball product. In 2003, the Company acquired through a court-approved sale substantially all of the golf-related assets of the TFGC Estate Inc. (f/k/a The Top-Flite Golf Company, f/k/a Spalding Sports Worldwide, Inc.), which included golf ball manufacturing facilities, the Top-Flite and Ben Hogan brands, and all golf-related patents and trademarks (the Top-Flite Acquisition). Beginning in 2001, the Company and its participating retailers partnered with FrogTrader, Inc. to develop the Trade In! Trade Up! program. In 2004, the Company acquired all of the issued and outstanding shares of stock of FrogTrader, Inc. (which subsequently changed its name to Callaway Golf Interactive, Inc.). The Company acquired FrogTrader to stimulate purchases of new clubs by growing its Trade In! Trade Up! program and to enable the Company to better manage the distribution of pre-owned golf clubs. The Company currently has the following wholly-owned operating subsidiaries: Callaway Golf Sales Company, Callaway Golf Ball Operations, Inc. (f/k/a The Top-Flite Golf Company), Callaway Golf Interactive, Inc., Callaway Golf Europe Ltd., Callaway Golf K.K., Callaway Golf Korea Ltd., Callaway Golf Canada Ltd., Callaway Golf South Pacific PTY Ltd., and Callaway Golf (Shanghai) Trading Company, Ltd.

The Company, together with its subsidiaries, designs, manufactures and sells high quality golf clubs (drivers, fairway woods, hybrids, irons, wedges and putters) and golf balls. The Company also sells golf accessories such as golf bags, golf gloves, golf headwear, golf footwear, golf towels and golf umbrellas. The Company generally sells its products to golf retailers (including pro shops at golf courses as well as off-course retailers), sporting goods retailers and mass merchants, directly and through its wholly-owned subsidiaries, and to third party distributors. The Company also sells pre-owned golf products through its website, www.callawaygolfpreowned.com. In addition, in November of 2006, the Company launched an online store, where consumers can place an order for Callaway Golf, Top-Flite, Ben Hogan and Odyssey products through its website Shop.CallawayGolf.com and have the order fulfilled by a local participating retailer or in certain circumstances, by the Company. The Company's products are sold in the United States and in over 100 countries around the world. The Company's products are designed for the enjoyment of both amateur and professional golfers. Golfers generally purchase the Company's products on the basis of performance, ease of use, brand recognition and appearance. In addition, the Company licenses its trademarks and service marks in exchange for a royalty fee to third parties for use on products such as golf apparel, watches, rangefinders, practice aids, travel gear and eyewear. The Company's business is seasonal and as a result approximately two-thirds of its sales and most, if not all, of its profitability occur during the first half of its fiscal year (see below Certain Factors Affecting Callaway Golf Company contained in Item 1A).

Financial Information about Segments and Geographic Areas

Information regarding the Company's segments and geographic areas in which the Company operates is contained in Note 15 to the Company's Consolidated Financial Statements for the years ended December 31, 2007, 2006, and 2005 (Consolidated Financial Statements), which note is incorporated herein by this reference and is included as part of Item 8. Financial Statements and Supplementary Data.

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The Company designs, manufactures and sells high quality golf clubs and golf balls and also sells golf footwear and accessories. The Company designs its products to be technologically-advanced and in this regard invests a considerable amount in research and development each year. The Company's products are designed for golfers of all skill levels, both amateur and professional.

The following table sets forth the contribution to net sales attributable to the principal product groups for the periods indicated:

	Year Ended December 31,					
	2007		2006		2005	
	(In millions)					
Drivers and fairway woods	\$ 305.9	27%	\$ 266.5	26%	\$ 241.3	24%
Irons	309.6	28%	288.0	28%	316.5	32%
Putters	109.1	10%	102.7	10%	109.3	11%
Golf balls	213.1	19%	214.8	21%	214.7	22%
Accessories and other	186.9	17%	145.9	15%	116.3	12%
Net sales	\$ 1,124.6	100%	\$ 1,017.9	100%	\$ 998.1	100%

For a discussion regarding the changes in net sales for each product group from 2007 to 2006 and from 2006 to 2005, see below, Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations contained in Item 7.

The Company's current principal products by product group are described below:

Drivers and Fairway Woods. This product category includes sales of the Company's drivers, fairway woods and hybrid products, which are sold under the Callaway Golf, Top-Flite and Ben Hogan brands. These products are generally made of metal (either titanium or steel) or a combination of metal and a composite material. The Company's products compete at various price levels in the drivers and fairway woods category. In general, composite/metal drivers, fairway woods and hybrids sell at higher price points than titanium drivers and fairway woods, and titanium products sell at higher price points than steel products. The Company's drivers, fairway woods and hybrid products are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers. All of the Company's current drivers, fairway woods and hybrid products conform to the current rules of the United States Golf Association (the USGA) or the Royal and Ancient Golf Club of St. Andrews (the R&A), as applicable to the markets in which the products are intended to be sold.

Irons. This product category includes sales of the Company's irons and wedges, which are sold under the Callaway Golf, Top-Flite and Ben Hogan brands. The Company's irons are generally made of metal (either titanium, steel or special alloy) or a composite material (a combination of metal and polymer materials). The Company's products compete at various price levels in the irons category. In general, the Company's composite metal irons and titanium irons sell at higher price points than its steel irons. The Company's irons are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers. All of the Company's current iron products conform to the current rules of the USGA and the R&A.

Putters. This product category includes sales of the Company's putters, which are sold under the Odyssey, Callaway Golf, Top-Flite and Ben Hogan brands. The Company's products compete at multiple price levels in the putters category. The Company's putters are available in a variety of styles, shafts and other specifications to accommodate the preferences and skill levels of all golfers. All of the Company's current putter products conform to the current rules of the USGA and the R&A.

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Golf Balls. This product category includes sales of the Company's golf balls, which are primarily sold under the Callaway Golf and Top-Flite brands. The Company's golf balls are generally either a 2-piece golf ball (consisting of a core and cover) or a multi-layer golf ball (consisting of two or more components in addition to the cover). The Company's golf ball products include covers that incorporate a traditional dimple pattern as well as covers that incorporate innovative designs, including the Company's proprietary HEX Aerodynamics (i.e., a series of hexagons and pentagons separated by tubular ridges), dimple-in-dimple and deep dimple technologies. The Company's products compete at all price levels in the golf ball category. In general, the Company's multi-layer golf balls sell at higher price points than its 2-piece golf balls. All of the Company's current golf ball products conform to the current rules of the USGA and the R&A.

Accessories and Other. This product category includes sales of golf bags, footwear, recreational club sets, gloves, headwear, towels, umbrellas, and other accessories, as well as sales of pre-owned products through Callaway Golf Interactive, Inc. Additionally, this product category includes royalties from licensing of the Company's trademarks and service marks on products such as golf and life style apparel, watches, travel gear, rangefinders, practice aids and eyewear.

Product Design and Development

Product design at the Company is a result of the integrated efforts of its brand management, research and development, manufacturing and sales departments, all of which work together to generate new ideas for golf equipment. The Company has not limited itself in its research efforts by trying to duplicate designs that are traditional or conventional and believes it has created a work environment in which new ideas are valued and explored. In 2007, 2006 and 2005 the Company invested \$32.0 million, \$26.8 million and \$27.0 million, respectively, in research and development. The Company intends to continue to invest substantial amounts in its research and development activities in connection with its development of new golf club and golf ball products.

The Company has the ability to create and modify product designs by using computer aided design (CAD) software, computer aided manufacturing (CAM) software and computer numerical control milling equipment. CAD software enables designers to develop computer models of new product designs. CAM software is then used by engineers to translate the digital output from CAD computer models so that physical prototypes can be produced. Further, the Company utilizes a variety of testing equipment and computer software, including a golf robot, launch monitors, a proprietary virtual test center, a proprietary performance analysis system, an indoor test range and other methods to develop and test its products. Through the use of these technologies, the Company has been able to accelerate and make more efficient the design, development and testing of new golf clubs and golf balls.

For certain risks associated with product design and development, see below, "Certain Factors Affecting Callaway Golf Company" contained in Item 1A.

Manufacturing

Golf Clubs

The Company's drivers, fairway woods, hybrids, irons, wedges and putters are assembled primarily at the Company's facilities in Carlsbad, California. A portion of these products are also assembled outside of the United States. The Company's products are assembled using components obtained from suppliers both internationally and within the United States. Significant progress has been made in automating certain facets of the manufacturing process during the last few years and continued emphasis will be placed on automated manufacturing by the Company. However, the overall golf club assembly process remains fairly labor intensive, and requires extensive global supply chain coordination.

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Golf Balls

Prior to the Top-Flite acquisition in September 2003, Callaway Golf manufactured golf balls in its Carlsbad, California facility and Top-Flite manufactured golf balls primarily in its Chicopee, Massachusetts and Gloversville, New York facilities. Following the Top-Flite acquisition, the Company began consolidating all golf ball manufacturing operations. The consolidation allowed the Company to eliminate redundant infrastructure and overhead while improving functionality. As a result of the consolidation, most of the Company's golf ball products are now manufactured at the Chicopee and Gloversville facilities. In October 2006, the Company entered into a supply agreement to have a limited portion of its golf ball products manufactured overseas beginning in 2007. See Note 3 to the Consolidated Financial Statements. Overall, although a significant amount of labor is still used in the golf ball manufacturing process, the golf ball manufacturing process is much more automated than the golf club assembly process.

For certain risks associated with golf club and golf ball manufacturing, see below, *Certain Factors Affecting Callaway Golf Company* contained in Item 1A.

Sales and Marketing

Sales in the United States

Approximately 53% of the Company's net sales were derived from sales within the United States in 2007 and 56% in both 2006 and 2005. The Company primarily sells to both on- and off-course golf retailers and sporting goods retailers who sell quality golf products and provide a level of customer service appropriate for the sale of such products. The Company also sells certain products to mass merchants. On a consolidated basis, no one customer that distributes golf clubs or golf balls in the United States accounted for more than 3% of the Company's consolidated revenues in 2007 and 2006 and 4% in 2005. On a segment basis, the golf ball customer base is much more concentrated than the golf club customer base. In 2007, the top five golf ball customers accounted for approximately 20% of the Company's total consolidated golf ball sales. A loss of one or more of these customers could have a significant adverse effect upon the Company's golf ball sales.

Sales of the Company's products in the United States are made and supported by full-time regional field representatives and in-house sales and customer service representatives. Most of the Company's geographic territories are covered by both a field representative and a dedicated in-house sales representative who work together to initiate and maintain relationships with customers through frequent telephone calls and in-person visits. In addition to these sales representatives, the Company also has dedicated in-house customer service representatives.

In addition, other dedicated sales representatives provide service to corporate customers who want their corporate logo imprinted on the Company's golf balls, putters or golf bags. The Company imprints the logos on the majority of these corporate products, thereby retaining control over the quality of the process and final product. The Company also pays a commission to certain on- and off-course professionals and retailers with whom it has a relationship for corporate sales that originate through such professionals and retailers.

The Company also has a separate team of club fitting specialists who focus on the Company's custom club sales. Custom club sales are generated primarily from the utilization of the Company's club fitting programs such as performance centers as well as other, iron and wood fitting carts, and a vehicle with club building capacity. In addition, during 2007, the Company introduced the Callaway Golf OptiFit System, which expands on the capabilities of the OptiFit Driver System that was launched in 2006 to now include irons in addition to drivers. The OptiFit System is a custom fitting system that enables golfers to experiment at participating on- and off-course retail stores with an extensive variety of clubhead and shaft combinations in order to find the driver or set of irons that fits their personal specifications. The OptiFit System equips retailers and pros with a compact, hi-tech fitting tool that can quickly identify the precise clubhead and shaft combination for each golfer's individual swing, thereby dramatically improving the process in which consumers select a new driver or set of

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irons. Club fittings are performed by golf professionals who are specifically trained to fit golfers of all abilities into custom-fitted clubs. The Company believes that offering golfers the opportunity to increase performance with custom club specifications increases sales and promotes brand loyalty.

The Company maintains various sales programs including a Preferred Retailer Program. The Preferred Retailer Program offers longer payment terms during the initial sell in period, as well as potential rebates and discounts, for participating retailers in exchange for providing certain benefits to the Company, including the maintenance of agreed upon inventory levels, prime product placement and retailer staff training.

Sales Outside of the United States

Approximately 47% of the Company's net sales were derived from sales for distribution outside of the United States in 2007 and 44% in both 2006 and 2005. The Company does business (either directly or through its subsidiaries and distributors) in more than 100 countries around the world. The Company's management believes that controlling the distribution of its products in certain major markets in the world has been and will continue to be an important element in the future growth and success of the Company.

The majority of the Company's international sales are made through its wholly-owned subsidiaries located in Europe, Japan, Canada, Korea and Australia. In addition to sales through its subsidiaries, the Company also sells through distributors in over 60 foreign countries, including Singapore, China, Taiwan, the Philippines, South Africa, Argentina and various countries in South America. Prices of golf clubs and balls for sales by distributors outside of the United States generally reflect an export pricing discount to compensate international distributors for selling and distribution costs. A change in the Company's relationship with significant distributors could negatively impact the volume of the Company's international sales.

The Company's sales programs in foreign countries are specifically designed based upon local laws and competitive conditions. Some of the sales programs utilized include the custom club fitting experiences and the Preferred Retailer Program or variations of those programs employed in the United States as described above.

Conducting business outside of the United States subjects the Company to increased risks inherent in international business. See below, *Certain Factors Affecting Callaway Golf Company* contained in Item 1A.

