

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

Form 10-Q

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

For the quarterly period ended September 30, 2001

Commission file number 1-10962

Callaway Golf Company

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-3797580
(I.R.S. Employer
Identification No.)

2180 Rutherford Road, Carlsbad, CA 92008-8815

(760) 931-1771
(Address, including zip code, and telephone number, including area code, of principal executive offices)

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

The number of shares outstanding of the Registrant's Common Stock, \$.01 par value, as of October 31, 2001 was 77,872,623.

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Important Notice: Statements made in this report that relate to future plans, events, financial results or performance, including statements relating to future liquidity, 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 as a result of certain risks and uncertainties. For details concerning these and other risks and uncertainties, see below — Certain Factors Affecting Callaway Golf Company, as well as the Company’s other periodic reports on Forms 10-K, 10-Q and 8-K subsequently filed with the Securities and Exchange Commission from time to time. Readers 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 republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Investors also should 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 issuing or confirming financial forecasts or projections issued by securities 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.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CALLAWAY GOLF COMPANY

CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands, except share and per share data)

	September 30, 2001	December 31, 2000
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 42,807	\$102,596
Marketable securities	63,685	—
Accounts receivable, net (Note 6)	97,032	58,836
Inventories, net	145,261	133,962
Deferred taxes	23,749	29,354
Other current assets	10,478	17,721
Total current assets	383,012	342,469
Property, plant and equipment, net	132,057	134,712
Intangible assets, net	123,395	112,824
Other assets	37,104	40,929
	\$ 675,568	\$630,934
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 53,883	\$ 44,173
Accrued employee compensation and benefits	33,368	22,574
Accrued warranty expense	36,179	39,363
Income taxes payable	—	3,196
Total current liabilities	123,430	109,306
Long-term liabilities	26,081	9,884
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred Stock, \$.01 par value, 3,000,000 shares authorized, none issued and outstanding at September 30, 2001 and December 31, 2000	—	—
Common Stock, \$.01 par value, 240,000,000 shares authorized, 82,585,873 and 78,958,963 issued at September 30, 2001 and December 31, 2000, respectively	826	790
Paid-in capital	345,373	347,765
Unearned compensation	(326)	(1,214)
Retained earnings	402,475	349,681
Accumulated other comprehensive income	(6,304)	(6,096)
Less: Grantor Stock Trust held at market value, 10,914,690 shares and 5,300,000 shares at September 30, 2001 and December 31, 2000, respectively	(136,240)	(98,713)
Less: Common Stock held in treasury, at cost, 4,659,900 shares and 4,815,241 shares at September 30, 2001 and December 31, 2000, respectively	(79,747)	(80,469)
Total shareholders' equity	526,057	511,744
	\$ 675,568	\$630,934

The accompanying notes are an integral part of these financial statements.

CALLAWAY GOLF COMPANY

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2001		2000		2001		2000	
Net sales	\$195,848	100%	\$208,081	100%	\$710,868	100%	\$695,409	100%
Cost of goods sold	100,824	51%	106,050	51%	347,001	49%	360,606	52%
Gross profit	95,024	49%	102,031	49%	363,867	51%	334,803	48%
Operating expenses:								
Selling	45,281	23%	41,066	20%	152,658	21%	131,806	19%
General and administrative	17,473	9%	20,683	10%	57,909	8%	55,804	8%
Research and development	8,025	4%	9,899	5%	25,402	4%	26,248	4%
Income from operations	24,245	12%	30,383	15%	127,898	18%	120,945	17%
Other (expense) income, net	(12,708)		2,689		(15,335)		6,415	
Income before provision for income taxes and cumulative effect of accounting change	11,537	6%	33,072	16%	112,563	16%	127,360	18%
Provision for income taxes	5,018		13,017		44,994		50,018	
Income before cumulative effect of accounting change	6,519	3%	20,055	10%	67,569	10%	77,342	11%
Cumulative effect of accounting change	—		—		—		(957)	
Net income	\$ 6,519	3%	\$ 20,055	10%	\$ 67,569	10%	\$ 76,385	11%
Earnings per common share:								
Basic								
Income before cumulative effect of accounting change	\$ 0.09		\$ 0.29		\$ 0.96		\$ 1.10	
Cumulative effect of accounting change	—		—		—		(0.01)	
Net income	\$ 0.09		\$ 0.29		\$ 0.96		\$ 1.09	
Diluted								
Income before cumulative effect of accounting change	\$ 0.09		\$ 0.29		\$ 0.92		\$ 1.07	
Cumulative effect of accounting change	—		—		—		(0.01)	
Net income	\$ 0.09		\$ 0.29		\$ 0.92		\$ 1.06	
Weighted average shares used in earnings per share computations:								
Basic	69,744		69,237		70,365		70,372	
Diluted	72,611		70,203		73,231		71,786	
Dividends paid per share	\$ 0.07		\$ 0.07		\$ 0.21		\$ 0.21	

The accompanying notes are an integral part of these financial statements.

CALLAWAY GOLF COMPANY

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2001	2000
Cash flows from operating activities:		
Net income	\$ 67,569	\$ 76,385
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	27,595	30,507
Loss on disposal of assets	1,827	338
Non-cash compensation	355	1,790
Tax benefit from exercise of stock options	13,844	5,043
Net non-cash energy derivative losses	19,922	—
Net non-cash foreign currency hedging gains	(4,418)	—
Deferred taxes	7,950	2,504
Changes in assets and liabilities, net of effects from acquisitions:		
Accounts receivable, net	(44,052)	(36,837)
Inventories, net	(12,593)	(11,064)
Other assets	1,303	789
Accounts payable and accrued expenses	9,549	2,707
Accrued employee compensation and benefits	10,899	8,302
Accrued warranty expense	(3,184)	3,497
Income taxes payable	5,138	13,044
Accrued restructuring cost-long term	—	(1,379)
Other liabilities	(7,123)	(544)
Net cash provided by operating activities	94,581	95,082
Cash flows from investing activities:		
Investment in marketable securities	(63,123)	—
Business acquisitions, net of cash acquired	(1,541)	(440)
Capital expenditures	(24,657)	(21,130)
Proceeds from sales of property and equipment	4,629	190
Net cash used in investing activities	(84,692)	(21,380)
Cash flows from financing activities:		
Issuance of Common Stock	46,934	21,284
Dividends paid	(14,775)	(15,101)
Acquisition of Treasury Stock	(99,922)	(71,521)
Other financing activities	(973)	1,268
Net cash used in financing activities	(68,736)	(64,070)
Effect of exchange rate changes on cash	(942)	(609)
Net (decrease) increase in cash and cash equivalents	(59,789)	9,023
Cash and cash equivalents at beginning of period	102,596	112,602
Cash and cash equivalents at end of period	\$ 42,807	\$ 121,625
Non-cash financing and investing activities:		
Issuance of note payable for acquisition of intangible assets	\$ 6,702	\$ —
Cancellation of restricted common stock	\$ 837	\$ —
Common stock issued for acquisition of intangible assets	\$ 516	\$ —
Unrealized gain on marketable securities	\$ 562	\$ —

The accompanying notes are an integral part of these financial statements.

CALLAWAY GOLF COMPANY

CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)
(In thousands)

	Common Stock		Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Income	GST	Treasury Stock		Total	Comprehensive Income
	Shares	Amount						Shares	Amount		
Balance, December 31, 2000	78,959	\$790	\$347,765	\$(1,214)	\$349,681	\$(6,096)	\$ (98,713)	(4,815)	\$(80,469)	\$511,744	\$ —
Exercise of stock options	3,331	33	41,280	—	—	—	—	—	—	41,313	—
Cancellation of Restricted Common Stock	(27)	—	(837)	837	—	—	—	—	—	—	—
Tax benefit from exercise of stock options	—	—	13,844	—	—	—	—	—	—	13,844	—
Acquisition of Treasury Stock	—	—	—	—	—	—	—	(5,722)	(99,922)	(99,922)	—
Compensatory stock and stock options	—	—	304	51	—	—	—	—	—	355	—
Employee stock purchase plan	283	3	2,244	—	—	—	3,374	—	—	5,621	—
Shares issued for intangible assets	40	—	(129)	—	—	—	—	40	645	516	—
Cash dividends paid	—	—	—	—	(14,775)	—	—	—	—	(14,775)	—
Addition to GST	—	—	(9,717)	—	—	—	(90,282)	5,837	99,999	—	—
Adjustment of GST shares to market value	—	—	(49,381)	—	—	—	49,381	—	—	—	—
Foreign currency translation	—	—	—	—	—	(1,651)	—	—	—	(1,651)	(1,651)
Unrealized gain on cash flow hedges, net of tax	—	—	—	—	—	881	—	—	—	881	881
Unrealized gain on marketable securities, net of tax	—	—	—	—	—	562	—	—	—	562	562
Net income	—	—	—	—	67,569	—	—	—	—	67,569	67,569
Balance, September 30, 2001	82,586	\$826	\$345,373	\$ (326)	\$402,475	\$(6,304)	\$(136,240)	(4,660)	\$(79,747)	\$526,057	\$67,361

The accompanying notes are an integral part of these financial statements.

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying financial information for the three and nine months ended September 30, 2001 and 2000 has been prepared by Callaway Golf Company (the "Company") and has not been audited. These financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring accruals) necessary for the fair presentation of the financial position, results of operations and cash flows for the periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed for the year ended December 31, 2000. Interim operating results are not necessarily indicative of operating results for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions.

2. Reclassifications and Recent Accounting Pronouncements

In the fourth quarter of 2000, the Company adopted Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101") with an effective date of January 1, 2000. SAB No. 101 summarizes the Securities and Exchange Commission's ("SEC") Division of Corporation Finance Staff's views in applying accounting principles generally accepted in the United States to revenue recognition in financial statements. The Company's Consolidated Condensed Statements of Operations for the three and nine months ended September 30, 2000 have been adjusted from amounts previously reported in the prior year Form 10-Q filed with the SEC to reflect the application of SAB No. 101. Accordingly, net sales, cost of goods sold and provision for income taxes have been increased by \$2,141,000, \$939,000 and \$475,000, respectively, for the three months ended September 30, 2000 from amounts previously reported. For the nine months ended September 30, 2000, net sales, cost of goods sold and provision for income taxes have been reduced by \$9,379,000, \$4,178,000 and \$2,040,000, respectively, from amounts previously reported. The cumulative effect of accounting change on periods prior to 2000 was \$957,000 and is included in the Consolidated Condensed Statements of Operations for the nine months ended September 30, 2000.

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. SFAS No. 142 requires the use of a non-amortization approach to account for goodwill and other intangible assets with indefinite lives. Goodwill and other intangible assets with indefinite lives existing at June 30, 2001 will no longer be amortized effective January 1, 2002. Goodwill and other intangible assets with indefinite lives acquired on or after July 1, 2001 will follow the non-amortization approach under SFAS No. 142. Under the non-amortization approach, goodwill and other intangible assets with indefinite lives will be tested for impairment, rather than being amortized to earnings. In addition, SFAS No. 142 requires that acquired intangible assets be separately identified and amortized over their individual useful lives. The Company will be required to adopt these statements beginning January 1, 2002. Based on the Company's current carrying value of goodwill and intangible assets at September 30, 2001, unamortized goodwill, intangible assets with indefinite lives, and other intangible asset balances are expected to be approximately \$17.0 million, \$88.6 million, and \$15.9 million, respectively, at December 31, 2001. In

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

accordance with SFAS No. 142, the goodwill and other intangible assets with indefinite lives that were being amortized over periods ranging from five to 40 years will follow the non-amortization approach after January 1, 2002.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121 but retains SFAS No. 121's fundamental provisions for (a) recognition/ measurement of impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. SFAS No. 144 also supersedes the accounting/ reporting provisions of Accounting Principles Board ("APB") Opinion No. 30 for segments of a business to be disposed of but retains APB Opinion No. 30's requirement to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. SFAS No. 144 is effective for the Company beginning January 1, 2002. The Company does not expect that SFAS No. 144 will have a material effect on its results of operations and financial position.

3. Marketable Securities

The Company classifies its marketable securities as available-for-sale. These securities are recorded at fair market value based on quoted market prices, with unrealized gains and losses reported in shareholders' equity as a component of "Accumulated other comprehensive income." Gains and losses on securities sold are determined based on the specific identification method and are included in "other income (expense), net."

4. Inventories

Inventories are summarized below (in thousands):

	September 30, 2001	December 31, 2000
	(Unaudited)	
Raw materials	\$ 65,390	\$ 56,936
Work-in-process	1,894	1,293
Finished goods	84,632	83,453
	151,916	141,682
Less reserve for obsolescence	(6,655)	(7,720)
	\$145,261	\$133,962

5. Bank Lines of Credit

The Company has a revolving credit facility of up to \$120.0 million (the "Amended Credit Agreement"). The Amended Credit Agreement is secured by substantially all of the assets of the Company and expires in February 2004. The Amended Credit Agreement bears interest at the Company's election at the London Interbank Offering Rate ("LIBOR") plus a margin or the higher of the base rate on corporate loans at large U.S. money center commercial banks (prime rate) or the Federal Funds Rate plus 50 basis points. The Amended Credit Agreement requires the Company to maintain certain minimum financial ratios including a fixed charge coverage ratio, as well as other restrictive covenants. As of September 30, 2001, up to \$119.5 million of the credit facility remained available for borrowings (including a reduction of \$0.5 million for outstanding letters of credit), subject to meeting certain availability requirements under a borrowing base formula and other limitations.

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company previously reported that its Japanese subsidiary had two separate credit facilities with an aggregate commitment of 2.5 billion yen (approximately \$20.9 million at September 30, 2001). As of September 30, 2001, the Company had no borrowings under these credit facilities. Effective October 22, 2001, the Company cancelled these facilities.

6. Accounts Receivable Securitization

The Company's wholly-owned subsidiary, Callaway Golf Sales Company, sells trade receivables on an ongoing basis to its wholly-owned subsidiary, Golf Funding Corporation ("Golf Funding"). Pursuant to an agreement with a securitization company (the "Accounts Receivable Facility"), Golf Funding, in turn, can sell such receivables to the securitization company on an ongoing basis, which could yield proceeds of up to \$80.0 million, subject to meeting certain availability requirements under a borrowing base formula and other limitations. Golf Funding's sole business is the purchase of trade receivables from Callaway Golf Sales Company. Golf Funding is a separate corporate entity with its own separate creditors, which in the event of its liquidation would be entitled to be satisfied out of Golf Funding's assets prior to any value in Golf Funding becoming available to the Company. The Accounts Receivable Facility expires in February 2004.

Under the Accounts Receivable Facility, the receivables are sold at face value with payment of a portion of the purchase price being deferred. As of September 30, 2001, no amount was outstanding under the Accounts Receivable Facility. Fees incurred in connection with this facility for each of the three and nine month periods ended September 30, 2001 were \$75,000 and \$227,000, respectively, and for the three and nine months ended September 30, 2000 were \$76,000 and \$228,000, respectively. These fees were recorded in "other (expense) income, net."

7. Earnings Per Share

A reconciliation of the weighted average shares used in the basic and diluted earnings per common share computations for the three and nine months ended September 30, 2001 and 2000 is presented below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
	(Unaudited)			
Weighted-average shares outstanding (in thousands):				
Weighted-average shares outstanding — Basic	69,744	69,237	70,365	70,372
Dilutive securities	2,867	966	2,866	1,414
Weighted-average shares outstanding — Diluted	72,611	70,203	73,231	71,786

For the three months ended September 30, 2001 and 2000, options outstanding totaling 10,336,000, and 9,722,000, respectively, were excluded from the calculations, as their effect would have been antidilutive. For the nine months ended September 30, 2001 and 2000, options outstanding totaling 6,254,000 and 9,051,000, respectively, were excluded from the calculations, as their effect would have been antidilutive.