Sales of Pre-Owned and Outlet Golf Clubs

The Company sells certified pre-owned Callaway Golf products through its websites, www.callawaygolfpreowned.com and www.callawaygolfoutlet.com. The Company generally acquires the pre-owned products through the Company's Trade In! Trade Up! program. The website for this program is www.tradeintradeup.com. The Trade In! Trade Up! program gives golfers the opportunity to trade in their used Callaway Golf clubs and certain competitor golf clubs at authorized Callaway Golf retailers or through the Callaway Golf Pre-Owned website for credit toward the purchase of new or pre-owned Callaway Golf equipment.

On-Line Store

In November of 2006, the Company announced Shop.CallawayGolf.com, an alliance between Callaway Golf and its network of authorized U.S. retailers that links consumers and golf retailers by allowing the consumer to place an order through Callaway Golf's website and have it fulfilled by a local participating retailer, or by the Company. This website is also accessible via the Company's main website, www.CallawayGolf.com. The website offers the full line of official Callaway Golf, Top-Flite, Ben Hogan and Odyssey products, including drivers, fairway woods, hybrids, irons, golf balls, footwear, eyewear, apparel and accessories.

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Advertising and Promotion

Within the United States, the Company has focused its advertising efforts mainly on a combination of printed advertisements in national magazines, such as *Golf Magazine*, *Sports Illustrated* and *Golf Digest*, and television commercials, primarily on The Golf Channel and on network television during golf telecasts, as well as web-based advertising. Advertising of the Company's products outside of the United States is generally handled by the Company's subsidiaries and is consistent with U.S. strategies.

In addition, the Company establishes relationships with professional golfers in order to promote the Company's products. The Company has entered into endorsement arrangements with members of the various professional golf tours to promote the Company's golf club and golf ball products. For certain risks associated with such endorsements, see below, "Certain Factors Affecting Callaway Golf Company" contained in Item 1A.

Competition

The golf club markets in which the Company competes are highly competitive, and are served by a number of well-established and well-financed companies with recognized brand names, as well as new companies with popular products. With respect to drivers, fairway woods and irons, the Company's major competitors are TaylorMade, Titleist, Cobra, Cleveland (Srixon), Ping, Mizuno, Bridgestone, MacGregor and Nike. For putters, the Company's major competitors are Ping, Titleist and TaylorMade. In addition, the Company also competes with Dunlop, Bridgestone and PRGR among others in Japan and throughout Asia. The Company believes that it is the leader, or one of the leaders, in every golf club market in which it competes.

The golf ball business is also highly competitive. There are a number of well-established and well-financed competitors, including Acushnet (Titleist and Pinnacle brands), Sumitomo Rubber Industries (Dunlop and Srixon brands), Bridgestone (Bridgestone and Precept brands), Nike, TaylorMade (Maxfli brand) and others. These competitors compete for market share in the golf ball business, with Acushnet having a market share of over 50% of the golf ball business in the United States. The Company's golf ball products have been well received by both professional and amateur golfers alike. The Company's golf ball products continue to receive a significant degree of usage on the major professional golf tours and maintained the number two position on the PGA tour in 2007. In addition, the Company's golf ball products remained number two in U.S. dollar market share in 2007.

For both golf clubs and golf balls, the Company generally competes on the basis of technology, quality, performance, customer service and price. In order to gauge the effectiveness of the Company's response to such factors, its management receives and evaluates Company-generated market research for U.S. and foreign markets, as well as periodic public and customized market research for U.S. markets from *Golf DataTech*. For risks relating to competition, see below, "Certain Factors Affecting Callaway Golf Company" contained in Item 1A.

Environmental Matters

The Company's operations are subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the environment and establish standards for the handling, generation, emission, release, discharge, treatment, storage and disposal of certain materials, substances and wastes and the remediation of environmental contaminants ("Environmental Laws"). In the ordinary course of its manufacturing processes, the Company uses paints, chemical solvents and other materials, and generates waste by-products, that are subject to these Environmental Laws. In addition, in connection with the Top-Flite Acquisition, the Company assumed certain monitoring and remediation obligations at the manufacturing facility in Chicopee, Massachusetts.

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The Company adheres to all applicable Environmental Laws and takes action as necessary to comply with these laws. The Company maintains an environmental and safety program and employs two full-time environmental engineers at its Carlsbad, California facility and a director of environmental, health and safety matters at its Chicopee, Massachusetts facility to manage the program. The environmental and safety program includes obtaining environmental permits as required, capturing and appropriately disposing of any waste by-products, tracking hazardous waste generation and disposal, air emissions, safety situations, material safety data sheet management, storm water management and recycling, and auditing and reporting on its compliance.

In addition, the facility in Chicopee was a charter member in the U.S. Environmental Protection Agency's National Performance Track program. This program recognizes facilities that have demonstrated a commitment to superior environmental performance and have a good record of compliance with environmental regulations. The National Environmental Performance Track was developed by the Environmental Protection Agency to reward companies who do more than environmental regulations require.

Historically, the costs of environmental compliance have not had a material adverse effect upon the Company's business. Furthermore, the Company does not believe that the monitoring and remedial obligations it assumed in connection with the Top-Flite Acquisition will have a material adverse effect upon the Company's business. The Company believes that its operations are in substantial compliance with all applicable Environmental Laws.

Intellectual Property

The Company is the owner of approximately 2,800 U.S. and foreign trademark registrations and over 2,100 U.S. and foreign patents relating to the Company's products, product designs, manufacturing processes and research and development concepts. Other patent and trademark applications are pending and await registration. In addition, the Company owns various other protectable rights under copyright, trade dress and other statutory and common laws. The Company's intellectual property rights are very important to the Company and the Company seeks to protect such rights through the registration of trademarks and utility and design patents, the maintenance of trade secrets and the creation of trade dress. When necessary and appropriate, the Company enforces its rights through litigation. Information regarding current litigation matters in connection with intellectual property is contained in Item 3 Legal Proceedings below and in Note 14 to the Company's Consolidated Financial Statements, Commitments and Contingencies: Legal Matters.

The Company's patents are generally in effect for up to 20 years from the date of the filing of the patent application. The Company's trademarks are generally valid as long as they are in use and their registrations are properly maintained and have not been found to become generic. See below, Certain Factors Affecting Callaway Golf Company contained in Item 1A.

Licensing

The Company from time to time, in exchange for a royalty fee, licenses its trademarks and service marks to third parties for use on products such as golf apparel, watches, travel gear, rangefinders, practice aids and eyewear. The Company has current licensing arrangements with (i) Ashworth, Inc. for a complete line of men's and women's apparel for distribution in the United States, Canada, Europe and South Africa, (ii) Sanei International Co., Ltd. for a complete line of men's and women's apparel for distribution in Japan, Korea, China and other Asian Pacific countries, and (iii) Playcorp Pty. Ltd. for a complete line of men's and women's apparel for distribution in Australia and New Zealand.

In addition to apparel, the Company has also licensed its trademarks to, among others, (i) Fossil, Inc. for a line of watches and clocks, (ii) TRG Accessories, LLC for a collection primarily consisting of travel gear, (iii) Global Wireless Entertainment, Inc. for the creation of golf-related software and applications for wireless handheld devices and platforms, (iv) MicroVision Optical, Inc. for eyewear, (v) Nikon Vision Co., Ltd.

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for rangefinders and (vi) IZZO Golf for practice aids. Prior to April 2006, the Company had a licensing arrangement with Tour Golf Group, Inc. (TGG) for a line of Callaway Golf footwear. In April 2006, the licensing arrangement was terminated and the Company acquired certain assets of TGG. The Company currently designs and sells its own Callaway Golf footwear line.

Employees

During 2005, in connection with the 2005 Restructuring Initiatives, the Company announced the elimination of approximately 500 positions worldwide, including full-time and part-time employees, temporary employees and open positions. Most of these positions were eliminated prior to December 31, 2005 and the remainder of the planned eliminations were completed during 2006. As of December 31, 2007, the Company and its subsidiaries had approximately 3,000 full-time and part-time employees. In addition, the Company employs temporary employees as the business requires.

Historically, Callaway Golf employees have not been represented by unions. The golf ball manufacturing employees in Chicopee, Massachusetts, however, are unionized. Shortly after the Top-Flite Acquisition was consummated the Company negotiated a new collective bargaining agreement with the union in Chicopee which is scheduled to expire on September 30, 2008. In addition, in connection with the Top-Flite Acquisition, certain of the Company's production employees in Canada and Australia are also unionized. As of December 31, 2007, the Company had approximately 530 employees covered under the collective bargaining agreement. The Company considers its employee relations to be good.

Access to SEC Filings through Company Website

Interested readers can access the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) through the Investor Relations section of the Company's website at www.callawaygolf.com. These reports can be accessed free of charge from the Company's website as soon as reasonably practicable after the Company electronically files such materials with, or furnishes them to, the Securities and Exchange Commission. In addition, the Company's Corporate Governance Guidelines, Code of Conduct and the written charters of the committees of the Board of Directors are available in the Corporate Governance portion of the Investor Relations section of the Company's website and are available in print to any shareholder who requests a copy. The information contained on the Company's website shall not be deemed to be incorporated into this report.

Item 1A. Risk Factors

Certain Factors Affecting Callaway Golf Company

The financial statements contained in this report and the related discussions describe and analyze the Company's financial performance and condition for the periods presented. For the most part, this information is historical. The Company's prior results, however, are not necessarily indicative of the Company's future performance or financial condition. The Company has also included certain forward-looking statements concerning the Company's future performance or financial condition. These forward-looking statements are based upon current information and expectations and actual results could differ materially. The Company therefore has included the following discussion of certain factors that could cause the Company's future performance or financial condition to differ materially from its prior performance or financial condition or from management's expectations or estimates of the Company's future performance or financial condition. These factors, among others, should be considered in assessing the Company's future prospects and prior to making an investment decision with respect to the Company's stock.

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Successfully managing the frequent introduction of new products that satisfy changing consumer preferences is very important to the Company's success.

The Company's main products, like those of its competitors, generally have life cycles of two years or less, with sales occurring at a much higher rate in the first year than in the second. Factors driving these short product life cycles include the rapid introduction of competitive products and quickly changing consumer preferences. In this marketplace, a substantial portion of the Company's annual revenues is generated each year by products that are in their first year of life.

These marketplace conditions raise a number of issues that the Company must successfully manage. For example, the Company must properly anticipate consumer preferences or its new products will not achieve sufficient market success to compensate for the usual decline in sales experienced by products already in the market. Second, the Company's R&D and supply chain groups face constant pressures to design, develop, source and supply new products many of which incorporate new or otherwise untested technology, suppliers or inputs. Third, for new products to generate equivalent or greater revenues than their predecessors, they must either maintain the same or higher sales levels with the same or higher pricing, or exceed the performance of their predecessors in one or both of those areas. Fourth, the relatively short window of opportunity for launching and selling new products requires great expertise in forecasting demand and assuring that supplies are ready and delivered during the critical selling periods. Finally, the rapid changeover in products creates a need to monitor and manage the close out of obsolete products both at retail and in the Company's own inventory.

Should the Company not successfully manage all of the risk factors associated with this rapidly moving marketplace, the Company's sales and earnings may be adversely affected.

A reduction in discretionary consumer spending could reduce sales of the Company's products.

The Company sells golf clubs, golf balls and golf accessories. These 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 and when consumers are feeling confident and prosperous. Discretionary spending is also affected by many other factors, including general business conditions, interest rates, the availability of consumer credit, taxation and consumer confidence in future economic conditions. Purchases of the Company's products could decline during periods when disposable income is lower, or during periods of actual or perceived unfavorable economic conditions. Any significant decline in general economic conditions or uncertainties regarding future economic prospects that adversely affect discretionary consumer spending, whether in the United States or in the Company's international markets (which represent almost half of the Company's total sales), could result in reduced sales of the Company's products.

A reduction in the number of rounds of golf played or in the number of golf participants could adversely affect the Company's sales.

The Company generates substantially all of its revenues from the sale of golf related products, including golf clubs, golf balls and golf accessories. The demand for golf related products, generally, and golf balls in particular, is directly related to the number of golf participants and the number of rounds of golf being played by these participants. If golf participation or the number of rounds of golf played decreases, sales of the Company's products may be adversely affected. In the future, the overall dollar volume of the market for golf-related products may not grow or may decline.

In addition, the demand for golf products is also directly related to the popularity of magazines, cable channels and other media dedicated to golf, television coverage of golf tournaments and attendance at golf events. The Company depends on the exposure of its products through advertising and the media or at golf tournaments and events. Any significant reduction in television coverage of, or attendance at, golf tournaments and events or any significant reduction in the popularity of golf magazines or golf channels, could reduce the visibility of the Company's brand and could adversely affect the Company's sales.

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The Company may have limited opportunities for future growth in sales of golf clubs and golf balls.

In order for the Company to significantly grow its sales of golf clubs or golf balls, the Company must either increase its share of the market for golf clubs or balls, or the market for golf clubs or balls must grow. The Company already has a significant share of worldwide sales of golf clubs and golf balls. Therefore, opportunities for additional market share may be limited. Furthermore, the Company does not believe there has been any material increase in the number of golfers worldwide in over five years. The Company also believes that overall dollar volume of the worldwide market for golf equipment sales has not experienced substantial growth in the past several years. In the future, the overall dollar volume of worldwide sales of golf clubs or golf balls may not grow or may decline.

If the Company inaccurately forecasts demand for its products, it may manufacture either insufficient or excess quantities, which, in either case, could adversely affect its financial performance.

The Company plans its manufacturing capacity based upon the forecasted demand for its products. The nature of the Company's business makes it difficult to quickly adjust its manufacturing capacity if actual demand for its products exceeds or is less than forecasted demand. If actual demand for its products exceeds the forecasted demand, the Company may not be able to produce sufficient quantities of new products in time to fulfill actual demand, which could limit the Company's sales and adversely affect its financial performance. On the other hand, if actual demand is less than the forecasted demand for its products, the Company could produce excess quantities, resulting in excess inventories and related obsolescence charges that could adversely affect the Company's financial performance.