8. Commitments and Contingencies

As part of a comprehensive strategy to ensure the uninterrupted supply of energy while capping electricity costs in the volatile California energy market, the Company entered into a long-term energy supply contract at a fixed rate for a delivery term defined as June 1, 2001 through May 31, 2006 (see Note 11). To obtain a more favorable price and to assure adequate supplies during times of peak loads, the Company agreed to purchase a

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

greater supply of electricity than it expects to use in its business. The Company expects to sell some or all of this excess supply based on energy market conditions. The total purchase price over the remaining contract term is approximately \$40.6 million.

At September 30, 2001, the Company was contingently liable for lease payments relating to a facility in New York City totaling \$3.8 million. This contingency is the result of the assignment of an operating lease to a third party and expires in February 2003.

As discussed in more detail in the Company's prior filings with the Securities and Exchange Commission, on July 24, 2000, Bridgestone Sports Co., Ltd. ("Bridgestone") filed a complaint for patent infringement in the United States District Court for the Northern District of Georgia, Civil Action No. 00-CV-1871, against Callaway Golf Company, Callaway Golf Ball Company (collectively "Callaway Golf"), and a golf retailer located in Georgia (the "U.S. Action"). On October 13, 2000, Bridgestone and the retailer defendant entered into a consent judgment discontinuing the action against the retailer. On December 14, 2000, Bridgestone filed an action in the Tokyo, Japan District Court asserting patent infringement against Callaway Golf's wholly-owned subsidiary, Callaway Golf K.K., based on its sale of Rule 35® Softfeel™ golf balls in Japan (the "Japan Action"). On October 9, 2001, the Company and Bridgestone announced that they have signed a golf ball patent license agreement permitting the Company to use a number of Bridgestone's three piece golf ball patents worldwide. As a result of such license agreement, the U.S. Action and Japan Action were dismissed.

On April 6, 2001, a complaint was filed against Callaway Golf Company and Callaway Golf Sales Company (collectively, the "Company"), in the Circuit Court of Sevier County, Tennessee, Case No. 2001-241-IV. The complaint seeks to assert a class action by plaintiff on behalf of himself and on behalf of consumers in Tennessee and Kansas who purchased selected Callaway Golf products on or after March 30, 2000. Specifically, the complaint alleges that the Company adopted a New Product Introduction Policy governing the introduction of certain of the Company's new products in violation of Tennessee and Kansas antitrust and consumer protection laws. The plaintiff is seeking damages, restitution and punitive damages.

On October 3, 2001, the Company filed suit in the United States District Court for the District of Delaware, Civil Action No. 01-669, against Dunlop Slazenger Group Americas Inc., d/b/a Maxfli ("Maxfli"), for infringement of a golf ball aerodynamics patent owned by the Company. On October 15, 2001, Maxfli filed an answer to the complaint denying any infringement, and also filed a counterclaim against the Company asserting that a former Maxfli employee now working for the Company had disclosed confidential Maxfli trade secrets to the Company, and that the Company had used that information to enter the golf ball business. Maxfli is seeking damages in an unspecified amount and injunctive relief.

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 ascertain the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance, or the financial impact with respect to these matters as of September 30, 2001. However, 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 annual consolidated financial position, results of operations or cash flows.

9. Restructuring

In 1998, the Company recorded a restructuring charge of \$54.2 million resulting from a number of cost reduction actions and operational improvements. During 1999, the Company completed its restructuring initiatives. During the three and nine month periods ended September 30, 2000, the Company paid \$0.3 million and \$1.4 million, respectively, related to its restructuring obligations, primarily rents associated

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

with its former New York City facility (see Note 8). During the quarter ended September 30, 2000, the restructuring reserve balance was fully depleted.

10. Segment Information

The Company's operating segments are organized on the basis of products and include golf clubs and golf balls. The Golf Clubs segment for the periods indicated below consists of Callaway Golf® titanium and stainless steel metal woods and irons, Callaway Golf® and Odyssey® putters and wedges, and related accessories. The Golf Balls segment consists of golf balls that are designed, manufactured, marketed and distributed by the Company. The table below contains information utilized by management to evaluate its operating segments for the interim periods presented.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
	(In thousands)			
	(Unaudited)			
Net sales				
Golf clubs	\$183,604	\$196,977	\$666,162	\$667,662
Golf balls	12,244	11,104	44,706	27,747
	<u>\$195,848</u>	<u>\$208,081</u>	<u>\$710,868</u>	<u>\$695,409</u>
Income (loss) before provision for income taxes and cumulative effect of accounting change				
Golf clubs	\$ 40,770	\$ 53,053	\$183,361	\$195,238
Golf balls	(3,592)	(10,154)	(13,501)	(38,145)
Reconciling items ⁽¹⁾	(25,641)	(9,827)	(57,297)	(29,733)
	<u>\$ 11,537</u>	<u>\$ 33,072</u>	<u>\$112,563</u>	<u>\$127,360</u>
Additions to long-lived assets				
Golf clubs	\$ 5,394	\$ 4,446	\$ 17,628	\$ 17,717
Golf balls	1,169	516	14,247	3,413
	<u>\$ 6,563</u>	<u>\$ 4,962</u>	<u>\$ 31,875</u>	<u>\$ 21,130</u>

(1) Represents corporate general and administrative expenses and other income (expense) not utilized by management in determining segment profitability.

11. Derivatives and Hedging

The Company uses derivative financial instruments to manage its exposures to electricity prices and foreign exchange rates. The derivative instruments are accounted for pursuant to SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." As amended, SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as an effective hedge that offsets certain exposures.

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Energy Derivative

During the second quarter of 2001, the Company entered into a long-term, fixed-price, fixed-capacity, energy supply contract as part of a comprehensive strategy to ensure the uninterrupted supply of energy while capping electricity costs in the volatile California energy market. The contract is effective through May 2006. As of September 30, 2001, this derivative did not qualify for hedge accounting treatment under SFAS No. 133. The Company recognized the changes in the fair value of the contract currently in earnings. The fair value of the contract as of September 30, 2001 was estimated based on market prices of electricity for the remaining period covered by the contract. The net differential between the contract price and market prices for future periods has been applied to the volume stipulated in the contract to arrive at an estimated future value. This estimated future value was discounted at rates commensurate with the Company's estimation of contract performance risk. In addition, the contract extends beyond 13 months into the future and the market for electricity in California beyond the 13-month horizon is unpredictable and published market quotations are not available. The Company has relied upon near-term market quotations and other market information to determine fair value estimates. For the three and nine months ended September 30, 2001, the Company recorded \$12.2 million and \$19.9 million of unrealized losses related to the energy derivative in "other (expense) income, net."

Foreign Currency Exchange Contracts

During the three and nine months ended September 30, 2001, the Company entered into forward foreign currency exchange rate contracts to hedge payments due on intercompany transactions from certain wholly-owned foreign subsidiaries and on certain euro-denominated accounts receivable. The effect of this practice is to minimize variability in the Company's operating results arising from foreign exchange rate movements. The Company does not engage in foreign currency speculation. These foreign exchange contracts do not subject the Company to risk due to exchange rate movements because gains and losses on these contracts offset the losses and gains on the transactions being hedged, and the Company does not engage in hedging contracts which exceed the amount of the intercompany transactions. At September 30, 2001, the Company had approximately \$43.6 million of foreign exchange contracts outstanding. The contracts mature between October 2001 and January 2002. Gains and losses on the contracts are recorded in income. The net realized and unrealized losses and gains from foreign exchange contracts for the three and nine months ended September 30, 2001 totaled approximately \$1.2 million of losses and \$2.6 million of gains, respectively. For the three and nine months ended September 30, 2000, net realized and unrealized gains totaled \$2.2 million and \$4.6 million, respectively.

During the fourth quarter of 2000 and during the nine months ended September 30, 2001, the Company utilized forward foreign currency exchange rate contracts to hedge cash flows associated with forecasted intercompany sales of inventory. These forward contracts are accounted for as cash flow hedges. The Company only hedges transactions that it deems to be more likely than not to occur. During 2000 and 2001, the Company hedged only those transactions forecasted to occur by December 31, 2001 and September 30, 2002, respectively. As of September 30, 2001, the Company had approximately \$66.6 million of cash flow hedges outstanding. The Company assesses the effectiveness of these derivatives using the spot rate. Changes in the spot-forward differential are excluded from the test of hedging effectiveness and are recorded currently in earnings as a component of "other (expense) income, net." Assessments of hedge effectiveness are performed using the dollar offset method and applying a hedge effectiveness ratio between 80% and 125%. Given that both the hedging item and the hedging instrument are evaluated using the same spot rate, the Company anticipates hedges of anticipated intercompany inventory sales to be highly effective. The effectiveness of each derivative is assessed monthly. During the three and nine months ended September 30, 2001, a gain of

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

\$575,000 and \$1.3 million, respectively, was recorded in “other (expense) income, net” representing the ineffective portion of the Company’s derivative instruments.

The effective portion of the fair value of the derivatives is deferred on the balance sheet in other comprehensive income (“OCI”), a component of “Accumulated other comprehensive income.” Amounts recorded in OCI will be released to earnings in the same period that the hedged transaction will impact the Company’s consolidated earnings. This transaction date is assumed to occur when the underlying sale of product to a third party occurs. At September 30, 2001, \$217,000 of deferred net loss is expected to be reclassified into earnings within the next twelve months. During the three and nine months ended September 30, 2001, no gains or losses were reclassified into earnings as a result of discontinuance of any cash flow hedges.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Consolidated Condensed Financial Statements and the related notes that appear elsewhere in this report. See also Important Notice on inside cover of this report.

Results of Operations

Prior Period Financial Statements

Prior period amounts have been restated to reflect the Company's current year presentation including the adoption of Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"). The Company adopted SAB No. 101 in the fourth quarter of 2000 with an effective date of January 1, 2000. As a result of the adoption of SAB No. 101, the Company adjusted amounts previously reported in the prior year Form 10-Q. See Note 2 to the Consolidated Condensed Financial Statements for further detail.

Three-Month Periods Ended September 30, 2001 and 2000

Net sales decreased 6% to \$195.8 million for the three months ended September 30, 2001 compared to \$208.1 million for the comparable period in the prior year. Both unit and dollar sales of irons and metal woods decreased in the third quarter of 2001 as compared to the third quarter of 2000. Sales of metal woods decreased by \$15.7 million (16%) in the third quarter of 2001 compared to the same quarter a year earlier. Sales of the Company's iron products decreased by \$1.1 million (2%) in the quarter ended September 30, 2001 compared to the same quarter of 2000. The decrease in sales of woods and irons primarily represents a decline in sales of Steelhead Plus® Stainless Steel metal woods, ERC® Forged Titanium Drivers, and Steelhead™ X-14® Stainless Steel Irons, all of which were introduced in January 2000. This decrease was expected as the Company's products generally sell better in their first year after introduction. The decrease in sales of irons and metal woods was partially offset by the growth in the Company's putters, accessories, and other sales and golf ball sales, which increased by \$3.4 million (13%) and \$1.1 million (10%), respectively, in the current quarter compared to the third quarter of 2000. The Company believes that the overall decline in net sales was largely due to a decline in the number of golf rounds played, aggressive competitive pricing, economic concerns among retailers and consumers, and the United States Golf Association's actions in the United States against the Big Bertha® ERC® II Driver. The strength of the U.S. dollar in relation to other foreign currencies also had an adverse effect upon the Company's net sales for the third quarter of 2001 as compared to the third quarter of 2000. As compared to the third quarter of 2000, fluctuations in foreign currency exchange rates adversely impacted third quarter 2001 net sales by approximately \$7.9 million, as measured by applying third quarter 2000 exchange rates to third quarter 2001 net sales.

Sales in the United States decreased \$5.1 million (5%) to \$102.6 million during the third quarter of 2001 versus the third quarter of 2000. Overall, the Company's sales in regions outside of the United States decreased \$7.2 million (7%) to \$93.2 million during the third quarter of 2001 versus the same quarter of 2000. Had exchange rates for the third quarter of 2001 been the same as the third quarter 2000 exchange rates, overall sales in regions outside of the United States would have been approximately 8% higher than reported. Sales in Japan decreased \$2.0 million (5%) in the third quarter of 2001 to \$33.9 million as compared to the same period in the prior year. Sales in Europe decreased \$0.8 million (3%) in the third quarter of 2001 to \$27.7 million as compared to the same period in the prior year. Sales in Rest of Asia (including Korea) decreased \$4.5 million (20%) to \$17.8 million as compared to the third quarter of 2000 and sales in the regions comprising Rest of World decreased \$0.9 million (16%) to \$4.4 million in the third quarter of 2001 as compared with the third quarter of 2000. Sales in Canada increased \$0.2 million (4%) to \$6.8 million as compared to the third quarter of 2000 and sales in Australia increased \$0.8 million (42%) to \$2.6 million during the third quarter of 2001 as compared to the third quarter of 2000. The Company acquired its distribution rights in Australia, Italy, Portugal, and Spain in the first quarter of 2001 and therefore began selling directly to retailers rather than a third party distributor.

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For the third quarter of 2001, gross profit decreased to \$95.0 million from \$102.0 million in the third quarter of 2000, and was flat as a percentage of net sales at 49%. Although the Company's gross profit percentage was negatively impacted by an unfavorable shift in club product mix, such impact was offset by a reduction in the Company's warranty expense as a percent of net sales and improved golf ball product margins associated with increased sales volume and an increase in plant utilization and production yields.

Selling expenses in the third quarter of 2001 increased to \$45.3 million from \$41.1 million in the comparable period of 2000, or 23% and 20% of net sales, respectively. This dollar increase was primarily due to demand creation initiatives and higher marketing costs.

General and administrative expenses decreased to \$17.5 million in the third quarter of 2001 from \$20.7 million in the comparable period of 2000, or 9% and 10% of net sales, respectively. This dollar decrease is mainly attributable to decreases in employee, depreciation, and bad debt expenses, partially offset by higher legal expenses and severance charges recorded in the third quarter of 2001.

Research and development expenses decreased to \$8.0 million in the third quarter of 2001 from \$9.9 million in the third quarter of 2000, or 4% and 5% of net sales, respectively. This dollar decrease resulted primarily from decreased employee costs and depreciation expenses.

Other expenses totaled \$12.7 million in the third quarter of 2001 as compared to other income of \$2.7 million in the third quarter of 2000. The \$15.4 million of additional expense is primarily attributable to unrealized losses of \$12.2 million associated with the valuation of a long-term energy supply contract, a reduction in interest income of \$2.5 million, realized losses of \$1.0 million generated from the sale of the Company's excess energy supply, and a \$0.3 million decrease in licensing fees, partially offset by a \$0.5 million increase in foreign currency transaction gains and a \$0.1 million increase in other income.

Third quarter 2001 net income declined 67% to \$6.5 million from \$20.1 million in the comparable period of the prior year. Third quarter 2001 diluted earnings per share decreased 69% to \$0.09 from \$0.29 in the same period last year. During the quarter ended September 30, 2001, the Company recorded a non-cash expense of \$7.8 million after-tax or \$0.11 per diluted share, as a result of the change in market value of the Company's energy supply contract. Excluding this non-cash energy supply contract charge, the Company's net income decreased 28% to \$14.3 million and diluted earnings per share decreased 31% to \$0.20.