The Company depends on single-source or a limited number of suppliers for some of its products, and the loss of any of these suppliers could harm its business.

The Company is dependent on a limited number of suppliers for its clubheads and shafts, some of which are single-sourced. In addition, some of the Company's products require specifically developed manufacturing techniques and processes which make it difficult to identify and utilize alternative suppliers quickly. If current suppliers are unable to deliver clubheads, shafts or other components, or if the Company is required to transition to other suppliers, the Company could experience significant production delays or disruption to its business. The Company also depends on a single or a limited number of suppliers for the materials it uses to make its golf balls. Many of these materials are customized for the Company. Any delay or interruption in such supplies could have a material adverse impact upon the Company's golf ball business. If the Company did experience any such delays or interruptions, the Company may not be able to find adequate alternative suppliers at a reasonable cost or without significant disruption to its business.

A significant disruption in the operations of the Company's golf club assembly facilities in Carlsbad, California or its golf ball manufacturing facilities in Chicopee, Massachusetts could have a material adverse effect on the Company's sales, profitability and results of operations.

A substantial majority of the Company's golf club products are assembled at and shipped from its facilities in Carlsbad, California. A large majority of the Company's golf ball products are manufactured at and shipped from its facilities in Chicopee, Massachusetts. Any natural disaster or other significant disruption to the operation of these facilities could substantially disrupt the Company's global supply chain coordination for the relevant golf club or golf ball business segment, including damage to inventory at the respective facilities. In addition, the Company could incur significantly higher costs and longer lead times associated with fulfilling orders and distributing product. As a result, a significant disruption at either of the Carlsbad, California or Chicopee, Massachusetts, facilities could adversely affect the Company's sales, profitability and results of operations.

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If the Company is unable to obtain at reasonable costs materials or electricity necessary for the manufacture of its products its business would be adversely affected.

The Company's size has made it a large consumer of certain materials, including steel, titanium alloys, carbon fiber and rubber. The Company does not produce these materials itself, and must rely on its ability to obtain adequate supplies in the world marketplace in competition with other users of such materials. In the future, the Company may be unable to obtain its requirements for such materials at a reasonable price or at all. An interruption in the supply of the materials used by the Company or a significant change in costs could have a material adverse effect on the Company's business.

The Company's golf club and golf ball manufacturing facilities use, among other resources, significant quantities of electricity to operate. An interruption in the supply of electricity or a significant increase in the cost of electricity could have a significant adverse effect upon the Company's results of operations.

A disruption in the service or a significant increase in the cost of the Company's primary delivery and shipping services for its products and component parts could have a material adverse effect on the Company's business.

The Company uses United Parcel Service, or UPS, for substantially all ground shipments of products to its U.S. customers. The Company uses air carriers and ship services for most of its international shipments of products. Furthermore, many of the components the Company uses to build its golf clubs, including clubheads and shafts, are shipped to the Company via air carrier and ship services. The Company's inbound and outbound shipments are particularly dependent upon air carrier facilities at Los Angeles International Airport and ship service facilities at the Port of Los Angeles (Long Beach) If there were any significant interruption in service by such providers or at other significant airports or shipping ports, the Company may be unable to engage alternative suppliers or to receive or ship goods through alternate sites in order to deliver its products or components in a timely and cost-efficient manner. As a result, the Company could experience manufacturing delays, increased manufacturing and shipping costs, and lost sales as a result of missed delivery deadlines and product demand cycles. Any significant interruption in UPS services, air carrier services or ship services could have a material adverse effect upon the Company's business. Furthermore, if the cost of delivery or shipping services were to increase significantly and the additional costs could not be covered by product pricing, the Company's operating results could be significantly adversely affected.

The Company faces intense competition in each of its markets.

Golf Clubs. The golf club business is highly competitive, and is served by a number of well-established and well-financed companies with recognized brand names. New product introductions, price reductions, consignment sales, extended payment terms, closeouts, including closeouts of products that were recently commercially successful, and significant tour and advertising spending by competitors continue to generate intense market competition. Furthermore, continued downward pressure on pricing in the market for new clubs could have a significant adverse effect on the Company's pre-owned club business as the gap narrows between the cost of a new club and a pre-owned club. Successful marketing activities, discounted pricing, consignment sales, extended payment terms or new product introductions by competitors could negatively impact the Company's future sales.

Golf Balls. The golf ball business is also highly competitive. There are a number of well-established and well-financed competitors, including one competitor with an estimated U.S. market share of approximately 50%. As competition in this business increases, many of these competitors are increasing advertising, tour or other promotional support. This increased competition has resulted in significant expenses for the Company in both tour and advertising support and product development. Unless there is a change in competitive conditions, these competitive pressures and increased costs will continue to adversely affect the profitability of the Company's golf ball business.

Accessories. The Company's accessories include golf bags, golf gloves, golf footwear and other items. The Company faces significant competition in every region with respect to each of these product categories. In most cases, the Company is not the market leader with respect to its accessory markets.

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The Company's golf ball business has a concentrated customer base. The loss of one or more of the Company's top customers could have a significant negative impact on this business.

On a consolidated basis, no one customer that distributes the Company's golf clubs or golf balls in the United States accounted for more than 3% of the Company's revenue in 2007 and 2006 and 4% in 2005. On a segment basis, the Company's golf ball customer base is much more concentrated than its golf club customer base. In 2007, the top five golf ball customers accounted for approximately 20% of the Company's total golf ball sales in the United States. A loss of one or more of these customers could have a significant adverse effect upon the Company's golf ball sales.

International political instability and terrorist activities may decrease demand for the Company's products and disrupt its business.

The Company's business has been adversely affected in recent years by terrorist activities and armed conflicts, such as the attacks on the World Trade Center and the Pentagon, bombings in London and Spain, incidents of Anthrax poisoning and the military actions in the Middle East, including the war in Iraq. Future similar or threatened events or conflicts could have an adverse effect upon the United States or worldwide economy and could cause decreased demand for the Company's products as consumers' attention and interest are diverted from golf and become focused on issues relating to these events. If such events disrupt domestic or international air, ground or sea shipments, the Company's ability to obtain the materials necessary to produce and sell its products and to deliver customer orders would be harmed. Furthermore, such events can negatively impact tourism, which could adversely affect the Company's sales to retailers at resorts and other vacation destinations.

The Company's business could be harmed by the occurrence of natural disasters or pandemic diseases.

The occurrence of a natural disaster, such as an earthquake, fire, flood or hurricane, or the outbreak of a pandemic disease, such as Severe Acute Respiratory Syndrome or the Avian Flu, could significantly adversely affect the Company's business. A natural disaster or a pandemic disease could significantly adversely affect both the demand for the Company's products as well as the supply of the components used to make the Company's products. Demand for golf products also could be negatively affected as consumers in the affected regions restrict their recreational activities and as tourism to those areas declines. If the Company's suppliers experienced a significant disruption in their business as a result of a natural disaster or pandemic disease, the Company's ability to obtain the necessary components to make its products could be significantly adversely affected. In addition, the occurrence of a natural disaster or the outbreak of a pandemic disease generally restricts the travel to and from the affected areas, making it more difficult in general to manage the Company's international operations.

The Company has significant international sales and purchases, and is exposed to currency exchange rate fluctuations.

A significant portion of the Company's purchases and sales are international purchases and sales, and the Company conducts transactions in approximately 12 currencies worldwide. Conducting business in such various currencies exposes the Company to fluctuations in foreign currency exchange rates relative to the U.S. dollar.

The Company's financial results are reported in U.S. dollars. As a result, transactions conducted in foreign currencies must be translated into U.S. dollars for reporting purposes based upon the applicable foreign currency exchange rates. Fluctuations in these foreign currency exchange rates therefore may positively or negatively affect the Company's reported financial results.

The effect of the translation of foreign currencies on the Company's financial results can be significant. The Company therefore engages in certain hedging activities to mitigate over time the impact of the translation of foreign currencies on the Company's financial results. The Company's hedging activities are designed to reduce, but not to eliminate, the effects of foreign currency fluctuations. Factors that could affect the effectiveness of the

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Company's hedging activities include accuracy of sales forecasts, volatility of currency markets and the availability of hedging instruments. Since the hedging activities are designed to reduce volatility, they not only reduce the negative impact of a stronger U.S. dollar but also reduce the positive impact of a weaker U.S. dollar. The Company's future financial results could be significantly affected by the value of the U.S. dollar in relation to the foreign currencies in which the Company conducts business. The degree to which the Company's financial results are affected will depend in part upon the effectiveness or ineffectiveness of the Company's hedging activities.

Foreign currency fluctuations can also affect the prices at which products are sold in the Company's international markets. The Company therefore adjusts its pricing based in part upon fluctuations in foreign currency exchange rates. Significant unanticipated changes in foreign currency exchange rates make it more difficult for the Company to manage pricing in its international markets. If the Company is unable to adjust its pricing in a timely manner to counteract the effects of foreign currency fluctuations, the Company's pricing may not be competitive in the marketplace and the Company's financial results in its international markets could be adversely affected.

The Company's business and therefore operating results are subject to seasonal fluctuations.

The Company's business is subject to seasonal fluctuations. The Company's first quarter sales generally represent the Company's sell-in to the golf retail channel of its golf club products for the new golf season. Orders for many of these sales are received during the fourth quarter of the prior year. The Company's second and third quarter sales generally represent re-order business for golf clubs. Sales of golf clubs during the second and third quarters are significantly affected not only by the sell-through of the Company's products that were sold into the channel during the first quarter but also by the sell-through of products by the Company's competitors. Retailers are sometimes reluctant to re-order the Company's products in significant quantity when they already have excess inventory of products of the Company or its competitors. The Company's sales of golf balls are generally associated with the level of rounds played in the areas where the Company's products are sold. Therefore, golf ball sales tend to be greater in the second and third quarters, when the weather is good in most of the Company's key markets and rounds played are up. Golf ball sales are also stimulated by product introductions as the retail channel takes on initial supplies. Like golf clubs, re-orders of golf balls depend on the rate of sell-through. The Company's sales during the fourth quarter are generally significantly less than the other quarters because in many of the Company's principal markets fewer people are playing golf during that time of year due to cold weather. Furthermore, in the past, the Company announced its new product line at the beginning of each calendar year. In recent years, the Company has departed from that practice and now generally announces its new product line in the fourth quarter to allow retailers to plan better. Such early announcements of new products could cause golfers, and therefore the Company's customers, to defer purchasing additional golf equipment until the Company's new products are available. Such deferments could have a material adverse effect upon sales of the Company's current products or result in close out sales at reduced prices.

The seasonality of the Company's business could exacerbate the adverse effects of unusual or severe weather conditions on the Company's business.

Because of the seasonality of the Company's business, the Company's business can be significantly adversely affected by unusual or severe weather conditions. Unfavorable weather conditions generally result in fewer golf rounds played, which generally results in reduced demand for golf products, generally, and golf balls in particular. Furthermore, catastrophic storms can negatively affect golf rounds played both during the storms and afterward, as storm damaged golf courses are repaired and golfers focus on repairing the damage to their homes, businesses and communities. Consequently, sustained adverse weather conditions, especially during the warm weather months, could materially affect the Company's sales.

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Changes in equipment standards under applicable Rules of Golf could adversely affect the Company's business.

New golf club and golf ball products generally seek to satisfy the standards established by the USGA and R&A because these standards are generally followed by golfers within their respective jurisdictions. The USGA rules are generally followed in the United States, Canada and Mexico, and the R&A rules are generally followed in most other countries throughout the world.

The Rules of Golf as published by the R&A and the USGA are virtually the same. The Company believes that all of its products conform to both the USGA and R&A rules.

The Company's future products may not satisfy USGA and/or R&A standards or existing USGA and/or R&A standards may be altered in ways that adversely affect the sales of the Company's products or the Company's brand. If a change in rules were adopted and caused one or more of the Company's current products to be non-conforming, the Company's sales of such products could be adversely affected. Furthermore, any such new rules could restrict the Company's ability to develop new products.

The Company's sales could decline if professional golfers do not endorse or use the Company's products.

The Company establishes relationships with professional golfers in order to evaluate and promote Callaway Golf, Odyssey, Top-Flite and Ben Hogan branded products. The Company has entered into endorsement arrangements with members of the various professional tours, including the Champions Tour, the PGA Tour, the LPGA Tour, the PGA European Tour, the Japan Golf Tour and the Nationwide Tour. While most professional golfers fulfill their contractual obligations, some have been known to stop using a sponsor's products despite contractual commitments. If certain of the Company's professional endorsers were to stop using the Company's products contrary to their endorsement agreements, the Company's business could be adversely affected in a material way by the negative publicity or lack of endorsement.

The Company believes that professional usage of its golf clubs and golf balls contributes to retail sales. The Company therefore spends a significant amount of money to secure professional usage of its products. Many other companies, however, also aggressively seek the patronage of these professionals and offer many inducements, including significant cash incentives and specially designed products. There is a great deal of competition to secure the representation of tour professionals. As a result, it is becoming increasingly difficult and more expensive to attract and retain such tour professionals. The inducements offered by other companies could result in a decrease in usage of the Company's products by professional golfers or limit the Company's ability to attract other tour professionals. A decline in the level of professional usage of the Company's products could have a material adverse effect on the Company's sales and business.

If the Company is unable to enforce its intellectual property rights, its reputation and sales could be adversely affected.

The golf club industry, in general, has been characterized by widespread imitation of popular club designs. The Company has an active program of monitoring, investigating and enforcing its proprietary rights against companies and individuals who market or manufacture counterfeits and knock off products. The Company asserts its rights against infringers of its copyrights, patents, trademarks, and trade dress. However, these efforts may not be successful in reducing sales of golf products by these infringers. Additionally, other golf club manufacturers may be able to produce successful golf clubs which imitate the Company's designs without infringing any of the Company's copyrights, patents, trademarks, or trade dress. The failure to prevent or limit such infringers or imitators, could adversely affect the Company's reputation and sales.

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The Company may become subject to intellectual property suits that could cause it to incur significant costs or pay significant damages or that could prohibit it from selling its products.

An increasing number of the Company's competitors have sought to obtain patent, trademark, copyright or other protection of their proprietary rights and designs for golf clubs and golf balls. As the Company develops new products, it attempts to avoid infringing the valid patents and other intellectual property rights of others. Before introducing new products, the Company's legal staff evaluates the patents and other intellectual property rights of others to determine if changes are required to avoid infringing any valid intellectual property rights that could be asserted against the Company's new product offerings. From time to time, third parties have claimed or may claim that the Company's products infringe upon their proprietary rights. The Company evaluates any such claims and, where appropriate, has obtained or sought to obtain licenses or other business arrangements. To date, there have been no interruptions in the Company's business as a result of any claims of infringement. However, in the future, intellectual property claims could force the Company to alter its existing products or withdraw them from the market or could delay the introduction of new products.

Various patents have been issued to the Company's competitors in the golf ball industry and these competitors may assert that the Company's golf balls infringe their patent or other proprietary rights. If the Company's golf balls are found to infringe third party intellectual property rights, the Company may be unable to obtain a license to use such technology, and it could incur substantial costs to redesign its products or to defend legal actions.

The Company's brands may be damaged by the actions of its licensees.

The Company licenses its trademarks to third party licensees who produce, market and sell their products bearing the Company's trademarks. The Company chooses its licensees carefully and imposes upon such licensees various restrictions on the products, and on the manner, on which such trademarks may be used. In addition, the Company requires its licensees to abide by certain standards of conduct and the laws and regulations of the jurisdictions in which they do business. However, if a licensee fails to adhere to these requirements, the Company's brands could be damaged. The Company's brands could also be damaged if a licensee becomes insolvent or by any negative publicity concerning a licensee or if the licensee does not maintain good relationships with its customers or consumers, many of which are also the Company's customers and consumers.

Sales of the Company's products by unauthorized retailers or distributors could adversely affect the Company's authorized distribution channels and harm the Company's reputation.

Some of the Company's products find their way to unauthorized outlets or distribution channels. This gray market for the Company's products can undermine authorized retailers and foreign wholesale distributors who promote and support the Company's products, and can injure the Company's image in the minds of its customers and consumers. On the other hand, stopping such commerce could result in a potential decrease in sales to those customers who are selling the Company's products to unauthorized distributors or an increase in sales returns over historical levels. While the Company has taken some lawful steps to limit commerce of its products in the gray market in both the United States and abroad, it has not stopped such commerce.

The Company has significant international operations and is exposed to risks associated with doing business globally.

The Company's management believes that controlling the distribution of its products in certain major markets in the world has been and will be an element in the future growth and success of the Company. The Company sells and distributes its products directly in many key international markets in Europe, Asia, North America and elsewhere around the world. These activities have resulted and will continue to result in investments in inventory, accounts receivable, employees, corporate infrastructure and facilities. In addition, there are a limited number of suppliers of golf club components in the United States, and the Company has increasingly become more reliant on suppliers and vendors located outside of the United States. The operation of

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foreign distribution in the Company's international markets, as well as the management of relationships with international suppliers and vendors, will continue to require the dedication of management and other Company resources.

As a result of this international business, the Company is exposed to increased risks inherent in conducting business outside of the United States. In addition to foreign currency risks, these risks include:

increased difficulty in protecting the Company's intellectual property rights and trade secrets;

unexpected government action or changes in legal or regulatory requirements;

social, economic or political instability;

the effects of any anti-American sentiments on the Company's brands or sales of the Company's products;

increased difficulty in ensuring compliance by employees, agents and contractors with the Company's policies as well as with the laws of multiple jurisdictions, including but not limited to the U.S. Foreign Corrupt Practices Act, and local international environmental, health and safety laws, and increasingly complex regulations relating to the conduct of international commerce;

increased difficulty in controlling and monitoring foreign operations from the United States, including increased difficulty in identifying and recruiting qualified personnel for its foreign operations; and

increased exposure to interruptions in air carrier or ship services.

Although the Company believes the benefits of conducting business internationally outweigh these risks, any significant adverse change in circumstances or conditions could have a significant adverse effect upon the Company's operations, financial performance and condition.

If the Company's customers and distributors do not pay for their purchases in a timely manner, the Company's financial results would be harmed.

The Company primarily sells its products to golf equipment retailers directly and through wholly owned domestic and foreign subsidiaries, and to foreign distributors. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral from these customers. Historically, the Company's bad debt expense has been low. However, a downturn in the retail golf equipment market could result in increased delinquent or uncollectible accounts for some of the Company's significant customers. A failure by the Company's customers to pay a significant portion of outstanding account receivable balances would adversely impact the Company's performance and financial condition.

The Company relies on increasingly complex information systems for management of its manufacturing, distribution, sales and other functions. If the Company's information systems fail to perform these functions adequately or if the Company experiences an interruption in their operation, its business and results of operations could suffer.

All of the Company's major operations, including manufacturing, distribution, sales and accounting, are dependent upon the Company's complex information systems. The Company's information systems are vulnerable to damage or interruption from:

earthquake, fire, flood, hurricane and other natural disasters;

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

hackers, computer viruses, software bugs or glitches.

Any damage or significant disruption in the operation of such systems or the failure of the Company's information systems to perform as expected could disrupt the Company's business, result in decreased sales, increased overhead costs, excess inventory and product shortages and otherwise adversely affect the Company's operations, financial performance and condition.

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Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

The Company and its subsidiaries conduct operations in both owned and leased properties. The Company's principal executive offices and domestic operations are located in Carlsbad, California. The eight buildings utilized in the Company's Carlsbad operations include corporate offices, as well as manufacturing, research and development, warehousing and distribution facilities. These buildings comprise approximately 735,000 square feet of space. The Company owns five of these buildings, representing approximately 492,000 square feet of space. An additional three properties, representing approximately 243,000 square feet of space, are leased and the leases are scheduled to expire between March 2009 and November 2017. The Company is in the process of converting its headquarters building to consolidate its campus into a more efficient layout. The Company also owns a manufacturing plant, warehouse and offices that encompass approximately 869,000 square feet in Chicopee, Massachusetts and a manufacturing plant in Gloversville, New York comprising approximately 70,000 square feet. In addition, the Company owns and leases a number of other properties domestically and internationally, including properties in Australia, Canada, Japan, Korea, the United Kingdom and China. The Company's operations at each of these properties are used to some extent for both the golf club and golf ball businesses. The Company believes that its facilities currently are adequate to meet its requirements.

Item 3. *Legal Proceedings*

In conjunction with the Company's program of enforcing its proprietary rights, the Company has initiated or may initiate actions against alleged infringers under the intellectual property laws of various countries, including, for example, the U.S. Lanham Act, the U.S. Patent Act, and other pertinent laws. The Company is also active internationally. For example, it has worked with other manufacturers to encourage Chinese government officials to conduct raids of identified counterfeiters, resulting in the seizure and destruction of counterfeit golf clubs. Defendants in these actions may, among other things, contest the validity and/or the enforceability of some of the Company's patents and/or trademarks. Others may assert counterclaims against the Company. Historically, these matters individually and in the aggregate have not had a material adverse effect upon the financial position or results of operations of the Company. It is possible, however, that in the future one or more defenses or claims asserted by defendants in one or more of those actions may succeed, resulting in the loss of all or part of the rights under one or more patents, loss of a trademark, a monetary award against the Company or some other material loss to the Company. One or more of these results could adversely affect the Company's overall ability to protect its product designs and ultimately limit its future success in the marketplace.

In addition, the Company from time to time receives information claiming that products sold by the Company infringe or may infringe patent or other intellectual property rights of third parties. It is possible that one or more claims of potential infringement could lead to litigation, the need to obtain licenses, the need to alter a product to avoid infringement, a settlement or judgment, or some other action or material loss by the Company.

On February 9, 2006, the Company filed a complaint in the United States District Court for the District of Delaware, Case No. C.A. 06-91, asserting claims against Acushnet Company for patent infringement. Specifically, Callaway Golf asserted that Acushnet's sale of the Titleist Pro V1 family of golf balls infringes four golf ball patents that Callaway Golf acquired when it acquired the assets of Top-Flite. Callaway Golf is seeking damages and an injunction to prevent future infringement by Acushnet. In its answer to the Complaint, Acushnet responded that the patents at issue are invalid and not infringed by the Pro V1 golf balls. On November 20, 2007, the District Court granted Callaway Golf's motion for summary judgment on a breach of contract claim, holding that Acushnet's initiation of parallel re-examination proceedings, described below, constituted a breach of a pre-existing dispute resolution agreement with Callaway Golf. The Court also rejected various legal challenges by Acushnet as to the validity of the patents, permitting Callaway Golf's claims against Acushnet to proceed to

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trial, and ruled that the issues of damages and willfulness would be decided in a second trial between the parties. On the eve of trial, Acushnet stipulated that its Pro V1 golf balls infringe one or more of the nine claims in the four patents asserted by Callaway Golf. As a result of the Court's rulings, and Acushnet's concession as to infringement, only the validity of the patents was tried before a jury commencing on December 5, 2007. On December 14, 2007, after a six day trial, a unanimous jury decided that eight of the nine patent claims asserted by Callaway Golf against Acushnet are valid. The Court entered judgment in favor of Callaway Golf and against Acushnet on December 20, 2007. Callaway Golf has requested that the Court enter a permanent injunction requiring Acushnet to stop production and sale of the Pro V1 golf balls. Acushnet has asked the Court to enter judgment notwithstanding the verdict or, alternatively, for a new trial. Those two motions are pending.

Acushnet also filed petitions for reexamination with the United States Patent and Trademark Office (PTO) challenging the validity of the patents asserted by Callaway Golf. Although the PTO agreed the petitions for reexamination raised substantial new questions of patentability, and issued a first office action preliminarily rejecting the claims of all four of the patents, the PTO has not made a final and binding determination as to the validity of any of the patents. The interim rulings by the PTO do not void the Court's judgment.

On June 9, 2007, the Company filed a complaint in the United States District Court for the District of Delaware, Case No. C.A. 07-367, asserting claims against Acushnet Company for patent infringement. Callaway Golf asserts that Acushnet's sale of numerous drivers, including but not limited to the King Cobra 454 Comp, King Cobra F Speed, King Cobra HS9 F Speed, King Cobra HS9 M speed, and King Cobra LD F Speed, Titleist 905R, Titleist 905S and Titleist 905T drivers, infringes one or more of Callaway Golf U.S. patents (numbers 6,348,015; 6,478,692; 6,669,579; 6,685,576; and 6,949,032). Callaway Golf is seeking damages and an injunction to prevent future infringement. Acushnet has answered the complaint denying infringement of any valid patent and asserting counterclaims against Callaway Golf. Acushnet asserts that sales of Callaway Golf's FT-i, FT-5, X-460, X-460 Tour, Big Bertha Fusion FT-3 and Big Bertha 460 drivers infringe two patents issued to Acushnet, namely U.S. patent numbers 6,960,142 and 7,041,003. Acushnet seeks damages and an injunction as well. Callaway Golf responded to the counterclaim on August 31, 2007, denying infringement of any valid patent claim. The parties are engaged in preliminary discovery. The trial of this matter is set to commence in the District Court on May 18, 2009.

On August 1, 2007, the Company filed a complaint in the United States District Court for the Eastern District of Texas, Case No. 207CV329, asserting claims of patent infringement against TaylorMade Golf Company, Inc. Specifically, Callaway Golf is asserting that sales of certain TaylorMade irons infringe Callaway Golf's U.S. patent No. 5,704,849. Callaway Golf is seeking damages and an injunction to prevent future infringement. On September 4, 2007, TaylorMade answered the complaint denying infringement.

On August 4, 2007, Callaway Golf filed a complaint in the United States District Court for the Southern District of California, Case No. 07 CV 1424, asserting claims against TaylorMade Golf Company, Inc. for patent infringement and seeking declaratory relief. Specifically, Callaway Golf asserts that TaylorMade's sales of its TP Red and TP Black golf balls infringe Callaway Golf's U.S. Patent Nos. 6,638,185 and 7,160,207, which relate to multi-layer golf balls. Callaway Golf is also seeking declarations of license, invalidity, unenforceability, and/or non-infringement of TaylorMade's U.S. Patent Nos. 6,991,558, 7,198,575, 6,719,644, and 6,547,678. TaylorMade filed an answer and counterclaim asserting non-infringement and/or invalidity of Callaway Golf's golf ball patents. TaylorMade also asserts that certain of Callaway Golf's drivers, including the FT-i, FT-5, and Big Bertha 460 infringe its above-named patents and related patent applications. In addition, Taylor Made is seeking declarations of invalidity, unenforceability, and non-infringement of Callaway Golf's U.S. Patent Nos. 5,704,849, 5,409,229 and 5,605,511, which relate to undercut irons.

On December 14, 2007, Callaway Golf and TaylorMade issued a joint press release announcing a resolution of all pending litigation between the parties. Specifically, the parties announced that they entered into a settlement and patent license agreement under the terms of which each company has specified rights to make products under patents owned by the other. Technologies at issue include high moment of inertia drivers, undercut irons, and golf balls.