Nine-Month Periods Ended September 30, 2001 and 2000

For the nine months ended September 30, 2001, net sales increased \$15.5 million, or 2%, to \$710.9 million from \$695.4 million in the comparable period of the prior year. The increase primarily represents an increase in sales of titanium metal woods, due to the worldwide launch of the new Big Bertha ERC II Driver and the new Big Bertha Hawk Eye® VFT™ Woods in October 2000. These products began shipping in significant quantities in the first quarter of 2001. In total, sales of metal woods increased by \$28.1 million (8%) in the first nine months of 2001 compared to the comparable period of 2000. The increase in revenues was also the result of growth in the Company's golf ball sales, which increased by \$17.0 million (61%) in the first nine months of 2001 compared to the same period of 2000 and an increase in the Company's putter, accessories, and other sales, which increased by \$17.5 million (22%) in the nine months ended September 30, 2001 compared to the same period of 2000. These increases were offset in part by lower sales of the Company's iron products. Sales of the Company's irons declined by \$47.2 million (18%) in the first nine months of 2001 compared to the same period a year earlier. The Company believes that net sales for the first nine months of 2001 were adversely affected by poor weather conditions earlier in the season, a persistent decline in the number of golf rounds played, aggressive competitive pricing, economic concerns among retailers and consumers, and the United States Golf Association's actions in the United States against the Big Bertha ERC II driver. The strength of the U.S. dollar in relation to other foreign currencies also had a significant adverse effect upon the Company's net sales for the first nine months of 2001 as compared to the first nine months of 2000. As compared to the first nine months of 2000, fluctuations in foreign currency exchange rates adversely impacted net sales for the first nine months of 2001 by approximately \$30.0 million, as measured by applying exchange rates for the first nine months of 2000 to sales for the first nine months of 2001.

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Sales in the United States increased \$14.0 million (4%) to \$390.1 million during the first nine months of 2001 versus the first nine months of 2000. Overall, the Company's sales in regions outside of the United States increased \$1.5 million (.5%) to \$320.8 million during the first nine months of 2001 versus the same period of 2000. Had exchange rates for the first nine months of 2001 been the same as the first nine months of 2000 exchange rates, overall sales in regions outside of the United States would have been approximately 9% higher. Sales in Japan increased \$16.8 million (18%) in the first nine months of 2001 to \$112.1 million as compared to the same period in the prior year. Sales in Europe decreased \$9.1 million (8%) to \$102.1 million in the first nine months of 2001 as compared with the first nine months of 2000. Sales in Rest of Asia (including Korea) decreased \$10.2 million (15%) to \$55.5 million as compared to the first nine months of 2000. Sales in Canada increased \$0.9 million (3%) to \$27.7 million and sales in the regions comprising the Rest of World increased \$0.4 million (2%) to \$15.5 million in the first nine months of 2001 versus the first nine months of 2000. Sales in Australia increased \$2.7 million (50%) to \$8.1 million in the first nine months of 2001 as compared to the same period in 2000. The Company acquired its distribution rights in Australia, Italy, Portugal, and Spain in the first quarter of 2001 and therefore began selling directly to retailers rather than a third party distributor.

For the nine months ended September 30, 2001, gross margin increased to \$363.9 million from \$334.8 million in the comparable period of 2000, and as a percentage of net sales, increased to 51% from 48%. This improvement in gross margin is a result of a shift in club product mix away from lower yielding iron products to higher yielding wood products. The margin was also favorably affected by a reduction in the Company's warranty expense as a percent of net sales during the nine month period ended September 30, 2001 as compared to the same period in 2000. Golf ball product margins improved in the first nine months of 2001 as compared to the first nine months of 2000, associated with increased sales volume and an increase in plant utilization and production yields.

Selling expenses in the nine months ended September 30, 2001 increased to \$152.7 million (21% of net sales) from \$131.8 million (19% of net sales) in the comparable period of 2000. The dollar increase was primarily due to increased advertising and promotional expenses related to the Company's new product launches, the rollout of the new fitting cart systems and store-in-store project, and other demand creation initiatives.

General and administrative expenses in the first nine months of 2001 increased to \$57.9 million (8% of net sales) from \$55.8 million (8% of net sales) in the comparable period of 2000. The dollar increase is mainly attributable to higher employee compensation costs including severance charges and legal expenses combined with moving costs associated with the consolidation of operating facilities, partially offset by a decrease in depreciation and bad debt expenses.

Research and development expenses in the nine months ended September 30, 2001 decreased to \$25.4 million (4% of net sales) from \$26.2 million (4% of net sales) in the comparable period of 2000. The dollar decrease resulted primarily from decreased depreciation expense and employee costs.

Other expenses in the nine months ended September 30, 2001 totaled \$15.3 million as compared to other income of \$6.4 million in the comparable period of 2000. The \$21.7 million of additional expense is primarily attributable to unrealized losses of \$19.9 million associated with the valuation of a long-term energy supply contract, a decrease in net interest income of \$4.1 million, and realized losses of \$1.4 million generated from the sale of the Company's excess energy supply, partially offset by a \$1.8 million increase in foreign currency transaction gains, a \$0.8 increase in licensing fees, and a \$1.1 million increase in other income.

Net income for the nine months ended September 30, 2001 decreased 12% to \$67.6 million, compared to \$76.4 million for the comparable period last year. Earnings per diluted share during the period, decreased 13% to \$0.92 from \$1.06 for the comparable period last year. During the first nine months of 2001, the Company recorded a non-cash expense of \$14.2 million after-tax or \$0.19 per diluted share, as a result of the change in market value of the Company's energy supply contract. Excluding this non-cash energy supply contract charge, the Company's net income for the nine months ended September 30, 2001 increased 7% to \$81.8 million and diluted earnings per share increased 5% to \$1.12.

Liquidity and Capital Resources

At September 30, 2001, cash and cash equivalents decreased to \$42.8 million from \$102.6 million at December 31, 2000. This decrease for the nine month period ended September 30, 2001 primarily resulted from cash used in investing and financing activities of \$84.7 million and \$68.7 million, respectively, partially offset by cash provided by operating activities of \$94.6 million. Cash flows used in investing activities are primarily attributable to the investment in marketable securities (\$63.1 million) and capital expenditures (\$24.7 million). Cash flows used in financing activities are primarily attributable to the acquisition of treasury stock (\$99.9 million) and the payment of dividends (\$14.8 million) partially offset by proceeds from the exercise of employee stock options and purchases under the employee stock purchase plan (\$46.9 million).

The Company's principal source of liquidity, both on a short-term and long-term basis, has been cash flow provided by operations and the Company's credit facilities. The Company currently expects this to continue. The Company has a revolving credit facility for up to \$120.0 million (the "Amended Credit Agreement") and an \$80.0 million accounts receivable securitization facility (the "Accounts Receivable Facility"). During the first nine months of 2001, the Company did not utilize either its Accounts Receivable Facility or its line of credit under the Amended Credit Agreement. At September 30, 2001, the Company had \$119.5 million available, net of outstanding letters of credit, under the Amended Credit Agreement, subject to meeting certain availability requirements under a borrowing base formula and other limitations. Also at September 30, 2001, there were no advances under the Accounts Receivable Facility, leaving up to \$80.0 million available under this facility. See Notes 5 and 6 to the Consolidated Condensed Financial Statements for further detail.

In May 2000, the Company announced that its Board of Directors authorized it to repurchase its Common Stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities from time to time, up to a maximum cost to the Company of \$100.0 million. The Company began its repurchase program in May 2000 and during the second quarter of 2001 completed the program which resulted in the repurchase of a total of 5.8 million shares of the Company's Common Stock at an average cost of \$17.13 per share.

In August 2001, the Company announced that its Board of Directors authorized it to repurchase its Common Stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities from time to time, up to a maximum cost to the Company of \$100.0 million. During the third quarter of 2001, the Company repurchased 4.7 million shares of its Common Stock at an average cost of \$17.07 per share.

Although the Company's golf club operations are mature and historically have generated cash from operations, the Company's golf ball operations are relatively new and to date have not generated cash flows sufficient to fund these operations. The Company does not expect that its golf ball operations will generate sufficient cash to fund these operations for the remainder of 2001. However, the Company believes that, based upon its current operating plan, analysis of consolidated financial position and projected future results of operations, it will be able to maintain its current level of consolidated operations, including purchase commitments and planned capital expenditures, for the foreseeable future through operating cash flows and its credit facilities. There can be no assurance, however, that future industry specific or other developments, or general economic trends, will not adversely affect the Company's operations or its ability to meet its future cash requirements.

Certain Factors Affecting Callaway Golf Company

The financial statements contained in this report and the related discussion describe and analyze the Company's financial performance and condition for the periods indicated. For the most part, this information is historical. The Company's prior results are not necessarily indicative of the Company's future performance or financial condition. The Company therefore has included the following discussion of certain factors which could affect the Company's future performance or financial condition. These factors 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

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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.

Terrorist Activity and Armed Conflict

Terrorist activities and armed conflicts (such as the bombing of the World Trade Center and the Pentagon, the incidents of Anthrax poisoning and the military actions in Afghanistan) could have a significant adverse effect upon the Company's business. Such events could have an adverse effect upon an already fragile world economy (discussed below) and could adversely affect the level of demand for the Company's products as consumer's attention and interest are diverted from golf and become focused on these events and the economic, political, and public safety issues and concerns associated with such events. Also, such events could adversely affect the Company's ability to manage its supply and delivery logistics. If such events caused a significant disruption in 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 effect delivery of customer orders also could be materially adversely affected. Furthermore, such events have had an adverse affect upon tourism. If this continues, the Company's sales to retailers at resorts and other vacation destinations could be materially adversely affected.

Adverse Global Economic Conditions

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. An adverse change in economic conditions in the United States or in the Company's international markets (which represent almost half of the Company's total sales), or even a decrease in consumer confidence as a result of anticipated adverse changes in economic conditions, could cause consumers to forgo or to postpone purchasing new golf products. Such forgone or postponed purchases could have a material adverse effect upon the Company.

The economic conditions in the United States, Japan, Europe, Korea and other countries are currently viewed by many as uncertain or troubled. In the United States, there have been many announcements by companies of large-scale reductions in force and others are expected. Consumers are less likely to purchase new golf equipment when they are unemployed. Furthermore, even if economic conditions were to improve during the latter part of 2002, the Company's sales in 2002 would not experience a corresponding improvement because the golf selling season would largely be over.

Growth Opportunities

Golf Clubs. In order for the Company to significantly grow its sales of golf clubs, the Company must either increase its share of the market for golf clubs or the market for golf clubs must grow. The Company already has a significant share of the worldwide premium golf club market and therefore opportunities for additional market share may be limited. The Company does not believe there has been any material increase in participation or the number of rounds played in 1999 and 2000. In fact, Golf Datatech reports that the number of rounds played has declined 11 out of the last 12 months, declining 2.4% year to date through August, 2001. Furthermore, the Company believes that since 1997 the overall worldwide premium golf club market has generally not experienced substantial growth in dollar volume from year to year. There is no assurance that the overall dollar volume of the worldwide premium golf club market will grow, or that it will not decline, in the future. The Company's future club sales growth therefore may be limited unless there is growth in the worldwide premium golf club market.

Golf Balls. The Company began selling its golf balls in February 2000 and does not have as significant of a market share as it does in the club business. Although opportunities exist for the acquisition of additional market share in the golf ball market, such market share is currently held by some well-established and well-financed competitors. There is no assurance that the Company will be able to obtain additional market share in this very competitive golf ball market. If the Company is unable to obtain additional market share, its golf ball sales growth may be limited.

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Golf Ball Costs

The cost of entering the golf ball business has been significant. To date, the development of the Company's golf ball business has had a significant negative impact on the Company's cash flows, financial position and results of operations. The Company will still need to produce and sell golf balls in large volumes to cover its costs and become profitable. There is no assurance that the Company will be able to achieve the sales or production efficiencies necessary to make its golf ball business profitable. Until the golf ball business becomes profitable, the Company's results of operations, cash flows and financial position will continue to be negatively affected.

Manufacturing Capacity

The Company plans its manufacturing capacity based upon the forecasted demand for its products. Actual demand for such products may exceed or be less than forecasted demand. The Company's unique product designs often require sophisticated manufacturing techniques, which can require significant start-up expenses and/or limit the Company's ability to quickly expand its manufacturing capacity to meet the full demand for its products. If the Company is unable to produce sufficient quantities of new products in time to fulfill actual demand, especially during the Company's traditionally busy season, it could limit the Company's sales and adversely affect its financial performance. On the other hand, the Company invests in manufacturing capacity and commits to components and other manufacturing inputs for varying periods of time, which can limit the Company's ability to quickly react if actual demand is less than forecast. This could result in less than optimum capacity usage and/or in excess inventories and related obsolescence charges that could adversely affect the Company's financial performance. In addition, if the Company were to experience delays, difficulties or increased costs in its production of golf clubs or golf balls, including production of new products needed to replace current products, the Company's future golf club or golf ball sales could be adversely affected.

Dependence on Energy Resources

The Company's golf club and golf ball manufacturing facilities use, among other resources, significant quantities of electricity to operate. Many companies in California have experienced periods of blackouts during which electricity was not available. The Company has experienced one blackout period to date, and it is possible the Company will experience additional blackout periods. The Company has taken certain steps to provide uninterruptible power supplies for its key operations, including the ball and club operations, and believes that these measures will mitigate any impact resulting from possible future blackouts.

During the second quarter of 2001, the Company entered into a long-term energy supply contract as part of a comprehensive strategy to ensure the interrupted supply of energy while capping electricity costs in the volatile California energy market. To obtain a more favorable price and to assure adequate supplies during times of peak loads, the Company agreed to purchase a significantly greater supply of electricity than it expects to use in its business. The Company had expected to be able to re-sell some or all of this excess supply and thereby reduce the net price of the electricity it uses in its business. However, due to cooler than normal weather, government intervention and market and regulatory imperfections, the current market price for electricity in California has dropped significantly. As a result, the Company has been unable to re-sell the excess supply of electricity at favorable rates and thus the net cost of the electricity used in the Company's business has increased and may be higher than that of its competitors. This scenario, if continued, could have a significant adverse effect upon the Company's results of operations. Furthermore, under current applicable accounting rules, the Company must recognize in earnings the change in the fair value of the electricity contract. Although the changes in the value of the contract result in non-cash charges, they could significantly affect the Company's reported earnings.

Dependence on Certain Suppliers and Materials

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

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techniques and processes which make it difficult to identify and utilize alternative suppliers quickly. The Company believes that suitable clubheads and shafts could be obtained from other manufacturers in the event its regular suppliers are unable to provide components. However, any significant production delay or disruption caused by the inability of current suppliers to deliver or the transition to other suppliers could have a material adverse impact on the Company's results of operations. The Company is also single-sourced or dependent on a limited number of suppliers for the materials it uses to make its golf balls. Many of the 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, there is no assurance that the Company would be able to find adequate alternative suppliers at a reasonable cost or without significant disruption to its business.

The Company uses United Parcel Service ("UPS") for substantially all ground shipments of products to its U.S. customers. The Company uses air carriers and ships for most of its international shipments of products. Any significant interruption in UPS, air carrier or ship services could have a material adverse effect upon the Company's ability to deliver its products to its customers. If there were any such interruption in its services, there is no assurance that the Company could engage alternative suppliers to deliver its products in a timely and cost-efficient manner. In addition, many of the components the Company uses to build its golf clubs, including clubheads and shafts, are shipped to the Company via air carrier. Any significant interruption in UPS services, air carrier services or shipping services into or out of the United States could have a material adverse effect upon the Company.

The Company's size has made it a large consumer of certain materials, including titanium alloys and carbon fiber. The Company does not make 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. While the Company has been successful in obtaining its requirements for such materials thus far, there can be no assurance that it always will be able to do so. 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.

Competition

Golf Clubs. The worldwide market for premium golf clubs is highly competitive, and is served by a number of well-established and well-financed companies with recognized brand names, as well as new companies with popular products. For example, Nike has announced that it intends to begin marketing and selling in 2002 golf clubs that will compete with the Company's products. New product introductions, price reductions, extended payment terms and "close-outs" by competitors continue to generate increased market competition. While the Company believes that its products and its marketing efforts continue to be competitive, there can be no assurance that successful marketing activities, discounted pricing, extended payment terms or new product introductions by competitors will not negatively impact the Company's future sales.

Golf Balls. The premium golf ball business is also highly competitive, and may be becoming even more competitive. There are a number of well-established and well-financed competitors, including one competitor with an estimated market share in excess of 50% of the premium golf ball business. There are also several recent entrants into the golf ball business, including Nike and Taylor Made. Many of these competitors have introduced or will introduce golf ball designs that directly compete with the Company's products. Furthermore, as competition in this business increases, many of these competitors are discounting substantially the prices of their products. In order for its golf ball business to be successful, the Company will need to penetrate the market share held by existing competitors, while competing with the other new entrants, and must do so at prices that are profitable. There can be no assurance that the Company's golf balls will obtain the market acceptance necessary to be commercially successful.

Market Acceptance of Products

A golf manufacturer's ability to compete is in part dependent upon its ability to satisfy the various subjective requirements of golfers, including a golf club's and golf ball's look and "feel," and the level of

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acceptance that a golf club and ball has among professional and recreational golfers. The subjective preferences of golf club and ball purchasers are difficult to predict and may be subject to rapid and unanticipated changes. For example, the Company's new HX Golf Balls employ revolutionary aerodynamic technology that the Company believes is superior to any golf ball in the market. Such performance, however, is based upon the Company's patented tubular lattice network (a criss-crossing network of tube-like projections that form hexagonal and pentagonal patterns around the golf ball, as opposed to the conventional dimple), which gives it a unique appearance different from any other golf ball on the market. There is no assurance that golfers will be willing to purchase golf balls with this unique appearance, notwithstanding the performance advantages. In general, there can be no assurance as to how long the Company's golf clubs and balls will maintain market acceptance and therefore no assurance that the demand for the Company's products will permit the Company to experience growth in sales, or maintain historical levels of sales, in the future.

New Product Introduction

The Company believes that the introduction of new, innovative golf clubs and golf balls is important to its future success. A major portion of the Company's revenues is generated by products that are less than two years old. The Company faces certain risks associated with such a strategy. For example, in the golf industry, new models and basic design changes in golf equipment are frequently met with consumer rejection. In addition, prior successful designs may be rendered obsolete within a relatively short period of time as new products are introduced into the marketplace. Further, any new products that retail at a lower price than prior products may negatively impact the Company's revenues unless unit sales increase.

The Company's new products have tended to incorporate significant innovations in design and manufacture, which have often resulted in higher prices for the Company's products relative to other products in the marketplace. There can be no assurance that a significant percentage of the public will always be willing to pay such premium prices for golf equipment or that the Company will be able to continue to design and manufacture premium products that achieve market acceptance in the future. For example, the Company's new Big Bertha C4TM Driver is made of a compression cured carbon composite. All current leading drivers in the marketplace are made of metal, generally either steel or titanium. Although the Company believes that its new graphite drivers provide exceptional performance, there is no assurance golfers will be willing to pay premium prices for a non-metallic driver or that the C4 Driver will be commercially successful.

The rapid introduction of new golf club or golf ball products by the Company could result in close-outs of existing inventories at both the wholesale and retail levels. Such close-outs can result in reduced margins on the sale of older products, as well as reduced sales of new products, given the availability of older products at lower prices. Furthermore, it previously was the Company's practice to announce its new product line at the beginning of each calendar year. The Company recently departed from that practice and now 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 and/or result in close-out sales at reduced prices.

Conformance with the Rules of Golf

New golf club and golf ball products generally seek to satisfy the standards established by the United States Golf Association ("USGA") and the Royal and Ancient Golf Club of St. Andrews ("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.

Currently, the Rules of Golf as published by the R&A and the USGA are virtually the same except with respect to the regulation of "driving clubs." In 1998, the USGA adopted a so-called "spring-like effect test" that limits the coefficient of restitution ("COR") of drivers. The R&A has announced that it does not believe

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that such a limitation is needed or in the best interests of the game of golf, and has not adopted such a test or other performance limitation on drivers.

Some countries, such as Japan and Canada, have local golf associations that exert some control over the game of golf within their jurisdictions. The Royal Canadian Golf Association (“RCGA”) has announced that it will generally follow the USGA with respect to equipment rules. So far, no other local organization within the R&A’s general jurisdiction has deviated from the R&A’s position with respect to equipment rules.

Currently, all of the Company’s products are believed to be “conforming” under the Rules of Golf as published by the R&A. In addition, all of the Company’s products with the exception of the Company’s ERC II (and ERC II Pro Series) Forged Titanium Driver are believed to be “conforming” under the Rules of Golf as published by the USGA and RCGA. Although the ERC II Drivers conform to all existing R&A equipment rules, and most existing USGA and RCGA equipment rules, they do not conform to the USGA’s so-called “spring-like effect” test protocol. There is no assurance that new designs will satisfy USGA and/or R&A standards, or that existing USGA and/or R&A standards will not be altered in ways that adversely affect the sales of the Company’s products. For example, if the R&A were to reverse its current position and rule that the ERC II Drivers are non-conforming under the Rules of Golf as published by the R&A, then the Company believes its sales of the ERC II Drivers in the Company’s international markets would be significantly adversely affected.

On October 18, 2000, the Company announced that it intended to sell its ERC II Forged Titanium Driver in the U.S. despite the fact that it has been ruled to be non-conforming by the USGA. To the Company’s knowledge, it is the first large, premium brand golf equipment company to sell non-conforming equipment in the U.S. By undertaking this approach, the Company hopes to expand participation in the game of golf in the United States — the source of more than half of the Company’s revenues — by making the game more enjoyable and accessible for more people, including those people who play the game primarily for fun, enjoyment and recreation.

While the Company believes that this is the best strategy for the Company and its shareholders, and one that is good for the game of golf as well, the strategy has proven to be risky. The USGA has vigorously and openly opposed the sale or use of the ERC II Driver. On December 8, 2000, the USGA announced that scores in rounds played with clubs that do not conform to USGA rules, such as the ERC II Forged Titanium Driver, may not be posted for USGA handicap purposes. That position has been reinforced by further announcements by the USGA. A significant number of U.S. retailers have declined to carry the ERC II Driver, and that number could grow. It also appears at this time that a significant number of U.S. golfers may decide that they do not wish to purchase a driver that may not be used in competitions in the U.S. played subject to USGA rules or that may not be used for handicap purposes. Retailer and/or consumer backlash against the introduction of a non-conforming product has hurt sales of ERC II Drivers in the U.S., and may injure sales of other, conforming products, or otherwise damage the brand. These negative effects will materially reduce U.S. sales of ERC II Drivers and other products in 2001 and in future years, and could even negatively affect in a material way the strength of the brand and the Company’s business overseas despite the fact that the ERC II Drivers fully conform with the R&A’s Rules. On the other hand, if the Company is correct in its belief that there are a large number of American golfers who do not play in tournaments subject to the USGA’s Rules and who are prepared to purchase an exceptional non-conforming driver for use in recreational play, and/or the Company’s strategy is successful over time in attracting more people to the game of golf in the U.S., then the beneficial effects could be significant.

Golf Professional Endorsements

The Company establishes relationships with professional golfers in order to evaluate and promote Callaway Golf® and Odyssey® branded products. The Company has entered into endorsement arrangements with members of the various professional tours, including the Senior PGA Tour, the PGA Tour, the LPGA Tour, the PGA European Tour, the Japan Golf Tour and the buy.com 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

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Company's products contrary to their endorsement agreements, the Company's business could be adversely affected in a material way by the negative publicity.

Golf Clubs. Many professional golfers throughout the world use the Company's golf clubs even though they are not contractually bound to do so and do not grant any endorsement to the Company. The Company previously created cash pools that rewarded such usage. In 2001, the Company discontinued these pools, as it believes it is better to allocate these resources to other tour programs. In addition, many other companies are aggressively seeking the patronage of these professionals, and are offering many inducements, including specially designed products and significant cash rewards. In the past, the Company has experienced an exceptional level of club usage on the world's major professional tours, and the Company has heavily advertised that fact. The Company's lack of cash inducements for non-staff golfers could result in a decrease in usage of the Company's clubs by professional golfers. While it is not clear to what extent professional usage contributes to retail sales, it is possible that 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.

Golf Balls. Many golf ball manufacturers, including the leading U.S. manufacturer of premium golf balls, have focused a great deal of their marketing efforts on promoting the fact that tour professionals use their balls. Some of these golf ball competitors spend large amounts of money to secure professional endorsements, and the market leader has obtained a very high degree of tour penetration. While almost all of the Company's staff professionals, as well as other professionals who are not on the Company's staff, have decided to use the Company's golf balls in play, there is no assurance they will continue to do so. Furthermore, there are many other professionals who are already under contract with other golf ball manufacturers or who, for other reasons, may not choose to play the Company's golf ball products. The Company does not plan to match the endorsement spending levels of the leading manufacturer, and will instead rely more heavily upon the performance of the ball and other factors to attract professionals to the product. In the future, the Company may or may not increase its tour spending in support of its golf ball. It is not clear to what extent use by professionals is important to the commercial success of the Company's golf balls, but it is possible that the results of the Company's golf ball business could be significantly affected by its success or lack of success in securing acceptance on the professional tours.

Intellectual Property and Proprietary Rights

The golf club industry, in general, has been characterized by widespread imitation of popular club designs. The Company has an active program of enforcing its proprietary rights against companies and individuals who market or manufacture counterfeits and "knock off" products, and aggressively asserts its rights against infringers of its copyrights, patents, trademarks, and trade dress. However, there is no assurance that these efforts will reduce the level of acceptance obtained by these infringers. Additionally, there can be no assurance that other golf club manufacturers will not 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.

An increasing number of the Company's competitors have, like the Company itself, sought to obtain patent, trademark, copyright or other protection of their proprietary rights and designs for golf clubs and golf balls. From time to time, others have contacted or may contact the Company to claim that they have proprietary rights that have been infringed by the Company and/or its products. 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. No assurance can be given, however, that the Company will not be adversely affected in the future by the assertion of intellectual property rights belonging to others. This effect could include alteration or withdrawal of existing products and delayed introduction of new products.

Various patents have been issued to the Company's competitors in the golf ball industry. As the Company develops its golf ball products, it attempts to avoid infringing valid patents or other intellectual property rights. Despite these attempts, it cannot be guaranteed that competitors will not assert and/or a court will not find that the Company's golf balls infringe certain patent or other rights of competitors. If the Company's golf balls

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are found to infringe on protected technology, there is no assurance that the Company would be able to obtain a license to use such technology, and it could incur substantial costs to redesign them and/or defend legal actions.

The Company has procedures to maintain the secrecy of its confidential business information. These procedures include criteria for dissemination of information and written confidentiality agreements with employees and suppliers. Suppliers, when engaged in joint research projects, are required to enter into additional confidentiality agreements. While these efforts are taken seriously, there can be no assurance that these measures will prove adequate in all instances to protect the Company's confidential information.

Seasonality and Adverse Weather Conditions

In the golf club and golf ball industries, sales to retailers are generally seasonal due to lower demand in the retail market during cold weather months. The Company's golf club business has generally experienced these seasonal fluctuations and the Company expects this to continue generally for both its golf club and golf ball businesses. Furthermore, unusual or severe weather conditions generally result in less golf rounds played, which generally results in less demand for golf clubs and golf balls. Consequently, sustained adverse weather conditions, especially during the warm weather months, could materially affect the Company's sales. The Company believes that overall in the Company's principal markets during the first half of 2001 there was unusually adverse weather, which affected retail sales of the Company's products and made the Company's customers reluctant to re-order in quantity.

Product Returns

Golf Clubs. The Company supports all of its golf clubs with a limited two year written warranty. Since the Company does not rely upon traditional designs in the development of its golf clubs, its products may be more likely to develop unanticipated problems than those of many of its competitors that use traditional designs. For example, clubs have been returned with cracked clubheads, broken graphite shafts and loose medallions. While any breakage or warranty problems are deemed significant to the Company, the incidence of clubs returned to date has not been material in relation to the volume of clubs that have been sold.

The Company monitors the level and nature of any golf club breakage and, where appropriate, seeks to incorporate design and production changes to assure its customers of the highest quality available in the market. Significant increases in the incidence of breakage or other product problems may adversely affect the Company's sales and image with golfers. While the Company believes that it has sufficient reserves for warranty claims, there can be no assurance that these reserves will be sufficient if the Company were to experience an unusually high incidence of breakage or other product problems.

Golf Balls. The Company has not experienced significant returns of defective golf balls, and in light of the quality control procedures implemented in the production of its golf balls, the Company does not expect a significant amount of defective ball returns. However, if future returns of defective golf balls were significant, it could have a material adverse effect upon the Company's golf ball business.

"Gray Market" Distribution

Some quantities of the Company's products find their way to unapproved 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 Callaway Golf products to unauthorized distributors and/or an increase in sales returns over historical levels. For example, the Company experienced a decline in sales in the U.S. in 1998, and believes the decline was due, in part, to a decline in "gray market" shipments to Asia and Europe. While the Company has taken some lawful steps to limit commerce in its products in the "gray market" in both the U.S. and abroad, it has not stopped such commerce.

International Distribution and Foreign Currency Fluctuations

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 has reorganized a substantial portion of its international operations, including the acquisition of distribution rights in certain key countries in Europe, Asia and North America. These efforts have resulted and will continue to result in additional investments in inventory, accounts receivable, employees, corporate infrastructure and facilities. The operation of foreign distribution in the Company's international markets will continue to require the dedication of management and other Company resources.

Additionally, the Company's operation of foreign distribution increases the Company's exposure to fluctuations in exchange rates for various foreign currencies which could result in losses and, in turn, could adversely impact the Company's results of operations. The Company's results to date in 2001 were significantly affected negatively by the strength of the U.S. dollar versus other foreign currencies as compared to the prior year. Continued weakness in such foreign currencies during the remainder of 2001 would have a significant negative effect upon the Company.

The Company tries to mitigate its exposure to foreign currency fluctuations by engaging in certain hedging activities. The Company's hedges reduce, but do not eliminate, the adverse affects of such foreign currency fluctuations on the Company's results of operations. For example, the Company successfully entered into hedges for certain transactions it anticipated to occur during the first nine months of 2001. These hedging activities mitigated the negative effects of foreign currency fluctuations on the hedged transactions that occurred during such period. There can be no assurance to what extent the Company might be able to mitigate its future exposure to fluctuations in foreign currency through its management of foreign currency transactions. (See below *Item 3, Quantitative and Qualitative Disclosures about Market Risk — Foreign Currency Fluctuations*).