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The Company and its subsidiaries, incident to their business activities, are parties to a number of legal proceedings, lawsuits and other claims, including the matters specifically noted above. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, management is unable to estimate the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance, or the financial impact with respect to these matters. Management believes at this time that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon the Company's consolidated annual results of operations, cash flows or financial position.

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

None.

Executive Officers of the Registrant

Biographical information concerning the Company's executive officers is set forth below.

Name	Age	Position(s) Held
George Fellows	65	President and Chief Executive Officer, Director
Steven C. McCracken	57	Senior Executive Vice President, Chief Administrative Officer and Secretary
Bradley J. Holiday	54	Senior Executive Vice President and Chief Financial Officer
David A. Laverty	50	Senior Vice President, Operations
Thomas Yang	55	Senior Vice President, International

George Fellows is President and Chief Executive Officer of the Company as well as one of its Directors. He has served in such capacities since joining the Company in August 2005. Prior to joining the Company, during the period from 2000 through July 2005, he served as President and Chief Executive Officer of GF Consulting, a management consulting firm, and served as Senior Advisor to Investcorp International, Inc. and J.P. Morgan Partners, LLC. Previously, Mr. Fellows was a member of senior management of Revlon, Inc. from 1993 to 1999, including his terms as President, which commenced in 1995, and Chief Executive Officer, which began in 1997. He is a member of the board of directors of VF Corporation (a global apparel company) and Jack in the Box, Inc. (fast food restaurant chain). Mr. Fellows is also chair of the Audit Committee and a member of the Nominating and Governance Committee of VF Corporation as well as a member of the Finance Committee of Jack in the Box, Inc. Previously, he has served on the boards of directors of Revlon, Inc.; the National Association of Chain Drug Stores; the Cosmetics, Toiletries and Fragrance Association; and has served on the New York Stock Exchange Listed Company Advisory Committee. Mr. Fellows graduated with a B.S. degree from City College of New York, received an MBA from Columbia University and completed the Harvard Advanced Management Program.

Steven C. McCracken is Senior Executive Vice President, Chief Administrative Officer and Secretary of the Company and has served in such capacity since October 2005. He previously served as Senior Executive Vice President, Chief Legal Officer and Secretary from August 2000 until October 2005. He served as Executive Vice President, Licensing and Chief Legal Officer from April 1997 to August 2000. He has served as an Executive Vice President since April 1996 and served as General Counsel from April 1994 to April 1997. He served as Vice President from April 1994 to April 1996. He has served as Secretary since April 1994. Prior to joining the Company, Mr. McCracken was a partner at Gibson, Dunn & Crutcher LLP for 11 years, and had been in the private practice of law for over 18 years. During a portion of that period, he provided legal services to the Company. Mr. McCracken serves on the boards of Pro Kids Golf Academy and Learning Center (First Tee San Diego) and Golf Entertainment International, Inc. (in which the Company has a minority interest investment). Mr. McCracken received a B.A., magna cum laude, from the University of California at Irvine and a J.D. from the University of Virginia.

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Bradley J. Holiday is Senior Executive Vice President and Chief Financial Officer of the Company and has served in such capacity since September 2003. Mr. Holiday previously served as Executive Vice President and Chief Financial Officer beginning in August 2000. Before joining the Company, Mr. Holiday served as Vice President Financial Planning & Analysis for Gateway, Inc. Prior to Gateway, Inc., Mr. Holiday was with Nike, Inc. in various capacities beginning in April 1993, including Chief Financial Officer Golf Company, where he directed all global financial initiatives and strategic planning for Nike, Inc.'s golf business. Prior to Nike, Inc., Mr. Holiday served in various financial positions with Pizza Hut, Inc. and General Mills, Inc. Mr. Holiday has an M.B.A. in Finance from the University of St. Thomas and a B.S. in Accounting from Iowa State University.

David A. Laverty is Senior Vice President, Operations of the Company and has served in such capacity since August 2006. Prior to joining the Company, Mr. Laverty was a Senior Vice President with Vertis Inc., in Baltimore, Maryland. Previously, until April 2005, he had spent 25 years at Revlon in numerous operations management posts. He has a B.A. in Economics from Temple University.

Thomas Yang is Senior Vice President, International and has served in such capacity since joining the Company in July 2006. Until July 2006, Mr. Yang served as Senior Vice President of Global Consumer Products, International for Starbucks Corporation, a position he held for the last 16 months of the nearly five years he worked for Starbucks. He also previously served in international roles for Coca Cola, Proctor & Gamble and the Clorox Company. Mr. Yang serves on the Diversity Council of Korn/Ferry International (an advisory council to its Board of Directors on diversity matters). He graduated from the University of Colorado with a B.S. in Marketing and has a Masters of International Management from the American Graduate School of International Management (Thunderbird) in Arizona.

Information with respect to the Company's employment agreements with its Chief Executive Officer, Chief Financial Officer and other three most highly compensated executive officers will be contained in the Company's definitive Proxy Statement in connection with the 2008 Annual Meeting of Shareholders. In addition, copies of the employment agreements are included as exhibits to this report.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

The Company's Common Stock is listed, and principally traded, on the New York Stock Exchange (NYSE). The Company's symbol for its Common Stock is ELY. As of January 31, 2008, the approximate number of holders of record of the Company's Common Stock was 8,800. The following table sets forth the range of high and low per share closing prices of the Company's Common Stock and per share dividends for the periods indicated.

Period:	Year Ended December 31,					
	2007			2006		
	High	Low	Dividend	High	Low	Dividend
First Quarter	\$ 16.91	\$ 13.98	\$ 0.07	\$ 17.29	\$ 13.57	\$ 0.07
Second Quarter	\$ 18.67	\$ 16.17	\$ 0.07	\$ 17.42	\$ 12.35	\$ 0.07
Third Quarter	\$ 19.26	\$ 15.62	\$ 0.07	\$ 13.73	\$ 11.49	\$ 0.07
Fourth Quarter	\$ 18.07	\$ 15.27	\$ 0.07	\$ 15.23	\$ 12.26	\$ 0.07

The Company intends to continue to pay quarterly dividends subject to capital availability and periodic determinations that cash dividends are in the best interests of our stockholders. Future dividends may be affected by, among other items, the Company's views on potential future capital requirements, projected cash flows and needs, and changes to our business model.

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PERFORMANCE GRAPH

The following graph presents a comparison of the cumulative total shareholder return since December 31, 2002 of the Company's Common Stock, the Standard & Poor's 500 Index and the Standard & Poor's 400 Midcap Index. The graph assumes an initial investment of \$100 at December 31, 2002 and reinvestment of all dividends.

	2002	2003	2004	2005	2006	2007
Callaway Golf	100.00	127.17	101.89	104.46	108.76	131.55
S&P 500	100.00	126.38	137.74	141.87	161.20	166.89
S&P 400 Midcap	100.00	134.02	154.34	171.73	187.17	199.70

The Callaway Golf Company index is based upon the closing prices of Callaway Golf Company Common Stock on December 31, 2002, 2003, 2004, 2005, 2006 and 2007 of \$13.25, \$16.85, \$13.50, \$13.84, \$14.41 and \$17.43, respectively.

Table of Contents**Securities Authorized for Issuance under Equity Compensation Plans**

The following table provides information about the number of stock options and shares underlying Restricted Stock Units (RSUs) and Performance Units outstanding and authorized for issuance under all equity compensation plans of the Company as of December 31, 2007. See Note 11 Share-Based Employee Compensation to the Notes of Consolidated Financial Statements for further discussion of the equity plans of the Company.

Equity Compensation Plan Information

Plan Category	Number of Shares to be Issued Upon Exercise of Outstanding Options and Vesting of RSUs and Performance Units	Weighted Average Exercise Price of Outstanding Options ⁽⁵⁾	Number of Shares Remaining Available for Future Issuance
	(In thousands, except dollar amounts)		
Equity Compensation Plans Approved by Shareholders (including ESPP) ⁽¹⁾	3,817 ⁽⁴⁾	\$ 15.81	7,757 ⁽²⁾
Equity Compensation Plans Not Approved by Shareholders ⁽³⁾	2,854	\$ 17.33	
Total	6,671	\$ 16.51	7,757⁽²⁾

- (1) Consists of the following plans: 1991 Stock Incentive Plan, 1996 Stock Option Plan, Non-Employee Directors Stock Option Plan, 2001 Non-Employee Directors Stock Incentive Plan and 2004 Incentive Plan and Employee Stock Purchase Plan. No shares are available for grant under the 1991 Stock Incentive Plan, 1996 Stock Option Plan or Non-Employee Directors Stock Option Plan at December 31, 2007. The 2001 Non-Employee Directors Stock Incentive Plan permits the awards of stock options, restricted stock and restricted stock units. The 2004 Incentive Plan permits the award of stock options, restricted stock, performance units and various other stock-based awards.
- (2) Includes 3,159,835 shares reserved for issuance under the Employee Stock Purchase Plan.
- (3) Consists of the following plans: 1995 Employee Stock Incentive Plan and 1992 Promotion, Marketing and Endorsement Stock Incentive Plan. In connection with shareholder approval of the 2004 Incentive Plan, the Company agreed that no further grants would be made under the 1995 Plan or the Promotion Plan. No grants have been made under the 1995 Plan since May, 2004 or under the Promotion Plan since March 2002.
- (4) Includes 177,669 and 268,385 shares underlying performance units and RSUs, respectively, issuable from the 2004 Incentive Plan, and 39,369 shares underlying RSUs issuable from the 2001 Non-Employee Directors Stock Incentive Plan.
- (5) Does not include shares underlying RSUs and Performance Units, which do not have an exercise price.

Equity Compensation Plans Not Approved By Shareholders

The Company has the following equity compensation plans which were not approved by shareholders: the 1995 Employee Stock Incentive Plan (the 1995 Plan) and the 1992 Promotion, Marketing and Endorsement Stock Incentive Plan (the Promotion Plan). No shares are available for grant under the 1995 Plan or the Promotion Plan at December 31, 2007. For additional information, see Note 11 Share-Based Employee Compensation to the Notes to Consolidated Financial Statements.

1995 Plan. Under the 1995 Plan, the Company granted stock options to non-executive officer employees and consultants of the Company. Although the 1995 Plan permitted stock option grants to be made at less than the fair market value of the Company's Common Stock on the date of grant, the Company's practice was to generally grant stock options at exercise prices equal to the fair market value of the Company's Common Stock on the date of grant.

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Promotion Plan. Under the Promotion Plan, the Company granted stock options to golf professionals and other endorsers of the Company's products. Such grants were generally made at prices that were equal to the fair market value of the Company's Common Stock on the date of grant.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

In June 2007, the Board of Directors authorized a new repurchase program (the June 2007 repurchase program) for the Company to repurchase shares of its common stock up to a maximum cost to the Company of \$100.0 million, which would remain in effect until completed or otherwise terminated by the Board of Directors. In November 2007, the Board of Directors authorized a new repurchase program (the November 2007 repurchase program) for the Company to repurchase shares of its common stock up to a maximum cost to the Company of \$100.0 million. The November 2007 repurchase program supersedes the June 2007 stock repurchase authorization and will remain in effect until completed or otherwise terminated by the Board of Directors. See Note 10 Capital Stock to the Notes to Consolidated Financial Statements.

Under the June 2007 repurchase program, during the three months ended December 31, 2007, the Company repurchased 0.7 million shares of its common stock at a weighted average cost per share of \$16.61 for a total cost of \$11.1 million. As of December 31, 2007, there were no repurchases made under the November 2007 repurchase program and the Company remained authorized to repurchase up to the maximum authorization of \$100.0 million of its common stock under this program.

The following table summarizes the purchases by the Company under its repurchase programs during the fourth quarter of 2007 (in thousands, except per share data):

		Three Months Ended December 31, 2007			
		Total Number	Weighted	Total Number	Maximum
		of Shares	Average Price	of Shares	Dollar
		Purchased	Paid per Share	Purchased as	Value that
				Part of	May Yet Be
				Publicly	Purchased
				Announced	Under the
				Programs	Programs
October 1, 2007	October 31, 2007	667	\$ 16.61	667	\$ 11,104
November 1, 2007	November 30, 2007		\$		\$ 100,000
December 1, 2007	December 31, 2007		\$		\$ 100,000
Total		667	\$ 16.61	667	\$ 100,000

Table of Contents**Item 6. Selected Financial Data**

The following statements of operations data and balance sheet data for the five years ended December 31, 2007 were derived from the Company's audited consolidated financial statements. Consolidated balance sheets at December 31, 2007 and 2006 and the related consolidated statements of operations and statements of cash flows for each of the three years in the period ended December 31, 2007 and notes thereto appear elsewhere in this report. The following data should be read in conjunction with the annual consolidated financial statements, related notes and other financial information appearing elsewhere in this report.