Credit Risk

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. In addition, as the Company integrates its foreign distribution its exposure to credit risks increases as it no longer sells to a few wholesalers but rather directly to many retailers. A failure of a significant portion of the Company's customers to meet their obligations to the Company would adversely impact the Company's performance and financial condition.

Information Systems

All of the Company's major operations, including manufacturing, distribution, sales and accounting, are dependent upon the Company's information computer systems. Any significant disruption in the operation of such systems, either as a result of an internal system malfunction or infection from an external computer virus, could have a significant adverse effect upon the Company's ability to operate its business. Although the Company has taken steps to mitigate the effect of any such disruptions, there is no assurance that such steps would be adequate in a particular situation. Consequently, a significant or extended disruption in the operation of the Company's information systems could have a material adverse effect upon the Company's operations and therefore financial performance and condition.

Many of the countries in which the Company sells its products are Member States of the Economic and Monetary Union ("EMU"). Beginning January 1, 1999, Member States of the EMU have the option of trading in either their local currencies or the euro, the official currency of EMU participating Member States. Parties are free to choose the unit they prefer in contractual relationships until 2002 when their local currencies will be phased out. The current version of the Company's enterprise-wide business system currently supports single transactions denominated in euro. At the end of 2001, the Company expects to convert the

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customers who are in the EMU groups from their national currency to the euro. Until such time as the conversion has occurred transactions denominated in euro will be processed manually. The Company does not believe that it will incur material costs specifically associated with manually processing data or preparing its business systems to operate in either the transitional period or beyond. However, there can be no assurance that the conversion of EMU Member States to euro will not have a material adverse effect on the Company and its operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company uses derivative financial instruments for hedging purposes and to manage its exposure to changes in foreign exchange rates and electricity prices. Transactions involving these financial instruments are with credit-worthy firms and major exchanges. The use of these instruments exposes the Company to market and credit risk which may at times be concentrated with certain counterparties, although counterparty nonperformance is not anticipated. The Company is also exposed to interest rate risk from its credit facilities and accounts receivable securitization arrangement. (See above *Certain Factors Affecting Callaway Golf Company — International Distribution and Foreign Currency Fluctuations*).

Foreign Currency Fluctuations

The Company is exposed to the impact of foreign currency fluctuations due to its international operations and certain export sales. The Company is exposed to both transactional currency/ functional currency and functional currency/ reporting currency exchange rate risks. In the normal course of business, the Company employs established policies and procedures to manage its exposure to fluctuations in the value of foreign currencies. Pursuant to its foreign exchange hedging policy, the Company may use forward foreign currency exchange rate contracts to hedge certain firm commitments and the related receivables and payables. During the nine months ended September 30, 2001, the Company entered into such contracts on behalf of two of its wholly-owned subsidiaries, Callaway Golf Europe Ltd. and Callaway Golf K.K. The effect of this practice is to minimize variability in the Company's operating results arising from foreign exchange rate movements. These foreign exchange contracts generally do not subject the Company to risk due to exchange rate movements because gains and losses on these contracts offset losses and gains on the transactions being hedged, and the Company does not engage in hedging contracts which exceed the amounts of these transactions.

Also pursuant to its foreign exchange hedging policy, the Company may hedge anticipated transactions denominated in foreign currencies using forward foreign currency exchange rate contracts and put or call options. Foreign currency derivatives are used only to the extent considered necessary to meet the Company's objectives. The Company does not enter into forward contracts for speculative purposes. The Company's foreign currency exposures include most European currencies, Japanese yen, Canadian dollars, Korean won, Australian dollars, and New Zealand dollars.

Sensitivity analysis is the measurement of potential loss in future earnings of market sensitive instruments resulting from one or more selected hypothetical changes in interest rates or foreign currency values. The Company used a sensitivity analysis model to quantify the estimated potential effect of unfavorable movements of 10% in foreign currencies to which the Company was exposed at September 30, 2001 through its derivative financial instruments.

The sensitivity analysis model is a risk analysis tool and does not purport to represent actual losses in earnings that will be incurred by the Company, nor does it consider the potential effect of favorable changes in market rates. It also does not represent the maximum possible loss that may occur. Actual future gains and losses will differ from those estimated because of changes or differences in market rates and interrelationships, hedging instruments and hedge percentages, timing and other factors.

The estimated maximum one-day loss in earnings from the Company's foreign-currency derivative financial instruments, calculated using the sensitivity analysis model described above, is \$11.6 million at September 30, 2001. The Company believes that such a hypothetical loss from its derivatives would be offset by increases in the value of the underlying transactions being hedged.

Electricity Price Fluctuations

The Company entered into a derivative commodity instrument as part of a comprehensive strategy to ensure the uninterrupted supply of energy while capping electricity costs in the volatile California energy market. The contract is a long-term fixed price physical delivery contract, which allows the Company greater predictability of energy costs and security in the supply of electricity in a volatile California energy market. This derivative commodity instrument is carried at fair value pursuant to requirements of SFAS No. 133.

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Therefore, fluctuations in the market price of electricity will directly affect the carrying value of the contract. At September 30, 2001, the change in fair value of the outstanding derivative commodity instrument that would be expected from a 10% adverse price change is \$1.6 million. The fair value of the derivative commodity instrument is estimated based on present value adjusted quoted market prices as further discussed in Note 11 to the Consolidated Condensed Financial Statements. Price changes were calculated by assuming a 10% adverse price change regardless of term or historical relationship between the contract price of the instrument and the underlying commodity price.

Interest Rate Fluctuations

Additionally, the Company is exposed to interest rate risk from its Amended Credit Agreement, Japanese credit facilities and Accounts Receivable Facility (see Notes 5 and 6 to the Company's Consolidated Condensed Financial Statements) which are indexed to the LIBOR, TIBOR and Redwood Receivables Corporation Commercial Paper Rate. No amounts were advanced or outstanding under these facilities at September 30, 2001.

Notes 5 and 6 to the Consolidated Condensed Financial Statements outline the principal amounts, if any, and other terms required to evaluate the expected cash flows and sensitivity to interest rate changes.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

The Company, incident to its business activities, is often the plaintiff in legal proceedings, both domestically and abroad, in various stages of development. 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. 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. Based upon the Company's experience, the Company believes that the outcome of these matters individually and in the aggregate will not have 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 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, however, that one or more claims of potential infringement could lead to litigation, the need to obtain additional licenses, the need to alter a product to avoid infringement, or some other action or loss by the Company.

As discussed in more detail in the Company's prior filings with the Securities and Exchange Commission, on July 24, 2000, Bridgestone Sports Co., Ltd. ("Bridgestone") filed a complaint for patent infringement in the United States District Court for the Northern District of Georgia, Civil Action No. 00-CV-1871, against Callaway Golf Company, Callaway Golf Ball Company (collectively "Callaway Golf"), and a golf retailer located in Georgia (the "U.S. Action"). On October 13, 2000, Bridgestone and the retailer defendant entered into a consent judgment discontinuing the action against the retailer. On December 14, 2000, Bridgestone filed an action in the Tokyo, Japan District Court asserting patent infringement against Callaway Golf's wholly-owned subsidiary, Callaway Golf K.K., based on its sale of Rule 35® Softfeel™ golf balls in Japan (the "Japan Action"). On October 9, 2001, the Company and Bridgestone announced that they have signed a golf ball patent license agreement permitting the Company to use a number of Bridgestone's three piece golf ball patents worldwide. As a result of such license agreement, the U.S. Action and Japan Action were dismissed.

On April 6, 2001, a complaint was filed against Callaway Golf Company and Callaway Golf Sales Company (collectively, the "Company"), in the Circuit Court of Sevier County, Tennessee, Case No. 2001-241-IV. The complaint seeks to assert a class action by plaintiff on behalf of himself and on behalf of consumers in Tennessee and Kansas who purchased selected Callaway Golf products on or after March 30, 2000. Specifically, the complaint alleges that the Company adopted a New Product Introduction Policy governing the introduction of certain of the Company's new products in violation of Tennessee and Kansas antitrust and consumer protection laws. The plaintiff is seeking damages, restitution and punitive damages.

On October 3, 2001, the Company filed suit in the United States District Court for the District of Delaware, Civil Action No. 01-669, against Dunlop Slazenger Group Americas Inc., d/b/a Maxfli ("Maxfli"), for infringement of a golf ball aerodynamics patent owned by the Company. On October 15, 2001, Maxfli filed an answer to the complaint denying any infringement, and also filed a counterclaim against the Company asserting that a former Maxfli employee now working for the Company had disclosed confidential Maxfli trade secrets to the Company, and that the Company had used that information to enter the golf ball business. Maxfli is seeking damages in an unspecified amount and injunctive relief.

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

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unable to ascertain the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance, or the financial impact with respect to these matters as of September 30, 2001. However, 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 annual consolidated financial position, results of operations or cash flows.

Item 2. *Changes in Securities and Use of Proceeds*

Effective as of September 21, 2001, the Company issued to a substantial foreign corporation 40,000 shares of the Company's common stock in exchange for certain intangible assets. The issuance of these shares was undertaken in reliance upon the exemption from registration afforded by Section 4(2) of the Securities Act of 1933. The acquirer of these shares represented that it was acquiring the shares for investment for its own account, not as a nominee or agent, and not with a view to, or for resale in connection with, any distribution thereof. The certificate evidencing the shares bears a legend stating that the shares may not be transferred other than pursuant to an effective registration statement or an exemption from the registration requirements under the Securities Act of 1933.

Item 3. *Defaults Upon Senior Securities*

None

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

None

Item 5. *Other Information*

None

Item 6. *Exhibits and Reports on Form 8-K*

a. Exhibits

3.1	Certificate of Incorporation, incorporated herein by this reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission (the "Commission") on July 1, 1999 (file no. 1-10962).
3.2	First Amended and Restated Bylaws, effective August 17, 2001.(†)
4.1	Dividend Reinvestment and Stock Purchase Plan, incorporated herein by this reference to the Prospectus in the Company's Registration Statement on Form S-3, as filed with the Commission on March 29, 1994 (file no. 33-77024).
10.54	First Amendment to Executive Officer Employment Agreement, effective May 15, 2001, by and between the Company and Ron Drapeau.(†)
10.55	Indemnification agreement, effective June 7, 2001, by and between the Company and Ronald S. Beard.(†)

(†) Included with this Report.

b. Reports on Form 8-K

Form 8-K, dated July 5, 2001, reporting the issuance of a press release of even date therewith, which press release was captioned, "Ely Callaway Succumbs to Cancer at Age 82."

SIGNATURES

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

Date: November 13, 2001

CALLAWAY GOLF COMPANY

By: /s/ BRADLEY J. HOLIDAY

Bradley J. Holiday
Executive Vice President
and Chief Financial Officer

EXHIBIT INDEX

Exhibit	Description
3.2	First Amended and Restated Bylaws, effective August 17, 2001.(†)
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(†) Included with this Report.

FIRST AMENDED AND RESTATED
BYLAWS
OF
CALLAWAY GOLF COMPANY
(A DELAWARE CORPORATION)
(AS AMENDED AND RESTATED AUGUST 17, 2001)

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ARTICLE I

CORPORATE OFFICES

1.1 REGISTERED OFFICE

The registered office of the corporation shall be fixed in the certificate of incorporation of the corporation.

1.2 OTHER OFFICES

The board of directors may at any time establish branch or subordinate offices at any place or places where the corporation is qualified to do business.

ARTICLE II

MEETINGS OF STOCKHOLDERS

2.1 PLACE OF MEETINGS

Meetings of stockholders shall be held at any place within or outside the State of Delaware designated by the board of directors. In the absence of any such designation, stockholders' meetings shall be held at the principal executive office of the corporation.

2.2 ANNUAL MEETING

(a) The annual meeting of stockholders shall be held each year on a date and at a time designated by the board of directors. At the meeting, directors shall be elected, and any other proper business may be transacted.

(b) Nominations of persons for election to the board of directors of the corporation and the proposal of business to be considered by the stockholders may be made at an annual meeting of stockholders (i) pursuant to the corporation's notice of meeting, (ii) by or at the direction of the board of directors or (iii) by any stockholder of the corporation who was a stockholder of record at the time of giving of notice provided for in this bylaw, who is entitled to vote at the meeting and who complied with the notice procedures set forth in this Section 2.2.

(c) For nominations or other business to be properly brought before an annual meeting by a stockholder pursuant to clause (iii) of Section 2.2(b) above, the stockholder must have given timely notice thereof in writing to the secretary of the corporation and such other business must be a proper matter for stockholder action. To be timely, a stockholder's notice shall be delivered to the secretary at the principal executive offices of the corporation not later than the close of business on the 90th day nor earlier than the close of business on the 120th day prior to the first anniversary of the preceding year's annual meeting; provided, however, that in the event that the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date, notice by the stockholder to be timely must be so delivered not

earlier than the close of business on the 120th day prior to such annual meeting and not later than the close of business on the later of the 90th day prior to such annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made. In no event shall the public announcement of an adjournment of an annual meeting commence a new time period for the giving of a stockholder's notice as described above. Such stockholder's notice shall set forth (i) as to each person whom the stockholder proposes to nominate for election or reelection as a director all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Rule 14a-11 thereunder (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected); (ii) as to any other business that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and (iii) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (x) the name and address of such stockholder, as they appear on the corporation's books, and of such beneficial owner and (y) the class and number of shares of the corporation which are owned beneficially and of record by such stockholder and such beneficial owner.

2.3 SPECIAL MEETING

A special meeting of the stockholders may be called at any time by the board of directors, or by the chairman of the board, or by the president. No other person or persons are permitted to call a special meeting.

2.4 NOTICE OF STOCKHOLDERS' MEETINGS

All notices of meetings of stockholders shall be sent or otherwise given in accordance with Section 2.6 of these bylaws not less than ten (10) nor more than sixty (60) days before the date of the meeting. The notice shall specify the place, date and hour of the meeting and (i) in the case of a special meeting, the purpose or purposes for which the meeting is called (no business other than that specified in the notice may be transacted) or (ii) in the case of the annual meeting, those matters which the board of directors, at the time of giving the notice, intends to present for action by the stockholders (but any proper matter may be presented at the meeting for such action). The notice of any meeting at which directors are to be elected shall include the name of any nominee or nominees who, at the time of the notice, the board intends to present for election.

2.5 CONDUCT OF MEETING

The board of directors may adopt by resolution such rules and regulations for the conduct of the meeting of stockholders as it shall deem appropriate. Except to the extent inconsistent with such rules and regulations as adopted by the board, the chairman of any meeting of stockholders shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of such chairman, are appropriate for the

proper conduct of the meeting. Such rules, regulations or procedures, whether adopted by the board or prescribed by the chairman of the meeting, may include, without limitation, the following: (i) the establishment of an agenda or order of business for the meeting; (ii) rules and procedures for maintaining order at the meeting and the safety of those present; (iii) limitations on attendance at or participation in the meeting to stockholders of record of the corporation, their duly authorized and constituted proxies or such other persons as the chairman of the meeting shall determine; (iv) restrictions on entry to the meeting after the time fixed for the commencement thereof; and (v) limitations on the time allotted to questions or comments by participants. Unless and to the extent determined by the board or the chairman of the meeting, meetings of stockholders shall not be required to be held in accordance with the rules of parliamentary procedure.

2.6 MANNER OF GIVING NOTICE; AFFIDAVIT OF NOTICE

Written notice of any meeting of stockholders shall be given either personally or by first-class mail or by telefacsimile or other written communication. Notices not personally delivered shall be sent charges prepaid and shall be addressed to the stockholder at the address of that stockholder appearing on the books of the corporation or given by the stockholder to the corporation for the purpose of notice. Notice shall be deemed to have been given at the time when delivered personally or deposited in the mail or sent by telefacsimile or other means of written communication.

An affidavit of the mailing or other means of giving any notice of any stockholders' meeting, executed by the secretary, assistant secretary or any transfer agent of the corporation giving the notice, shall be prima facie evidence of the giving of such notice.

2.7 QUORUM

The holders of a majority in voting power of the stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business except as otherwise provided by statute or by the certificate of incorporation. If, however, such quorum is not present or represented at any meeting of the stockholders, then either (i) the chairman of the meeting or (ii) the stockholders entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting in accordance with this Section 2.7.

When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which, by express provision of the laws of the State of Delaware or of the certificate of incorporation or these bylaws, a different vote is required, in which case such express provision shall govern and control the decision of the question.

If a quorum be initially present, the stockholders may continue to transact business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less

than a quorum, if any action taken is approved by a majority of the stockholders initially constituting the quorum.

2.8 ADJOURNED MEETING; NOTICE

When a meeting is adjourned to another time and place, unless these bylaws otherwise require, notice need not be given of the adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting the corporation may transact any business that might have been transacted at the original meeting. If the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

2.9 VOTING

The stockholders entitled to vote at any meeting of stockholders shall be determined in accordance with the provisions of Section 2.11 of these bylaws, subject to the provisions of Sections 217 and 218 of the General Corporation Law of Delaware (relating to voting rights of fiduciaries, pledgors and joint owners, and to voting trusts and other voting agreements).

Except as may be otherwise provided in the certificate of incorporation or these bylaws, each stockholder shall be entitled to one vote for each share of capital stock held by such stockholder.

2.10 WAIVER OF NOTICE

Whenever notice is required to be given under any provision of the General Corporation Law of Delaware or of the certificate of incorporation or these bylaws, a written waiver thereof, signed by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholders need be specified in any written waiver of notice unless so required by the certificate of incorporation or these bylaws.

2.11 STOCKHOLDER ACTION BY WRITTEN CONSENT

Except as may be otherwise provided in the certificate of incorporation, any action which may be taken at any annual or special meeting of stockholders may be taken without a meeting and without prior notice, if a consent in writing, setting forth the action so taken, is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote on that action were present and voted. In the case of election of directors, if the certificate of incorporation so provides, such a consent shall be effective only if signed by the holders of all outstanding shares entitled to vote for the election of directors; provided, however,

that a director may be elected at any time to fill a vacancy on the board of directors (other than a vacancy created by the removal of a director) that has not been filled by the directors, by the written consent of the holders of a majority of the outstanding shares entitled to vote for the election of directors. All such consents shall be filed with the secretary of the corporation and shall be maintained in the corporate records. Any stockholder giving a written consent, or the stockholder's proxy holders, may revoke the consent by a writing received by the secretary of the corporation before written consents of the number of shares required to authorize the proposed action have been filed with the secretary.

If the consents of all stockholders entitled to vote have not been solicited in writing, and if the unanimous written consent of all such stockholders shall not have been received, the secretary shall give prompt notice of the corporate action approved by the stockholders without a meeting.

2.12 RECORD DATE FOR STOCKHOLDER NOTICE; VOTING

For purposes of determining the stockholders entitled to notice of any meeting or to vote thereat or entitled to give consent to corporate action without a meeting, the board of directors may fix, in advance, a record date, which shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors and which shall not be more than sixty (60) days nor less than ten (10) days before the date of any such meeting, nor more than ten (10) days after the date upon which the resolution fixing the record date is adopted by the board of directors in the case of an action in writing without a meeting, and in such event only stockholders of record on the date so fixed are entitled to notice and to vote, notwithstanding any transfer of any shares on the books of the corporation after the record date.

If the board of directors does not so fix a record date, (a) the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the business day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held, and (b) the record date for determining stockholders entitled to consent to corporate action in writing without a meeting shall be the first date on which a signed written consent setting forth the action to be taken is delivered to the corporation at its principal place of business or to the corporation's registered office in Delaware.

A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting unless the board of directors fixes a new record date for the adjourned meeting, but the board of directors shall fix a new record date if the meeting is adjourned for more than thirty (30) days from the date set for the original meeting.

The record date for any other purpose shall be as provided in Section 8.1 of these bylaws.

2.13 PROXIES

Every person entitled to vote for directors, or on any other matter, shall have the right to do so either in person or by one or more agents authorized by a written proxy signed by the person and filed with the secretary of the corporation, but no such proxy shall be voted or acted upon after three (3) years from its date unless the proxy provides for a longer period. A proxy shall be deemed signed if the stockholder's name is placed on the proxy (whether by manual signature, typewriting, telegraphic transmission, telefacsimile or otherwise) by the stockholder or the stockholder's attorney-in-fact. The revocability of a proxy that states on its face that it is irrevocable shall be governed by the provisions of Section 212(e) of the General Corporation Law of Delaware.

2.14 LIST OF STOCKHOLDERS ENTITLED TO VOTE

The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

ARTICLE III

DIRECTORS

3.1 POWERS

Subject to the provisions of the General Corporation Law of Delaware and any limitations in the certificate of incorporation and these bylaws relating to action required to be approved by the stockholders or by the outstanding shares, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board of directors.

3.2 NUMBER OF DIRECTORS

The board of directors shall consist of not less than six (6) nor more than fifteen (15) members, with the exact number within that range to be set from time to time exclusively by resolution of the board of directors.

3.3 ELECTION AND TERM OF OFFICE OF DIRECTORS

Except as provided in Section 3.4 of these bylaws, directors shall be elected at each annual meeting of stockholders to hold office until the next annual meeting. Each director,

including a director elected or appointed to fill a vacancy, shall hold office until the expiration of the term for which elected and until a successor has been elected and qualified.

3.4 RESIGNATION AND VACANCIES

Any director may resign effective on giving written notice to the chairman of the board, the president, the secretary or the board of directors, unless the notice specifies a later time for that resignation to become effective. If the resignation of a director is effective at a future time, the board of directors may elect a successor to take office when the resignation becomes effective.

All vacancies in the board of directors may be filled by a majority of the remaining directors, even if less than a quorum, or by a sole remaining director; provided, that whenever the holders of any class or classes of stock or series thereof are entitled to elect one or more directors by the provisions of the certificate of incorporation, vacancies and newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected.

3.5 PLACE OF MEETINGS; MEETINGS BY TELEPHONE

Regular meetings of the board of directors may be held at any place within or outside the State of Delaware that has been designated from time to time by resolution of the board. In the absence of such a designation, regular meetings shall be held at the principal executive office of the corporation. Special meetings of the board may be held at any place within or outside the State of Delaware that has been designated in the notice of the meeting or, if not stated in the notice or if there is no notice, at the principal executive office of the corporation.

Any meeting, regular or special, may be held by conference telephone or similar communication equipment, so long as all directors participating in the meeting can hear one another; and all such directors shall be deemed to be present in person at the meeting.

3.6 REGULAR MEETINGS

Regular meetings of the board of directors may be held without notice if the times of such meetings are fixed by the board of directors. If any regular meeting day shall fall on a legal holiday, then the meeting shall be held next succeeding full business day.

3.7 SPECIAL MEETINGS; NOTICE

Special meetings of the board of directors for any purpose or purposes may be called at any time by the chairman of the board, the president or any two directors.

Notice of the time and place of special meetings shall be delivered personally or by telephone to each director or sent by first-class mail or telefacsimile, charges prepaid, addressed to each director at that director's address as it is shown on the records of the corporation. If the notice is mailed, it shall be deposited in the United States mail at least four (4) days before the time of the holding of the meeting. If the notice is delivered personally or by

telephone or telefacsimile, it shall be delivered personally or by telephone or telefacsimile at least forty-eight (48) hours before the time of the holding of the meeting. Any oral notice given personally or by telephone or telefacsimile may be communicated either to the director or to a person at the office of the director who the person giving the notice has reason to believe will promptly communicate it to the director. The notice need not specify the purpose or the place of the meeting, if the meeting is to be held at the principal executive office of the corporation.

3.8 QUORUM

A majority of the authorized number of directors shall constitute a quorum for the transaction of business, except to adjourn as provided in Section 3.10 of these bylaws. Every act or decision done or made by a majority of the directors present at a duly held meeting at which a quorum is present shall be regarded as the act of the board of directors, subject to the provisions of the certificate of incorporation and other applicable law.

A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting.

3.9 WAIVER OF NOTICE

Notice of a meeting need not be given to any director (i) who signs a waiver of notice or a consent to holding the meeting or an approval of the minutes thereof, whether before or after the meeting, or (ii) who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to such directors. All such waivers, consents, and approvals shall be filed with the corporate records or made part of the minutes of the meeting. A waiver of notice need not specify the purpose of any regular or special meeting of the board of directors.

3.10 ADJOURNMENT

A majority of the directors present, whether or not constituting a quorum, may adjourn any meeting to another time and place.

3.11 NOTICE OF ADJOURNMENT

Notice of the time and place of holding an adjourned meeting need not be given unless the meeting is adjourned for more than twenty-four (24) hours. If the meeting is adjourned for more than twenty-four (24) hours, then notice of the time and place of the adjourned meeting shall be given before the adjourned meeting takes place, in the manner specified in Section 3.7 of these bylaws, to the directors who were not present at the time of the adjournment.

3.12 BOARD ACTION BY WRITTEN CONSENT WITHOUT A MEETING

Any action required or permitted to be taken by the board of directors may be taken without a meeting, provided that all members of the board individually or collectively consent in writing to that action. Such action by written consent shall have the same force and

effect as a unanimous vote of the board of directors. Such written consent and any counterparts thereof shall be filed with the minutes of the proceedings of the board.

3.13 FEES AND COMPENSATION OF DIRECTORS

Directors and members of committees may receive such compensation, if any, for their services and such reimbursement of expenses as may be fixed or determined by resolution of the board of directors. This Section 3.13 shall not be construed to preclude any director from serving the corporation in any other capacity as an officer, agent, employee or otherwise and receiving compensation for those services.

3.14 APPROVAL OF LOANS TO OFFICERS

The corporation may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the corporation or any of its subsidiaries, including any officer or employee who is a director of the corporation or any of its subsidiaries, whenever, in the judgment of the directors, such loan, guaranty or assistance may reasonably be expected to benefit the corporation. The loan, guaranty or other assistance may be with or without interest and may be unsecured, or secured in such manner as the board of directors shall approve, including, without limitation, a pledge of shares of stock of the corporation. Nothing contained in this section shall be deemed to deny, limit or restrict the powers of guaranty or warranty of the corporation at common law or under any statute.

ARTICLE IV

COMMITTEES

4.1 COMMITTEES OF DIRECTORS

The board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one (1) or more committees, each consisting of one or more directors, to serve at the pleasure of the board. The board may designate one (1) or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. The appointment of members or alternate members of a committee requires the vote of a majority of the authorized number of directors. Any committee, to the extent provided in the resolution of the board, shall have and may exercise all the powers and authority of the board, but no such committee shall have the power or authority to:

(a) approve or adopt, or recommend to the stockholders, any action or matter expressly required by the Delaware General Corporation Law to be submitted to stockholders for approval; or

(b) adopt, amend or repeal any bylaw of the corporation.

4.2 MEETINGS AND ACTION OF COMMITTEES

Meetings and actions of committees shall be governed by, and held and taken in accordance with, the provisions of Article III of these bylaws, Section 3.5 (place of meetings), Section 3.6 (regular meetings), Section 3.7 (special meetings and notice), Section 3.8 (quorum), Section 3.9 (waiver of notice), Section 3.10 (adjournment), Section 3.11 (notice of adjournment), and Section 3.12 (action without meeting), with such changes in the context of those bylaws as are necessary to substitute the committee and its members for the board of directors and its members; provided, however, that the time of regular meetings of committees may be determined either by resolution of the board of directors or by resolution of the committee, that special meetings of committees may also be called by resolution of the board of directors, and that notice of special meetings of committees shall also be given to all alternate members, who shall have the right to attend all meetings of the committee. The board of directors may adopt rules for the government of any committee not inconsistent with the provisions of these bylaws.

4.3 COMMITTEE MINUTES

Each committee shall keep regular minutes of its meetings and report the same to the board of directors when requested.

ARTICLE V

OFFICERS

5.1 OFFICERS

The officers of the corporation shall be a president, a secretary, and a chief financial officer. The corporation may also have, at the discretion of the board of directors, a chairman of the board, one or more vice presidents, one or more assistant secretaries, one or more assistant treasurers, and such other officers as may be appointed in accordance with the provisions of Section 5.3 of these bylaws. Any number of offices may be held by the same person.

5.2 ELECTION OF OFFICERS

The officers of the corporation, except such officers as may be appointed in accordance with the provisions of Section 5.3 or Section 5.5 of these bylaws, shall be chosen by the board, subject to the rights, if any, of an officer under any contract of employment.

5.3 SUBORDINATE OFFICERS

The board of directors may appoint, or may empower the president to appoint, such other officers as the business of the corporation may require, each of whom shall hold office for such period, have such authority, and perform such duties as are provided in these bylaws or as the board of directors may from time to time determine.

5.4 REMOVAL AND RESIGNATION OF OFFICERS

Subject to the rights, if any, of an officer under any contract of employment, any officer may be removed, either with or without cause, by the board of directors at any regular or special meeting of the board or, except in case of an officer chosen by the board of directors, by any officer upon whom such power of removal may be conferred by the board of directors.

Any officer may resign at any time by giving written notice to the corporation. Any resignation shall take effect at the date of the receipt of that notice or at any later time specified in that notice; and, unless otherwise specified in that notice, the acceptance of the resignation shall not be necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party.

5.5 VACANCIES IN OFFICES

A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these bylaws for regular appointments to that office.

5.6 CHAIRMAN OF THE BOARD

The chairman of the board, if such an officer be elected, shall, if present, preside at meetings of the board of directors and exercise and perform such other powers and duties as may from time to time be assigned by the board of directors or as may be prescribed by these bylaws. If there is no president, then the chairman of the board shall also be the chief executive officer of the corporation and shall have the powers and duties prescribed in Section 5.7 of these bylaws.

5.7 PRESIDENT

Subject to such supervisory powers, if any, as may be given by the board of directors to the chairman of the board, if there be such an officer, the president shall be the chief executive officer of the corporation and shall, subject to the control of the board of directors, have general supervision, direction, and control of the business and the officers of the corporation. The president shall preside at all meetings of the stockholders and, in the absence or nonexistence of a chairman of the board, at all meetings of the board of directors. The president shall have the general powers and duties of management usually vested in the office of president of a corporation, and shall have such other powers and duties as may be prescribed by the board of directors or these bylaws.

5.8 VICE PRESIDENTS

In the absence or disability of the president, the vice presidents, if any, in order of their rank as fixed by the board of directors or, if not ranked, a vice president designated by the board of directors, shall perform all the duties of the president and when so acting shall have all the powers of, and be subject to all the restrictions upon, the president. The vice presidents shall have such other powers and perform such other duties as from time to time may be prescribed for

them respectively by the board of directors, these bylaws, the president or the chairman of the board.