	2007	Year Ended December 31,			2003 ⁽²⁾
		2006	2005	2004 ⁽¹⁾	
	(In thousands, except per share data)				
Statement of Operations Data:					
Net sales	\$ 1,124,591	\$ 1,017,907	\$ 998,093	\$ 934,564	\$ 814,032
Cost of sales	631,368	619,832	583,679	575,742	445,417
Gross profit	493,223	398,075	414,414	358,822	368,615
Selling, general and administrative expenses	371,020	334,235	370,219	352,967	273,231
Research and development expenses	32,020	26,785	26,989	30,557	29,529
Income (loss) from operations	90,183	37,055	17,206	(24,702)	65,855
Interest and other income (expense), net	3,455	3,364	(390)	1,934	3,550
Interest expense	(5,363)	(5,421)	(2,279)	(945)	(1,522)
Income (loss) before income taxes	88,275	34,998	14,537	(23,713)	67,883
Income tax provision (benefit)	33,688	11,708	1,253	(13,610)	22,360
Net income (loss)	\$ 54,587	\$ 23,290	\$ 13,284	\$ (10,103)	\$ 45,523
Earnings (loss) per common share:					
Basic	\$ 0.82	\$ 0.34	\$ 0.19	\$ (0.15)	\$ 0.69
Diluted	\$ 0.81	\$ 0.34	\$ 0.19	\$ (0.15)	\$ 0.68
Dividends paid per share	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.28

	2007	2006	December 31,		
			2005	2004	2003
	(In thousands)				
Balance Sheet Data:					
Cash and cash equivalents	\$ 49,875	\$ 46,362	\$ 49,481	\$ 31,657	\$ 47,340
Working capital	\$ 273,033	\$ 269,745	\$ 298,385	\$ 272,934	\$ 253,302
Total assets	\$ 856,963	\$ 845,947	\$ 764,498	\$ 735,737	\$ 748,566
Long-term liabilities	\$ 63,207	\$ 43,388	\$ 28,245	\$ 28,622	\$ 29,023
Total shareholders' equity	\$ 568,230	\$ 577,117	\$ 596,048	\$ 586,317	\$ 589,383

- (1) On May 28, 2004, the Company acquired all of the issued and outstanding shares of stock of FrogTrader, Inc. Thus, the Company's financial data includes the FrogTrader, Inc. results of operation commencing May 28, 2004.
- (2) On September 15, 2003 the Company completed the domestic portion of the Top-Flite Acquisition. The settlement of the international assets was effective October 1, 2003. Thus, the Company's financial data includes The Top-Flite Golf Company results of operations in the United States commencing September 15, 2003, and the international operations commencing October 1, 2003.

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

The following discussion should be read in conjunction with the Consolidated Financial Statements, the related notes and the Important Notice to Investors that appear elsewhere in this report.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its results of operations, financial condition and liquidity are based upon the Company's 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 the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, as well as related disclosures of contingent assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an ongoing basis, the Company reviews its estimates to ensure that the estimates appropriately reflect changes in its business and new information as it becomes available.

Management believes the critical accounting policies discussed below affect its more significant estimates and assumptions used in the preparation of its consolidated financial statements. For a complete discussion of all of the Company's significant accounting policies, see Note 2 to the Consolidated Financial Statements.

Revenue Recognition

Sales are recognized in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements, as products are shipped to customers, net of an allowance for sales returns and accruals for sales programs. The Company records a reserve for anticipated returns through a reduction of sales and cost of sales in the period that the related sales are recorded. Sales returns are estimated based upon historical returns, current economic trends, changes in customer demands and sell-through of products. Historically, the Company's actual sales returns have not been materially different from management's original estimates. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate the allowance for sales returns. However, if the actual costs of sales returns are significantly different than the recorded estimated allowance, the Company may be exposed to losses or gains that could be material. For example, assuming there had been a 10% increase in the Company's 2007 sales returns, net earnings for the year ended December 31, 2007 would have been reduced by approximately \$2.3 million.

The Company also records estimated reductions to revenue for sales programs such as incentive offerings. Sales program accruals are estimated based upon the attributes of the sales program, management's forecast of future product demand, and historical customer participation in similar programs. The Company's primary sales program the Preferred Retailer Program offers longer payment terms during the initial sell in period, as well as potential rebates and discounts, for participating retailers in exchange for providing certain benefits to the Company, including the maintenance of agreed upon inventory levels, prime product placement and retailer staff training. Under this program, qualifying retailers can earn either discounts or rebates based upon the amount of product purchased. Discounts are applied and recorded at the time of sale. For rebates, the Company accrues an estimate of the rebate at the time of sale based on the customer's estimated qualifying current year product purchases. The estimate is based on the historical level of purchases, adjusted for any factors expected to affect the current year purchase levels. The estimated year-end rebate is adjusted quarterly based on actual purchase levels, as necessary. The Preferred Retailer Program is generally short term in nature and the actual costs of the program are known as of the end of the year and paid to customers shortly after year-end. In addition to the Preferred Retailer Program, the Company from time to time offers additional sales program incentive offerings which are also generally short term in nature. Historically the Company's actual costs related to its Preferred Retailer Program and other sales programs have not been materially different than its estimates.

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Revenues from gift cards are deferred and recognized when the cards are redeemed. In addition, the Company recognizes revenue from unredeemed gift cards when the likelihood of redemption becomes remote and under circumstances that comply with applicable state escheatment laws, if any. The Company's gift cards have no expiration, therefore, to determine when redemption is remote, the Company analyzes an aging of unredeemed cards (based on the date the card was last used or the activation date if the card has never been used) and compares that information with historical redemption trends. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to determine the timing of recognition of gift card revenues. However, if the Company is not able to accurately determine when gift card redemption is remote, the Company may be exposed to losses or gains that could be material. The deferred revenue associated with outstanding gift cards increased \$1.8 million to \$4.8 million during the year ended December 31, 2007.

Inventories

Inventories are valued at the lower of cost or fair market value. Cost is determined using the first-in, first-out (FIFO) method. The inventory balance, which includes material, labor and manufacturing overhead costs, is recorded net of an estimated allowance for obsolete or unmarketable inventory. The estimated allowance for obsolete or unmarketable inventory is based upon current inventory levels, sales trends and historical experience as well as management's understanding of market conditions and forecasts of future product demand, all of which are subject to change.

The calculation of the Company's allowance for obsolete or unmarketable inventory requires management to make assumptions and to apply judgment regarding inventory aging, forecasted consumer demand and pricing, regulatory (USGA and R&A) rule changes, the promotional environment and technological obsolescence. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate the allowance. However, if estimates regarding consumer demand are inaccurate or changes in technology affect demand for certain products in an unforeseen manner, the Company may be exposed to losses that could be material. Historically, there have been no material inventory write-offs for which an allowance had not previously been established. Assuming there had been a 10% increase in the Company's 2007 allowance for obsolete or unmarketable inventory, net earnings for the year ended December 31, 2007 would have been reduced by approximately \$2.0 million.

Long-Lived Assets

In the normal course of business, the Company acquires tangible and intangible assets. The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets (including property, plant and equipment, investments, goodwill and other intangible assets) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. Impairment is assessed when the undiscounted future cash flows estimated to be derived from an asset are less than its carrying amount. Determining whether an impairment has occurred typically requires various estimates and assumptions, including determining the amount of undiscounted cash flows directly related to the potentially impaired asset, the useful life over which cash flows will occur, the timing of the impairment test, and the asset's residual value, if any. The Company uses its best judgment based on current facts and circumstances related to its business when applying these impairment rules. To determine fair value, the Company uses its internal cash flow estimates discounted at an appropriate interest rate, quoted market prices and royalty rates when available and independent appraisals, as appropriate. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate long-lived asset impairment losses. However, if actual results are not consistent with the Company's estimates and assumptions used in calculating future cash flows and asset fair values, the Company may be exposed to losses that could be material.

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Warranty Policy

The Company has a stated two-year warranty policy for its golf clubs, although the Company's historical practice has been to honor warranty claims well after the two-year stated warranty period. The Company's policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty.

The Company's estimates for calculating the warranty reserve are principally based on assumptions regarding the warranty costs of each club product line over the expected warranty period, where little or no claims experience may exist. Experience has shown that warranty rates can vary between product models, therefore the Company's warranty obligation calculation is based upon long-term historical warranty rates until sufficient data is available. As actual model-specific rates become available, the Company's estimates are modified to ensure that the forecast is within the range of likely outcomes.

Historically, the Company's actual warranty claims have not been materially different from management's original estimated warranty obligation. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate the warranty obligation. However, if the number of actual warranty claims or the cost of satisfying warranty claims significantly exceeds the estimated warranty reserve, the Company may be exposed to losses that could be material. Assuming there had been a 10% increase in the Company's 2007 warranty obligation, net earnings for the year ended December 31, 2007 would have been reduced by approximately \$1.2 million.

Income Taxes

Current income tax expense or benefit is the amount of income taxes expected to be payable or receivable for the current year. A deferred income tax asset or liability is established for the difference between the tax basis of an asset or liability computed pursuant to FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. The Company provides a valuation allowance for its deferred tax assets when, in the opinion of management, it is more likely than not that such assets will not be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should the Company determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Effective January 1, 2007, the Company was required to adopt and implement the provisions of FIN 48, which requires the Company to accrue for the estimated additional amount of taxes for uncertain tax positions if it is more likely than not that the Company would be required to pay such additional taxes. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. As a result of the adoption of FIN 48, the Company recognized an increase in the liability for its uncertain tax positions of \$437,000, of which the entire charge was accounted for as a decrease to the beginning balance of retained earnings. The accrual for uncertain tax positions can result in a difference between the estimated benefit recorded in the Company's financial statements and the benefit taken or expected to be taken in the Company's income tax returns. This difference is generally referred to as an unrecognized tax benefit.

The Company is required to file federal and state income tax returns in the United States and various other income tax returns in foreign jurisdictions. The preparation of these income tax returns requires the Company to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of

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tax paid by the Company. The Company, in consultation with its tax advisors, bases its income tax returns on interpretations that are believed to be reasonable under the circumstances. The income tax returns, however, are subject to routine audits by the various federal, state and international taxing authorities in the jurisdictions in which the Company files its income tax returns. As part of these reviews, a taxing authority may disagree with respect to the tax positions taken by the Company. The resolution of any disagreements over the Company's tax positions often involves complex issues and may span multiple years, particularly if litigation is involved. The ultimate resolution of these tax positions is often uncertain until the audit is complete and any disagreements are resolved. As required under applicable accounting rules, the Company therefore accrues an amount for its estimate of additional tax liability, including interest and penalties, for any uncertain tax positions taken or expected to be taken in an income tax return. The Company reviews and updates the accrual for uncertain tax positions as more definitive information becomes available from taxing authorities, completion of tax audits, expiration of statute of limitations, or upon occurrence of other events. Historically, additional taxes paid as a result of the resolution of the Company's uncertain tax positions have not been materially different from the Company's expectations. Information regarding income taxes is contained in Note 13 to the Consolidated Financial Statements.

Share-based Employee Compensation

Beginning in fiscal year 2006, the Company accounts for share-based compensation arrangements in accordance with the provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R) Share-Based Payments, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options at the date of grant. The Black-Scholes option valuation model requires the input of highly subjective assumptions including the Company's expected stock price volatility, the expected dividend yield, the expected life of an option and the number of awards ultimately expected to vest. Changes in subjective input assumptions can materially affect the fair value estimates of an option. Furthermore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by an employee. The Company uses historical data to estimate the expected price volatility, the expected dividend yield, the expected option life and the expected forfeiture rate. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. If actual results are not consistent with the Company's assumptions and judgments used in estimating the key assumptions, the Company may be required to increase or decrease compensation expense, which could be material to its results of operations.

In accordance with SFAS 123R, the Company records compensation expense for Restricted Stock Awards based on the estimated fair value of the award on the date of grant. The estimated fair value is determined based on the closing price of the Company's Common Stock on the award date multiplied by the number of awards expected to vest. The number of awards expected to vest is based on the number of awards granted adjusted by estimated forfeiture rates. The total compensation cost is then recognized ratably over the vesting period. If actual forfeiture rates are not consistent with the Company's estimates, the Company may be required to increase or decrease compensation expenses in future periods.

During 2006 the Company granted Performance Units to certain employees under the Company's 2004 Equity Incentive Plan. Performance Units are a form of share-based award in which the number of shares ultimately received depends on the Company's performance against specified performance targets over a three year period. The estimated fair value of the Performance Units is determined based on the closing price of the Company's Common Stock on the grant date multiplied by the expected number of shares to be issued at the end of the performance period. The compensation cost is then amortized on a straight-line basis over the performance period. The Company uses forecasted performance metrics to estimate the number of shares that will ultimately be issued. If actual results are not consistent with the Company's assumptions and judgments used in estimating the forecasted metrics, the Company may be required to increase or decrease compensation expense, which could be material to its results of operations.

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Recent Accounting Pronouncements

Information regarding recent accounting pronouncements is contained in Note 2 to the Consolidated Financial Statements, which is incorporated herein by this reference.

Results of Operations

Overview of Business and Seasonality

The Company designs, manufactures and sells high quality golf clubs and golf balls and also sells golf footwear, golf bags and other golf related accessories. The Company designs its products to be technologically-advanced and in this regard invests a considerable amount in research and development each year. The Company's products are designed for golfers of all skill levels, both amateur and professional.

The Company has two operating segments that are organized on the basis of products, which are segregated between golf clubs and golf balls. The golf clubs segment consists primarily of Callaway Golf, Top-Flite and Ben Hogan woods, hybrids, irons, wedges and putters as well as Odyssey putters. This segment also includes other golf-related accessories described above and royalties from licensing of the Company's trademarks and service marks as well as sales of pre-owned golf clubs. The golf balls segment consists primarily of Callaway Golf and Top-Flite golf balls. As discussed below and in Note 15 to the Company's consolidated financial statements, the Company's operating segments exclude a significant amount of corporate and general administrative expenses and other income (expense) not utilized by management in determining segment profitability. While the Company's golf clubs segment has been profitable, the Company's golf balls segment has historically reported annual operating losses for all periods until the current year. The operating results of the Company's golf balls segment includes charges for the applicable periods related to the integration of the Callaway Golf and Top-Flite golf ball operations acquired in September 2003 (the Top-Flite Integration Initiatives), charges for the company-wide restructuring initiatives announced in September 2005 (the 2005 Restructuring Initiatives) and charges related to the cost reduction initiatives that target gross margin improvements announced during the fourth quarter of 2006 (the Gross Margin Improvement Initiatives). The Company's golf balls segment results of operations have improved significantly from a loss of \$52.7 million in 2003 (including charges of \$24.1 million for the Top-Flite Integration Initiatives) to profitability of \$0.9 million in 2007 (including charges of \$0.3 million and \$3.2 million for the 2005 Restructuring Initiatives and the Gross Margin Improvement Initiatives, respectively). As previously announced, the Company has taken action to address the profitability of its golf ball business, including a re-launch of the Top-Flite brand in 2007, which included among other things the launch of the new D2 golf ball, an updated brand logo as well as an aggressive marketing campaign.