5.9 SECRETARY

The secretary shall keep or cause to be kept, at the principal executive office of the corporation or such other place as the board of directors may direct, a book of minutes of all meetings and actions of directors, committees of directors and stockholders. The minutes shall show the time and place of each meeting, whether regular or special (and, if special, how authorized and the notice given), the names of those present at directors' meetings or committee meetings, the number of shares present or represented at stockholders' meetings, and the proceedings thereof.

The secretary shall keep, or cause to be kept, at the principal executive office of the corporation or at the office of the corporation's transfer agent or registrar, as determined by resolution of the board of directors, a share register, or a duplicate share register, showing the names of all stockholders and their addresses, the number and classes of shares held by each, the number and date of certificates evidencing such shares, and the number and date of cancellation of every certificate surrendered for cancellation.

The secretary shall give, or cause to be given, notice of all meetings of the stockholders and of the board of directors required to be given by law or by these bylaws, shall keep the seal of the corporation, if one be adopted, in safe custody and shall have such other powers and perform such other duties as may be prescribed by the board of directors or by these bylaws.

5.10 CHIEF FINANCIAL OFFICER

The chief financial officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of accounts of the properties and business transactions of the corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, retained earnings, and shares. The books of account shall at all reasonable times be open to inspection by any director.

The chief financial officer shall deposit all money and other valuables in the name and to the credit of the corporation with such depositories as may be designated by the board of directors. The chief financial officer shall disburse the funds of the corporation as may be ordered by the board of directors, shall render to the president and directors, whenever they request it, an account of all transactions effected as chief financial officer and of the financial condition of the corporation, and shall have such other powers and perform such other duties as may be prescribed by the board of directors or these bylaws.

ARTICLE VI

INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES AND OTHER AGENTS

6.1 INDEMNIFICATION OF DIRECTORS AND OFFICERS

The corporation shall, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware as the same now exists or may hereafter be amended, indemnify any person against expenses (including attorneys' fees), judgments, fines, and amounts paid in settlement actually and reasonably incurred in connection with any threatened, pending or completed action, suit, or proceeding in which such person was or is a party or is threatened to be made a party by reason of the fact that such person is or was a director or officer of the corporation. For purposes of this Section 6.1, a "director" or "officer" of the corporation shall mean any person (i) who is or was a director or officer of the corporation, (ii) who is or was serving at the request of the corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise, or (iii) who was a director or officer of a corporation which was a predecessor corporation of the corporation or of another enterprise at the request of such predecessor corporation.

The corporation shall be required to indemnify a director or officer in connection with an action, suit, or proceeding (or part thereof) initiated by such director or officer only if the initiation of such action, suit, or proceeding (or part thereof) by the director or officer was authorized by the board of directors of the corporation.

The corporation shall pay the expenses (including attorney's fees) incurred by a director or officer of the corporation entitled to indemnification hereunder in defending any action, suit or proceeding referred to in this Section 6.1 in advance of its final disposition; provided, however, that payment of expenses incurred by a director or officer of the corporation in advance of the final disposition of such action, suit or proceeding shall be made only upon receipt of an undertaking by the director or officer to repay all amounts advanced if it should ultimately be determined that the director or officer is not entitled to be indemnified under this Section 6.1 or otherwise.

This Section shall create a right of indemnification for each person referred to above, whether or not the proceeding to which the indemnification relates arose in whole or in part prior to the adoption of this Section, and in the event of death, such right shall extend to such person's legal representatives. The rights conferred on any person by this Section shall not be exclusive of any other rights which such person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation, these bylaws, agreement, vote of the stockholders or disinterested directors or otherwise. Any repeal or modification of the foregoing provisions of this Section shall not adversely affect any right or protection hereunder of any person in respect of any act or omission occurring prior to the time of such repeal or modification.

6.2 INDEMNIFICATION OF OTHERS

The corporation shall have the power, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware as the same now exists or may hereafter be amended, to indemnify any person (other than directors and officers) against expenses (including attorneys' fees), judgments, fines, and amounts paid in settlement actually and reasonably incurred in connection with any threatened, pending or completed action, suit, or proceeding, in which such person was or is a party or is threatened to be made a party by reason of the fact that such person is or was an employee or agent of the corporation. For purposes of this Section 6.2, an "employee" or "agent" of the corporation (other than a director or officer) shall mean any person (i) who is or was an employee or agent of the corporation, (ii) who is or was serving at the request of the corporation as an employee or agent of another corporation, partnership, joint venture, trust or other enterprise, or (iii) who was an employee or agent of a corporation which was a predecessor corporation of the corporation or of another enterprise at the request of such predecessor corporation.

6.3 INSURANCE

The corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him or her and incurred by him or her in any such capacity, or arising out of his or her status as such, whether or not the corporation would have the power to indemnify him or her against such liability under the provisions of the General Corporation Law of Delaware.

ARTICLE VII

RECORDS AND REPORTS

7.1 MAINTENANCE AND INSPECTION OF RECORDS

The corporation shall, either at its principal executive office or at such place or places as designated by the board of directors, keep a record of its stockholders listing their names and addresses and the number and class of shares held by each stockholder, a copy of these bylaws as amended to date, accounting books and other records of its business and properties.

Any stockholder of record, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder. In every instance where an attorney or other agent is the person who seeks the right to inspection, the demand under oath shall be accompanied by a power of attorney or such other writing that authorizes the attorney or other agent to so act on behalf of the stockholder. The demand under

oath shall be directed to the corporation at its registered office in Delaware or at its principal place of business.

7.2 INSPECTION BY DIRECTORS

Any director shall have the right to examine (and to make copies of) the corporation's stock Any director shall have the right to examine (and to make copies of) the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to his or her position as a director.

7.3 REPRESENTATION OF SHARES OF OTHER CORPORATIONS

The chairman of the board, if any, the president, any vice president, the chief financial officer, the secretary or any assistant secretary of this corporation, or any other person authorized by the board of directors or the president or a vice president, is authorized to vote, represent and exercise on behalf of this corporation all rights incident to any and all shares of the stock of any other corporation or corporations standing in the name of this corporation. The authority herein granted may be exercised either by such person directly or by any other person authorized to do so by proxy or power of attorney duly executed by such person having the authority.

7.4 CERTIFICATION AND INSPECTION OF BYLAWS

The original or a copy of these bylaws, as amended or otherwise altered to date, certified by the secretary, shall be kept at the corporation's principal executive office and shall be open to inspection by the stockholders of the corporation, at all reasonable times during office hours.

ARTICLE VIII

GENERAL MATTERS

8.1 RECORD DATE FOR PURPOSES OTHER THAN NOTICE AND VOTING

For purposes of determining the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or the stockholders entitled to exercise any rights in respect of any other lawful action, the board of directors may fix, in advance, a record date, which shall not be more than sixty (60) days before any such action. In that case, only stockholders of record at the close of business on the date so fixed are entitled to receive the dividend, distribution or allotment of rights, or to exercise such rights, as the case may be, notwithstanding any transfer of any shares on the books of the corporation after the record date so fixed, except as otherwise provided in the General Corporation Law of Delaware.

If the board of directors does not so fix a record date, then the record date for determining stockholders for any such purpose shall be at the close of business on the day on which the board adopts the applicable resolution.

8.2 CHECKS; DRAFTS; EVIDENCES OF INDEBTEDNESS

From time to time, the board of directors shall determine by resolution which person or persons may sign or endorse all checks, drafts, other orders for payment of money, notes or other evidences of indebtedness that are issued in the name of or payable to the corporation, and only the persons so authorized shall sign or endorse those instruments.

8.3 CORPORATE CONTRACTS AND INSTRUMENTS: HOW EXECUTED

The board of directors, except as otherwise provided in these bylaws, may authorize any officer or officers, or agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the corporation; such authority may be general or confined to specific instances. Unless so authorized or ratified by the board of directors or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or for any amount.

8.4 STOCK CERTIFICATES; TRANSFER; PARTLY PAID SHARES

The shares of the corporation shall be represented by certificates, provided that the board of directors of the corporation may provide by resolution or resolutions that some or all of any or all classes or series of its stock shall be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the corporation. Notwithstanding the adoption of such a resolution by the board of directors, every holder of stock represented by certificates and, upon request, every holder of uncertificated shares, shall be entitled to have a certificate signed by, or in the name of the corporation by, the chairman or vice-chairman of the board of directors, or the president or any vice president, and by the treasurer or an assistant treasurer, or the secretary or an assistant secretary of such corporation representing the number of shares registered in certificate form. Any or all of the signatures on the certificate may be a facsimile.

In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate has ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he or she were such officer, transfer agent or registrar at the date of issue.

Certificates for shares shall be of such form and device as the board of directors may designate and shall state the name of the record holder of the shares represented thereby; its number; date of issuance; the number of shares for which it is issued; a summary statement or reference to the powers, designations, preferences or other special rights of such stock and the qualifications, limitations or restrictions of such preferences and/or rights, if any; a statement or summary of liens, if any; a conspicuous notice of restrictions upon transfer or registration of transfer, if any; a statement as to any applicable voting trust agreement; if the shares be assessable, or, if assessments are collectible by personal action, a plain statement of such facts.

Upon surrender to the secretary or transfer agent of the corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books.

The corporation may issue the whole or any part of its shares as partly paid and subject to call for the remainder of the consideration to be paid therefor. Upon the face or back of each stock certificate issued to represent any such partly paid shares, or upon the books and records of the corporation in the case of uncertificated partly paid shares, the total amount of the consideration to be paid therefor and the amount paid thereon shall be stated. Upon the declaration of any dividend on fully paid shares, the corporation shall declare a dividend upon partly paid shares of the same class, but only upon the basis of the percentage of the consideration actually paid thereon.

8.5 SPECIAL DESIGNATION ON CERTIFICATES

If the corporation is authorized to issue more than one class of stock or more than one series of any class, then the powers, the designations, the preferences and the relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate that the corporation shall issue to represent such class or series of stock; provided, however, that, except as otherwise provided in Section 202 of the General Corporation Law of Delaware, in lieu of the foregoing requirements there may be set forth on the face or back of the certificate that the corporation shall issue to represent such class or series of stock a statement that the corporation will furnish without charge to each stockholder who so requests the powers, the designations, the preferences and the relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

8.6 LOST CERTIFICATES

Except as provided in this Section 8.6, no new certificates for shares shall be issued to replace a previously issued certificate unless the latter is surrendered to the corporation and cancelled at the same time. The board of directors may, in case any share certificate or certificate for any other security is lost, stolen or destroyed, authorize the issuance of replacement certificates on such terms and conditions as the board may require; the board may require indemnification of the corporation secured by a bond or other adequate security sufficient to protect the corporation against any claim that may be made against it, including any expense or liability, on account of the alleged loss, theft or destruction of the certificate or the issuance of the replacement certificate.

8.7 TRANSFER AGENTS AND REGISTRARS

The board of directors may appoint one or more transfer agents or transfer clerks, and one or more registrars, each of which shall be an incorporated bank or trust company -- either

domestic or foreign, who shall be appointed at such times and places as the requirements of the corporation may necessitate and the board of directors may designate.

8.8 CONSTRUCTION; DEFINITIONS

Unless the context requires otherwise, the general provisions, rules of construction, and definitions in the General Corporation Law of Delaware shall govern the construction of these bylaws. Without limiting the generality of this provision, the singular number includes the plural, the plural number includes the singular, and the term "person" includes both a corporation and a natural person.

ARTICLE IX

AMENDMENTS

The original or other bylaws of the corporation may be adopted, amended or repealed by the stockholders entitled to vote or by the board of directors of the corporation. The fact that such power has been so conferred upon the directors shall not divest the stockholders of the power, nor limit their power to adopt, amend or repeal bylaws.

Whenever an amendment or new bylaw is adopted, it shall be copied in the book of bylaws with the original bylaws, in the appropriate place. If any bylaw is repealed, the fact of repeal with the date of the meeting at which the repeal was enacted or the filing of the operative written consent(s) shall be stated in said book.

FIRST AMENDMENT TO
EXECUTIVE OFFICER EMPLOYMENT AGREEMENT

This First Amendment to Executive Officer Employment Agreement ("First Amendment") is effective as of May 15, 2001 by and between CALLAWAY GOLF COMPANY, a Delaware corporation (the "Company") and RON DRAPEAU ("Employee").

A. The Company and Employee are parties to a certain Executive Officer Employment Agreement effective as of September 1, 2000 (the "Agreement").

B. The Company has promoted Employee to the positions of President and Chief Executive Officer, and given Employee the duties and responsibilities that accompany those positions.

C. In light of the foregoing, the Company and Employee desire to amend the Agreement pursuant to Section 16 of the Agreement, in the manner set forth herein.

NOW, THEREFORE, in consideration of the foregoing and other consideration, the value and sufficiency of which are hereby acknowledged, the Company and Employee hereby agree as follows:

1. Section 2(a) of the Agreement is hereby amended to read as follows:

"Employee shall serve as President and Chief Executive Officer of the Company. Employee's duties shall be the usual and customary duties of the offices in which Employee serves. Employee shall report to the Board of Directors."

2. Section 4(a) of the Agreement is hereby amended to read as follows:

"The Company agrees to pay Employee a base salary at the rate of \$700,000.00 per year."

3. Section 5(b) of the Agreement is hereby amended to read as follows:

"Vacation. Employee shall receive five (5) weeks paid vacation for each twelve (12) month period of employment with the Company. The vacation may be taken any time during the year subject to prior approval by the Company, such approval not to be unreasonably withheld. Any unused vacation will be carried forward from year to year. The maximum vacation time Employee may accrue shall be three times Employee's annual vacation benefit. The Company reserves the right to pay Employee for unused, accrued vacation benefits in lieu of providing time off."

4. But for the amendments contained herein, and any other written amendments properly executed by the parties, the Agreement shall otherwise remain unchanged.

IN WITNESS WHEREOF, the Company and Employee have caused this First Amendment to be executed effective as of the date set forth above.

EMPLOYEE

COMPANY

Callaway Golf Company,
a Delaware corporation

Ron Drapeau

By: -----
Steven C. McCracken, Senior Executive
Vice President, Chief Legal Officer

INDEMNIFICATION AGREEMENT

THIS INDEMNIFICATION AGREEMENT is made as of the 7th day of June, 2001, by and between Callaway Golf Company, a Delaware corporation (the "Company"), and Ronald S. Beard ("Indemnitee"), a director of the Company.

WHEREAS, the Company and Indemnitee recognize the increasing difficulty in obtaining liability insurance covering directors, the significant increases in the cost of such insurance and the general reductions in the coverage of such insurance;

WHEREAS, although the Company currently has directors liability insurance, the coverage of such insurance is such that many claims which may be brought against Indemnitee may not be covered, or may not be fully covered, and the Company may be unable to maintain such insurance;

WHEREAS, the Company and the Indemnitee further recognize the substantial increase in corporate litigation subjecting directors to expensive litigation risks at the same time that liability insurance has been severely limited;

WHEREAS, the current protection available may not be adequate given the present circumstances, and Indemnitee may not be willing to serve as a director without adequate protection;

WHEREAS, the Company desires to attract and retain the services of highly qualified individuals, such as Indemnitee, to serve as directors of the Company and to indemnify its directors so as to provide them with the maximum protection permitted by law;

NOW, THEREFORE, the Company and Indemnitee hereby agree as follows:

1. DEFINITIONS. The following terms, as used herein, have the following meaning:

1.1 Affiliate. "Affiliate" means, (i) with respect to any corporation, any officer, director or 10% or more shareholder of such corporation, or (ii) with respect to any individual, any partner or immediate family member of such individual or the estate of such individual, or (iii) with respect to any partnership, trust or joint venture, any partner, co-venturer or trustee of such partnership, trust or joint venture, or any beneficiary or owner having 10% or more interest in the equity, property or profits of such partnership, trust or joint venture, or (iv) with respect to any Person, any other Person which, directly or indirectly, controls, is controlled by, or is under common control with such Person or any Affiliate of such Person.