Beginning in November 2006 and continuing throughout 2007, the Company implemented certain Gross Margin Improvement Initiatives. These Gross Margin Improvement Initiatives primarily consisted of process improvements in (i) the procurement of direct materials, including all components used in finished products, (ii) the procurement of indirect goods and services not utilized in finished product such as travel and non-manufacturing temporary labor among others, (iii) the Company's manufacturing and distribution process primarily through the elimination of redundant activities as well as streamlining the process in which the Company distributes components and finished goods worldwide, and (iv) value engineering and automation, which incorporates strategic capital investments to automate processes and create efficiencies within the Company's operational areas. As a result of these initiatives, as well as certain other factors, the Company's gross margins improved to 44% for the year ended December 31, 2007 from 39% for the same period in 2006. The Company expects to continue implementing these and other Gross Margin Improvement Initiatives in 2008.

In most of the Company's key markets, the game of golf is played primarily on a seasonal basis. Weather conditions generally restrict golf from being played year-round, except in a few small markets, with many of the Company's on-course customers closing for the cold weather months. The Company's business is therefore also subject to seasonal fluctuations. In general, during the first quarter, the Company begins selling its products into the golf retail channel for the new golf season. This initial sell-in generally continues into the second quarter. The Company's second quarter sales are also significantly affected by the amount of re-order business of the products

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sold during the first quarter. The Company's third quarter sales are generally dependent on re-order business but are generally less than the second quarter as many retailers begin decreasing their inventory levels in anticipation of the end of the golf season. The Company's fourth quarter sales are generally less than the other quarters due to the end of the golf season in many of the Company's key markets. This seasonality, and therefore quarter to quarter fluctuations, can be affected by many factors, including the timing of new product introductions. In general, however, because of this seasonality, a majority of the Company's sales and most, if not all, of its profitability generally occurs during the first half of the year.

Years Ended December 31, 2007 and 2006

Net sales increased \$106.7 million (10%) to \$1,124.6 million for the year ended December 31, 2007 as compared to \$1,017.9 million for the year ended December 31, 2006. The overall increase in net sales is primarily due to the Company's strong 2007 product line and improvements to the Company's supply chain during the current year, which improvements allowed the Company to make the necessary adjustments to supply the products for the increased demand. On an operating segment basis, net sales increased as result of a \$108.4 million (13%) increase in net sales from the Company's golf clubs segment, offset by a decrease of \$1.7 million (1%) in net sales from the Company's golf balls segment. The Company's net sales by operating segment is set forth below (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2007	2006	Dollars	Percent
Net sales				
Golf clubs	\$ 911.5	\$ 803.1	\$ 108.4	13%
Golf balls	213.1	214.8	(1.7)	(1)%
	\$ 1,124.6	\$ 1,017.9	\$ 106.7	10%

For further discussion of each operating segment's results, see "Golf Club and Golf Ball Segments Results" below.

Net sales information by region is summarized as follows (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2007	2006	Dollars	Percent
Net sales:				
United States	\$ 597.6	\$ 566.6	\$ 31.0	5%
Europe	193.3	159.9	33.4	21%
Japan	120.1	105.7	14.4	14%
Rest of Asia	86.1	75.6	10.5	14%
Other foreign countries	127.5	110.1	17.4	16%
	\$ 1,124.6	\$ 1,017.9	\$ 106.7	10%

Net sales in the United States increased \$31.0 million (5%) to \$597.6 million during the year ended December 31, 2007 compared to 2006. The Company's sales in regions outside of the United States increased \$75.7 million (17%) to \$527.0 million during the year ended December 31, 2007 compared to 2006. This increase in U.S. and international sales is attributable to increased sales in all regions primarily due to favorable consumer acceptance of the Company's new products. The Company's net sales were positively affected during 2007 by changes in foreign currency rates, primarily in Europe, Australia, Canada and Korea partially offset by unfavorable foreign currency rate changes in Japan.

For the year ended December 31, 2007, gross profit increased \$95.1 million (24%) to \$493.2 million from \$398.1 million in 2006. Gross profit as a percentage of net sales improved to 44% during the year ended

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December 31, 2007 from 39% in the comparable period of 2006. Overall gross margins during 2007 were favorably impacted by increases in average selling prices resulting from a more favorable current year product mix combined with improved manufacturing efficiencies, a decline in freight costs as well as other Gross Margin Improvement Initiatives. Gross profit for the year ended December 31, 2007 was negatively affected by charges of \$8.9 million related to the implementation of the Company's Gross Margin Improvement Initiatives. Gross profit for the year ended December 31, 2006 was negatively affected by charges of \$3.5 million related to the Top-Flite Integration Initiatives, \$1.9 million related to the Gross Margin Improvement Initiatives, as well as \$0.3 million in connection with the Company's 2005 Restructuring Initiatives.

Selling expenses increased \$27.5 million (11%) to \$282.0 million for the year ended December 31, 2007 as compared to \$254.5 million for the year ended December 31, 2006. As a percentage of net sales, selling expense remained constant at 25% for the years ended December 31, 2007 and 2006. The dollar increase was primarily due to a \$14.1 million increase in employee costs primarily related to employee incentive compensation as a result of the Company's improved financial performance in 2007. In addition, advertising and other promotional expenses increased \$8.0 million primarily due to expenditures associated with current year new product introductions as well as the previously announced re-launch of the Top-Flite brand, and depreciation expense increased \$2.2 million as a result of an increase in display and shelving fixtures as well as fitting carts acquired during 2007.

General and administrative expenses increased \$9.4 million (12%) to \$89.1 million for the year ended December 31, 2007 as compared to \$79.7 million for the year ended December 31, 2006. As a percentage of net sales, general and administrative expenses remained constant at 8% for the years ended December 31, 2007 and 2006. The dollar increase was due to a \$7.7 million increase in employee costs primarily related to employee incentive compensation as a result of the Company's improved financial performance, a \$5.2 million increase in corporate legal expense primarily associated with golf ball intellectual property rights litigation and a \$1.8 million increase in professional fees primarily related to consulting services. These increases were partially offset by a \$5.4 million gain recognized in connection with the sale of two buildings in August and December of 2007.

Research and development expenses increased \$5.2 million (19%) to \$32.0 million for the year ended December 31, 2007 as compared to \$26.8 million for the year ended December 31, 2006. As a percentage of net sales, research and development expenses remained constant at 3% for the years ended December 31, 2007 and 2006. The dollar increase was primarily due to a \$3.6 million increase in employee costs primarily related to employee incentive compensation as a result of the Company's improved financial performance combined with an increase in salaries and wages.

Other net expense decreased \$0.2 million (10%) to \$1.9 million for the year ended December 31, 2007 as compared to \$2.1 million for the year ended December 31, 2006. This improvement is primarily a result of a \$0.9 million increase in net interest income primarily due to improved management of cash on hand, partially offset by a decrease of \$0.6 million in other income as a result of a favorable insurance claim recognized in the fourth quarter of 2006.

The effective tax rate for the year ended December 31, 2007 was 38% compared to 33% for the year ended December 31, 2006. The tax rate benefited from net favorable adjustments to previously estimated tax liabilities in the amount of \$1.6 million and \$3.0 million for the years ended December 31, 2007 and 2006, respectively. Additionally, the relative impact of these net favorable adjustments on the effective tax rate was greater in 2006 as a result of lower income before taxes in that year. Historically, the most significant favorable adjustments resulted from the finalization of the Company's prior year U.S. and state income tax returns as well as agreements reached with major jurisdictions on certain issues necessitating a reassessment of the Company's tax exposures for all open tax years, with no individual year being significantly affected.

Net income for 2007 improved 134% to \$54.6 million from net income of \$23.3 million in 2006. The diluted earnings per share improved 138% to \$0.81 per share in 2007 compared to diluted earnings per share of

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\$0.34 in 2006. In 2007, net income was positively impacted by after-tax gains of \$3.3 million (\$0.05 per share) that were recognized in connection with the sale of two buildings in August and December of 2007. Net income in 2007 was negatively impacted by after-tax charges of \$5.5 million (\$0.08 per share) related to costs associated with the Company's Gross Margin Improvement Initiatives. Net income in 2006 was negatively impacted by after-tax charges of \$2.5 million (\$0.04 per share) related to the Top-Flite Integration Initiatives, after-tax charges of \$1.9 million (\$0.03 per share) in connection with the Company's 2005 Restructuring Initiatives and after-tax charges of \$1.1 million (\$0.02 per share) related to costs associated with the Gross Margin Improvement Initiatives.

Golf Clubs and Golf Balls Segments Results for the Years Ended December 31, 2007 and 2006**Golf Clubs Segment**

Net sales for the golf clubs segment increased \$108.4 million (13%) to \$911.5 million for the year ended December 31, 2007 as compared to \$803.1 million for the year ended December 31, 2006. This increase is primarily attributable to a \$39.4 million (15%) increase in net sales of woods, a \$41.0 million (28%) increase in net sales of accessories and other products and a \$21.6 million (8%) increase in net sales of irons compared to the prior year.

Net sales information for the golf clubs segment by product category is summarized as follows (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2007	2006	Dollars	Percent
Net sales:				
Woods	\$ 305.9	\$ 266.5	\$ 39.4	15%
Irons	309.6	288.0	21.6	8%
Putters	109.1	102.7	6.4	6%
Accessories and other	186.9	145.9	41.0	28%
	\$ 911.5	\$ 803.1	\$ 108.4	13%

The \$39.4 million (15%) increase in net sales of woods to \$305.9 million for the year ended December 31, 2007 is primarily attributable to an increase in average selling prices partially offset by lower unit volume. The increase in average selling prices is primarily attributable to a favorable shift in product mix as a result of the launch of two premium multi-material drivers, the FT-i and FT-5, and one titanium driver, the Big Bertha 460, which were introduced during the first quarter of 2007. These products sold at higher price points than the prior generation FT-3 driver, which was in the third year of its product lifecycle and the titanium X460 driver, which was introduced during the first quarter of 2006. The decline in unit volume primarily resulted from a decrease in unit volume of older fairway wood products, which were in the second and third years of their product lifecycles, partially offset by an increase in unit volume of the new driver products discussed above.

The \$21.6 million (8%) increase in net sales of irons to \$309.6 million for the year ended December 31, 2007 resulted primarily from higher unit volume combined with an increase in average selling prices. The increase in unit volume is primarily attributable to an increase in sales of X-20 irons products that were launched during the first quarter of 2007 partially offset by a decrease in sales of the Company's older irons products, primarily Big Bertha irons and prior generation X-18 irons, which were in the second and third years of their product lifecycles. The increase in average selling prices is attributable to a more favorable mix of higher priced irons products during 2007 compared to 2006. This shift in product mix primarily resulted from the current year introduction of more premium multi-material irons products compared to the prior year introduction of steel irons products which generally have lower average selling prices.

The \$6.4 million (6%) increase in net sales of putters to \$109.1 million for the year ended December 31, 2007 resulted primarily from an increase in average selling prices offset by lower unit volume. The increase in

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average selling prices is attributable to the current year introduction of the White Hot XG and Black Series putter product lines. The decrease in unit volume is primarily due to decreases in sales of the Company's older White Hot, White Steel, Tri-ball and 2-ball SRT putter products, which were in the second and third years of their product lifecycles.

The \$41.0 million (28%) increase in sales of accessories and other products to \$186.9 million is primarily attributable to an increase in sales of Callaway Golf footwear and other accessories (primarily bags and gloves). The increase in sales of Callaway Golf footwear was primarily due to an increase in unit volume as well as the fact that golf footwear was sold primarily through a licensing arrangement until April of 2006 whereas the Company sold golf footwear directly to retailers during the full year in 2007.

Golf Balls Segment

Net sales information for the golf balls segment is summarized as follows (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2007	2006	Dollars	Percent
Net sales:				
Golf balls	\$ 213.1	\$ 214.8	\$ (1.7)	(1)%

The \$1.7 million (1%) decrease in net sales of golf balls to \$213.1 million for the year ended December 31, 2007 is primarily due to a decrease in unit volume of Top-Flite golf balls, partially offset by an increase in unit volume of Callaway Golf balls. The decrease in unit volume for Top-Flite golf balls is primarily due to a planned 30% reduction in product SKUs combined with a decline in sales of the Company's older Top-Flite brand golf ball products that were in the second and third years of their product lifecycles, partially offset by net sales of the D2 golf ball introduced in the current year. The increase in unit volume for the Callaway Golf balls is attributable to favorable consumer acceptance of the Company's current year product introductions, including the new 2007 HX Hot, Big Bertha and Warbird golf ball product lines.

Segment Profitability

Profitability by operating segment is summarized as follows (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2007	2006	Dollars	Percent
Income (loss) before provision for income taxes ⁽¹⁾				
Golf clubs	\$ 151.8	\$ 101.8	\$ 50.0	49%
Golf balls	0.9	(6.4)	7.3	114%
	\$ 152.7 ⁽¹⁾	\$ 95.4 ⁽¹⁾	\$ 57.3	60%

(1) Amounts shown are before the deduction of corporate general and administration expenses and other income (expenses) of \$64.4 million and \$60.4 million for the years ended December 31, 2007 and 2006, respectively, which are not utilized by management in determining segment profitability. For further information on segment reporting see Note 15 to the Consolidated Condensed Financial Statements Segment Information in this Form 10-K.

Pre-tax income (loss) in the Company's golf clubs and golf balls operating segments improved to \$151.8 million and \$0.9 million, respectively, for the year ended December 31, 2007 compared to income of \$101.8 million and a loss of \$6.4 million, respectively, for the same period in 2006. The increase in the golf clubs operating segment pre-tax income is primarily attributable to improved net sales as well as improved gross

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margins resulting from a more favorable club product mix due to the current year launch of higher margin driver and irons products. The increase in the golf balls operating segment pre-tax income is primarily due to improved net sales as well as improved gross margins resulting from a shift in product mix toward increased sales of more premium Callaway branded golf balls and the introduction of a higher-priced Top-Flite branded golf ball combined with a decline in sales of lower margin range balls during the year ended December 31, 2007. Additionally, during 2006, the Company recorded a \$3.3 million charge due to a work-in-progress inventory write-down as a result of an annual physical inventory count. Furthermore, both golf clubs and golf balls operating segment margins were favorably impacted by cost reductions resulting from improved manufacturing efficiencies, declines in freight costs and the successful implementation of the Company's Gross Margin Improvement Initiatives during 2007.

As previously mentioned in the overview above, during 2006 the Company incurred charges in connection with the 2005 Restructuring Initiatives and the Top-Flite Integration Initiatives. The Company's income before provision for income taxes for the golf clubs and golf balls operating segments includes the recognition of charges in connection with these initiatives in the amounts of \$3.2 million and \$3.8 million, respectively, for the year ended December 31, 2006. In connection with the Company's Gross Margin Improvement Initiatives announced during the fourth quarter of 2006, the Company's golf clubs and golf balls operating segments absorbed charges of \$5.7 million and \$3.2 million, respectively, during 2007.

Years Ended December 31, 2006 and 2005

Net sales increased 2% to \$1,017.9 million for the year ended December 31, 2006 as compared to \$998.1 million for the year ended December 31, 2005. The overall increase in net sales is primarily due to a 9% increase in sales of the Callaway Golf and Odyssey branded products partially offset by a 31% decline in sales of the Top-Flite and Ben Hogan branded products. The Company is in the process of implementing several initiatives designed to restore the Top-Flite brand. The Company's net sales by operating segment is set forth below (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2006	2005	Dollars	Percent
Net sales				
Golf clubs	\$ 803.1	\$ 783.4	\$ 19.7	3%
Golf balls	214.8	214.7	0.1	0%
	\$ 1,017.9	\$ 998.1	\$ 19.8	2%

For further discussion of each operating segment's results, see [Golf Club and Golf Ball Segments Results](#) below.

Net sales information by region is summarized as follows:

	Years Ended December 31,		Growth (Decline)	
	2006	2005	Dollars	Percent
Net Sales:				
United States	\$ 566.6	\$ 563.0	\$ 3.6	1%
Europe	159.9	166.2	(6.3)	(4)%
Japan	105.7	103.4	2.3	2%
Rest of Asia	75.6	66.9	8.7	13%
Other foreign countries	110.1	98.6	11.5	12%
	\$ 1,017.9	\$ 998.1	\$ 19.8	2%

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Net sales in the United States increased \$3.6 million (1%) to \$566.6 million during 2006 compared to 2005. The Company's sales in regions outside of the United States increased \$16.2 million (4%) to \$451.3 million during 2006 compared to 2005. This increase in international sales is primarily attributable to a \$11.0 million increase in sales in Japan and the rest of Asia as well as an increase of \$11.5 million in sales in other foreign countries due to favorable consumer acceptance of the Company's new products launched in those regions late in 2005 and the beginning of 2006. These increases were partially offset by \$6.3 million decrease in sales in Europe, as a result of a general decline in the golf equipment market due to unfavorable weather conditions in that region and the World Cup soccer event, which reduced traffic in golf retail stores, as well as a decline in Top-Flite and Ben Hogan sales. The Company's 2006 net sales were also positively affected by changes in foreign currency rates primarily in Canada and Korea, partially offset by unfavorable changes in Japan and Europe.

For the year ended December 31, 2006, gross profit decreased \$16.3 million to \$398.1 million from \$414.4 million in the comparable period of 2005. Gross profit as a percentage of net sales decreased to 39% in 2006 from 42% in 2005. This decrease is primarily attributable to (i) decreased sales volumes of higher margin premium irons products which were in the second year of their product life cycles, (ii) price reductions on older club and golf ball products, (iii) higher costs associated with manufacturing certain of the Company's new club products that incorporate more complex designs, and (iv) an increase in freight charges, golf ball material costs and utility costs. Additionally, total gross profit for 2006 was negatively affected by charges of \$3.5 million, \$0.3 million and \$1.9 million related to the integration of the Top-Flite operations, the 2005 Restructuring Initiatives and costs associated with the implementation of the Company's gross margin initiatives, respectively, as well as \$0.5 million in employee share-based compensation expense recorded during the period. In 2005, gross profit was negatively affected by charges of \$6.4 million and \$2.1 million, respectively, related to the integration of the Top-Flite operations and the 2005 Restructuring Initiatives.

Selling expenses decreased \$35.6 million (12%) in 2006 to \$254.5 million from \$290.1 million in 2005. As a percentage of sales, selling expenses decreased to 25% in 2006 compared to 29% in 2005. This decrease was primarily due to decreases of \$20.5 million in advertising, tour and other promotional expenses, \$9.7 million in employee costs as well as \$1.1 million in asset disposal losses all associated with the 2005 Restructuring Initiatives implemented during the second half of 2005. In addition, accrued employee incentive compensation expense decreased by \$0.9 million, depreciation and amortization expense decreased by \$1.7 million and share-based compensation expense for non-employees decreased by \$2.7 million, partially offset by an increase of \$1.7 million in share-based compensation for employees as a result of the Company's adoption of SFAS 123R.

General and administrative expenses decreased \$0.4 million (0.5%) in 2006 to \$79.7 million from \$80.1 million in 2005. As a percentage of sales, general and administrative expenses remained consistent at 8% in both 2006 and 2005. The dollar decrease was due primarily to a net decrease of \$1.8 million in employee costs and a decrease of \$0.9 million in asset disposal losses both in connection with the 2005 Restructuring Initiatives. In addition, there were decreases of \$0.9 million in accrued employee incentive compensation expense, \$1.4 million in bad debt expense, \$0.9 million in building expenses, \$1.4 million in consulting and professional fees, \$0.6 million in computer equipment, supplies and telephone charges as well as \$0.9 million in depreciation and amortization expense as a result of assets that became fully depreciated during 2005. These decreases were partially offset by increases of \$6.6 million in employee costs primarily due to share-based compensation expense as a result of the Company's adoption of SFAS 123R and employee relocation expenses recorded during the period as well as \$2.2 million in legal expenses.

Research and development expenses decreased \$0.2 million (1%) in 2006 to \$26.8 million from \$27.0 million in 2005. As a percentage of sales, research and development expenses remained consistent at 3% in both periods. The dollar decrease was primarily due to a decrease in consulting fees partially offset by increases in employee costs and travel expenses.

Other expense, net improved to \$2.1 million in 2006 compared to other expense, net of \$2.7 million in 2005. This decrease in other expense is due to a \$2.7 million improvement in net foreign currency fluctuation gains as

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well as a \$0.6 million increase in other income due to an insurance claim recognized in the fourth quarter of 2006. These improvements are partially offset by an increase in interest expense of \$2.7 million due to an increase in average outstanding borrowings under the Company's line of credit during 2006 as compared to 2005.

The income tax provision reflects effective tax rates of 33% and 9% for the years ended December 31, 2006 and 2005, respectively. During 2006 and 2005, the Company's tax rate varied from its statutory rate primarily as a result of recorded net favorable adjustments of \$3.0 million and \$3.6 million, respectively, related to the reassessment and resolution of various tax exposures. The relative impact of these adjustments on the effective tax rates was greater in 2005 as a result of lower income before taxes in that year.

Net income for 2006 increased \$10.0 million (75%) to \$23.3 million from net income of \$13.3 million in 2005. Diluted earnings per share increased to \$0.34 in 2006 compared to diluted earnings per share of \$0.19 in 2005. In 2006, net income was negatively impacted by after-tax charges related to the recognition of share-based compensation expense, the Top-Flite Integration, the 2005 Restructuring Initiatives, and the 2006 Gross Margin Initiatives and in the amounts of \$5.8 million (\$0.08 per share), \$2.5 million (\$0.04 per share), \$1.9 million (\$0.03 per share), and \$1.1 million (\$0.02 per share), respectively. In 2005, net income was negatively impacted by after-tax charges related to the Top-Flite Integration and the 2005 Restructuring Initiatives in the amounts of \$7.7 million (\$0.11 per share) and \$5.2 million (\$0.07 per share), respectively.

Golf Clubs and Golf Balls Segments Results for the Years Ended December 31, 2006 and 2005**Golf Clubs Segment**

Net sales for the golf clubs segment increased 3% to \$803.1 million for the year ended December 31, 2006 as compared to \$783.4 million for the year ended December 31, 2005. The overall increase in golf clubs net sales during 2006 was due to a \$29.6 million (26%) increase in net sales of accessories and other, a \$25.2 million (10%) increase in net sales of drivers and fairway woods, partially offset by decreases of \$28.5 million (9%) in net sales of irons and \$6.6 million (6%) in net sales of putters compared to the prior year.

Net sales information for the golf clubs segment by product category is summarized as follows:

	Years Ended		Growth (Decline)	
	December 31, 2006	2005	Dollars	Percent
Net Sales:				
Driver and fairway woods	\$ 266.5	\$ 241.3	\$ 25.2	10%
Irons	288.0	316.5	(28.5)	(9)%
Putters	102.7	109.3	(6.6)	(6)%
Accessories and other	145.9	116.3	29.6	26%
	\$ 803.1	\$ 783.4	\$ 19.7	3%

The \$25.2 million (10%) increase in net sales of drivers and fairway woods to \$266.5 million for the year ended December 31, 2006 is primarily due to higher average selling prices as well as an increase in units sold. The increase in average selling prices is primarily attributable to a more favorable mix of higher priced multi-material driver and hybrid products introduced during the current year as well as continued favorable consumer acceptance of the Company's multi-material driver and fairway woods that were launched during the second half of 2005. These increases were partially offset by a reduction in average selling price of the Company's older Ben Hogan and Callaway Golf brand driver and fairway woods products. The increase in units sold is primarily due to the launch of steel fairway woods and multi-material hybrid clubs during 2006 as well as continued favorable consumer acceptance of the Company's 2005 product introductions mentioned above.

The \$28.5 million (9%) decrease in net sales of irons to \$288.0 million for the year ended December 31, 2006 is primarily due to a decline in average selling prices as well as a decrease in units sold during 2006

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compared to 2005. The decrease in average selling prices is primarily due to a higher mix of lower priced irons products during 2006 compared to 2005. This shift in product mix primarily resulted from the current year introduction of lower priced steel irons products compared to the prior year introduction of multi-material irons products which generally have higher average selling prices. The decrease in units sold is primarily attributable to the Company offering fewer new irons models in its 2006 product line than its 2005 product line, as well as a decline in sales of the Company's older irons products which were in the second and third years of their product life cycles.

The \$6.6 million (6%) decrease in net sales of putters to \$102.7 million for the year ended December 31, 2006 resulted primarily from supply issues experienced by the Company during the first half of 2006 on the SRT line of putters combined with a reduction in units sold of the Company's older Odyssey White Steel and White Hot putter lines (which were in the second and third years of their product lifecycles, respectively). This decrease was partially offset by the current year introduction of the Odyssey White Hot XG and XG 2-ball, Odyssey White Steel SRT 2-ball and 3-ball and Dual Force 2 putter models. The decrease in net putter sales was further impacted by a decline in average selling prices primarily as a result of a higher mix of lower priced putter products during the year ended December 31, 2006.

The \$29.6 million (26%) increase in net sales of accessories and other products to \$145.9 million for the year ended December 31, 2006 is primarily attributable to an increase in sales of Callaway Golf brand golf bag and accessories and other products as well as an increase in licensing revenue and revenue from the Company's Trade In! Trade Up! pre-owned golf club program. These increases were partially offset by a decrease in sales of Top-Flite and Ben Hogan brand golf bags and accessories and other products

Golf Balls Segment

Net sales information for the golf balls segment is summarized as follows (dollars in millions):

	Years Ended		Growth (Decline)	
	December 31, 2006	December 31, 2005	Dollars	Percent
Net sales:				
Golf balls	\$ 214.8	\$ 214.7	\$ 0.1	0%

The Company's net sales of golf balls remained flat at \$214.8 million for the year ended December 31, 2006 compared to \$214.7 million for the year ended December 31, 2005. Although total net sales remained flat, the Company experienced a decrease in Top-Flite golf ball sales, offset by an increase in sales of Callaway Golf brand golf balls. The decrease in Top-Flite golf ball sales is primarily attributable to a decline in average selling prices resulting from an unfavorable shift in product mix to lower priced golf ball products (including range balls), as well as a reduction in selling prices of certain products related to initiatives to clear Top-Flite golf ball inventory in preparation for the 2007 re-launch of the Top-Flite brand. The increase in Callaway Golf brand golf ball sales is primarily due to the introduction of the Callaway Golf new HX Tour model in the second quarter of 2006 combined with higher sales of the HX Tour 56, which was launched during the third quarter of 2005.

Segment Profitability

Profitability by operating segment is summarized as follows (dollars in millions):

	Years Ended		Growth (Decline)	
	December 31, 2006	December 31, 2005	Dollars	Percent
Income before provision for income taxes ⁽¹⁾				
Golf clubs	\$ 101.8	\$ 68.3	\$ 33.5	