1.2 Agreement. "Agreement" shall mean this Indemnification Agreement, as the same may be amended from time to time hereafter.

1.3 DGCL. "DGCL" shall mean the Delaware General Corporation Law, as amended.

1.4 Person. "Person" shall mean any individual, partnership, corporation, joint venture, trust, estate, or other entity.

1.5 Subsidiary. "Subsidiary" shall mean any corporation of which the Company owns, directly or indirectly, through one or more subsidiaries, securities having more than 50% of the voting power of such corporation.

2. INDEMNIFICATION

2.1 Third Party Proceedings. The Company shall indemnify Indemnitee if Indemnitee is or was a party or witness or other participant in, or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than action by or in the right of the Company) by reason of the fact that Indemnitee is or was a director of the Company or any subsidiary of the Company, by reason of any action or inaction on the part of Indemnitee while a director of the Company or any Subsidiary, and/or by reason of the fact that Indemnitee is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against all expense, liability and loss (including attorneys' fees), judgments, fines and amounts paid in settlement (if such settlement is approved in advance by the Company, which approval shall not be unreasonably withheld) actually and reasonably incurred by Indemnitee in connection with such action, suit or proceeding if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in or not opposed to the best interests of the Company, and, with respect to any criminal action or proceeding, had no reasonable cause to believe Indemnitee's conduct was unlawful and provided, further, that the Company has determined that such indemnification is otherwise permitted by applicable law.

The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that Indemnitee did not act in good faith and in a manner which Indemnitee reasonably believed to be in the best interests of the Company or that Indemnitee had reasonable cause to believe that Indemnitee's conduct was unlawful.

2.2 Proceedings by or in the Right of the Company. The Company shall indemnify Indemnitee if Indemnitee was or is a party or a witness or other participant in or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Company or any Subsidiary to procure a judgment in its favor by reason of the fact that Indemnitee is or was a director of the Company or any Subsidiary, by reason of any action or inaction on the part of

Indemnitee while a director of the Company or a Subsidiary or by reason of the fact that Indemnitee is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against all expense, liability and loss (including attorneys' fees) and amounts paid in settlement (if such settlement is court-approved) actually and reasonably incurred by Indemnitee in connection with the defense or settlement of such action or suit if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in or not opposed to the best interests of the Company and its shareholders and provided, further, that the Company has determined that such indemnification is otherwise permitted by applicable law. No indemnification shall be made in respect of any claim, issue or matter as to which Indemnitee shall have been adjudged to be liable to the Company in the performance of Indemnitee's duties to the Company and its shareholders, unless and only to the extent that the court in which such proceeding is or was pending shall determine upon application that, in view of all the circumstances of the case, Indemnitee is fairly and reasonably entitled to indemnity for expenses and then only to the extent that the court shall determine.

2.3 Mandatory Payment of Expenses. To the extent that Indemnitee has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Section 2.1 or 2.2 or the defense of any claim, issue or matter therein, Indemnitee shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by Indemnitee in connection therewith.

2.4 Enforcing the Agreement. If Indemnitee properly makes a claim for indemnification or an advance of expenses which is payable pursuant to the terms of this Agreement, and that claim is not paid by the Company, or on its behalf, within ninety days after a written claim has been received by the Company, the Indemnitee may at any time thereafter bring suit against the Company to recover the unpaid amount of the claim and if successful in whole or in part, the Indemnitee shall be entitled to be paid also all expenses actually and reasonably incurred in connection with prosecuting such claim.

2.5 Subrogation. In the event of payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of the Indemnitee, who shall execute all papers required and shall do everything that may be necessary to secure such rights, including the execution of such documents necessary to enable the Company effectively to bring suit to enforce such rights.

3. EXPENSES; INDEMNIFICATION PROCEDURE

3.1 Advancement of Expenses. The Company shall advance all expenses incurred by Indemnitee in connection with the investigation, defense, settlement or appeal of any civil or criminal action, suit or proceeding referenced in Section 2.1 or 2.2 hereof. Indemnitee hereby undertakes to repay such amounts advanced only if, and to the extent that, it shall ultimately be determined that Indemnitee

is not entitled to be indemnified by the Company as authorized hereby or that such indemnification is not otherwise permitted by applicable law. The advances to be made hereunder shall be paid by the Company to Indemnitee within thirty (30) days following delivery of a written request therefor or by Indemnitee to the Company.

3.2 Determination of Conduct. Any indemnification (unless ordered by a court) shall be made by the Company only as authorized in the specified case upon a determination that indemnification of Indemnitee is proper under the circumstances because Indemnitee has met the applicable standard of conduct set forth in Sections 2.1 or 2.2 of this Agreement. Such determination shall be made by any of the following: (1) the Board of Directors (or by an executive committee thereof) by a majority vote of directors (or committee members) who are not parties to such action, suit or proceeding, even though less than a quorum, (2) if there are no such disinterested directors, or if such disinterested directors so direct, by independent legal counsel in a written opinion, (3) by the shareholders, with the shares owned by Indemnitee not being entitled to vote thereon, or (4) the court in which such proceeding is or was pending upon application made by the Company or Indemnitee or the attorney or other person rendering services in connection with the defense, whether or not such application by Indemnitee, the attorney or the other person is opposed by the Company.

3.3 Notice/Cooperation by Indemnitee. Indemnitee shall, as a condition precedent to Indemnitee's right to be indemnified under this Agreement, give the Company notice in writing as soon as practicable of any claim made against Indemnitee for which indemnification will or could be sought under this Agreement. Notice to the Company shall be given in the manner set forth in Section 10.3 hereof and to the address stated therein, or such other address as the Company shall designate in writing to Indemnitee. In addition, Indemnitee shall give the Company such information and cooperation as it may reasonably require and as shall be within Indemnitee's power.

3.4 Notice to Insurers. If, at the time of the receipt of a notice of a claim pursuant to Section 3.3 hereof, the Company has director liability insurance in effect, the Company shall give prompt notice of the commencement of such proceeding to the insurers in accordance with the procedures set forth in the respective policies. The Company shall thereafter take all necessary or desirable actions to cause such insurers to pay, on behalf of the Indemnitee, all amounts payable as a result of such proceeding in accordance with the terms of such policies.

3.5 Selection of Counsel. In the event the Company shall be obligated under Section 3.1 hereof to pay the expenses of any proceeding against Indemnitee, the Company shall be entitled to assume the defense of such proceeding, with counsel approved by Indemnitee, upon the delivery to Indemnitee of written notice of its election so to do. After delivery of such notice, approval of such counsel by Indemnitee and the retention of such counsel by the Company, the Company will not be liable to Indemnitee under this Agreement for any fees of counsel subsequently incurred by Indemnitee with respect to the same proceeding, provided that (a) Indemnitee shall have the right to

employ separate counsel in any such proceeding at Indemnitee's expense; and (b) if (i) the employment of counsel by Indemnitee has been previously authorized by the Company, (ii) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Company and Indemnitee in the conduct of any such defense, or (iii) the Company shall not, in fact, have employed counsel to assume the defense of such proceeding, then the fees and expenses of Indemnitee's counsel shall be at the expense of the Company (subject to the provisions of this Agreement).

4. ADDITIONAL INDEMNIFICATION RIGHTS; NON-EXCLUSIVITY

4.1 Application. The provisions of this Agreement shall be deemed applicable to all actual or alleged actions or omissions by Indemnitee during any and all periods of time that Indemnitee was, is, or shall be serving as a director of the Company or a Subsidiary.

4.2 Scope. The Company hereby agrees to indemnify Indemnitee to the fullest extent permitted by law (except as set forth in Section 8 hereof), notwithstanding that such indemnification is not specifically authorized by the other provisions of this Agreement, the Company's Certificate of Incorporation, the Company's Bylaws or by statute. In the event of any changes, after the date of this Agreement, in any applicable law, statute, or rule which expands the right of a Delaware corporation to indemnify a member of its board of directors, such changes shall be, ipso facto, within the purview of Indemnitee's rights and the Company's obligations under this Agreement. In the event of any change in any applicable law, statute, or rule which narrows the right of a Delaware corporation to indemnify a member of its board of directors, such changes, except to the extent otherwise required by such law, statute or rule to be applied to this Agreement shall have no effect on this Agreement or the parties' rights and obligations hereunder.

4.3 Non-Exclusivity. The indemnification provided by this Agreement shall not be deemed exclusive of any rights to which an Indemnitee may be entitled under the Company's Certificate of Incorporation, its Bylaws, any agreement, any vote of shareholders or disinterested directors, the DGCL, or otherwise, both as to action in Indemnitee's official capacity and as to action in another capacity while holding such office. The indemnification provided under this Agreement shall continue as to Indemnitee for an action taken or not taken while serving in an indemnified capacity even though he may have ceased to serve in such capacity at the time of any action, suit or other covered proceeding.

5. PARTIAL INDEMNIFICATION

If Indemnitee is entitled under any provision of this Agreement to indemnification by the Company for some or a portion of the expenses, judgments, fines or penalties actually or reasonably incurred by Indemnitee in the investigation, defense, appeal or settlement of any civil or criminal action, suit or proceedings but not, however,

for the total amount thereof, the Company shall nevertheless indemnify Indemnitee for that portion to which Indemnitee is entitled.

6. MUTUAL ACKNOWLEDGMENT

Both the Company and Indemnitee acknowledge that in certain instances, federal law or public policy may override applicable state law and prohibit the Company from indemnifying its directors under this Agreement or otherwise. For example, the Company and Indemnitee acknowledge that the Securities and Exchange Commission (the "SEC") has taken the position that indemnification is not permissible for liabilities arising under certain federal securities laws, and federal legislation prohibits indemnification for certain ERISA violations. Indemnitee understands and acknowledges that the Company has undertaken or may be required in the future to undertake with the SEC to submit the question of indemnification to a court in certain circumstances for a determination of the Company's right under public policy to indemnify Indemnitee.

7. LIABILITY INSURANCE

The Company shall, from time to time, make the good faith determination whether or not it is practicable for the Company to obtain and maintain a policy or policies of insurance with reputable, insurance companies providing the directors with coverage for losses from wrongful acts, or to ensure the Company's performance of its indemnification obligations under this Agreement. Among other considerations, the Company will weigh the costs of obtaining such insurance coverage against the protection afforded by such coverage. In all such policies of liability insurance, Indemnitee shall be named as an insured in such a manner as to provide Indemnitee the same rights and benefits as are accorded to the most favorably insured of the Company's directors. Notwithstanding the foregoing, the Company shall have no obligation, to obtain or maintain such insurance if the Company determines in good faith that such insurance is not reasonably available, if the premium costs for such insurance are disproportionate to the amount of coverage provided, if the coverage provided by such insurance is limited by exclusions so as to provide an insufficient benefit, or if Indemnitee is covered by similar insurance maintained by a parent or Subsidiary of the Company.

8. SEVERABILITY

Nothing in this Agreement is intended to require or shall be construed as requiring the Company to do or fail to do any act in violation of applicable law. The Company's inability, pursuant to court order, to perform its obligations under this Agreement shall not constitute a breach of this Agreement. The provisions of this Agreement shall be severable as provided in this Section 8. If this Agreement or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, the Company shall nevertheless indemnify Indemnitee to the full extent permitted by any applicable portion of this Agreement that shall not have been invalidated, and the

balance of this Agreement not so invalidated shall be enforceable in accordance with its terms.

9. EXCEPTIONS

9.1 Exceptions to Company's Obligations. Any other provision to the contrary notwithstanding, the Company shall not be obligated pursuant to the terms of this Agreement for the following:

(a) Claims Initiated by Indemnitee. To indemnify or advance expenses to Indemnitee with respect to proceedings or claims initiated or brought voluntarily by Indemnitee and not by way of defense, unless said proceedings or claims were authorized by the board of directors of the Company.

(b) Improper Personal Benefit. To indemnify Indemnitee against liability for any transactions from which Indemnitee, or any Affiliate of Indemnitee, derived an improper personal benefit, including, but not limited to, self-dealing or usurpation of a corporate opportunity.

(c) Dishonesty. To indemnify Indemnitee if a judgment or other final adjudication adverse to Indemnitee established that Indemnitee committed acts of active and deliberate dishonesty, with actual dishonest purpose and intent, which acts were material to the cause of action so adjudicated.

(d) Insured Claims; Paid Claims. To indemnify Indemnitee for expenses or liabilities of any type whatsoever (including but not limited to, judgments, fines, ERISA excise taxes or penalties, and amounts paid in settlement) which have been paid directly to Indemnitee (i) by an insurance carrier under a policy of liability insurance maintained by the Company, or (ii) otherwise by any other means.

(e) Claims Under Section 16(b). To indemnify Indemnitee for an accounting of profits in fact realized from the purchase and sale of securities within the meaning of Section 16(b) of the Securities Exchange Act of 1934, as amended, or any similar successor statute.

10. MISCELLANEOUS

10.1 Construction of Certain Phrases.

(a) For purposes of this Agreement, references to the "Company" shall include any resulting or surviving corporation in any merger or consolidation in which the Company (as then constituted) is not the resulting or surviving corporation so that Indemnitee will continue to have the full benefits of this Agreement.

(b) For purposes of this Agreement, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on Indemnitee with respect to an employee benefit plan; and references to "serving at the request of the Company" shall include any service as a director, officer, employee or agent of the Company which impose duties on, or involves services by, such director, officer, employee or agent with respect to an employee benefit plan, its participants, or beneficiaries; and if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in the best interests of the participants and beneficiaries of an employee benefit plan, Indemnitee shall be deemed to have acted in a manner "reasonably believed to be in the best interests of the Company and its shareholders" as referred to in this Agreement.

10.2 Successors and Assigns. This Agreement shall be binding upon the Company and its successors and assigns, and shall inure to the benefit of Indemnitee and Indemnitee's estate, heirs, legal representatives and assigns. Notwithstanding the foregoing, the Indemnitee shall have no right or power to voluntarily assign or transfer any rights granted to Indemnitee, or obligations imposed upon the Company, by or pursuant to this Agreement. Further, the rights of the Indemnitee hereunder shall in no event accrue to the benefit of, or be enforceable by, any judgment creditor or other involuntary transferee of the Indemnitee.

10.3 Notice. All notices, requests, demands and other communications under this Agreement shall be in writing and shall be deemed duly given (i) if mailed by domestic certified or registered mail with postage prepaid, properly addressed to the parties at the addresses set forth below, or to such other address as may be furnished to Indemnitee by the Company or to the Company by Indemnitee, as the case may be, on the third business day after the date postmarked, or (ii) otherwise notice shall be deemed received when such notice is actually received by the party to whom it is directed.

If to Indemnitee:	Ronald S. Beard Gibson, Dunn & Crutcher LLP Jamboree Center, 4 Park Plaza Irvine, CA 92614
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If to Company:	Callaway Golf Company 2180 Rutherford Road Carlsbad, CA 92008 Attention: General Counsel
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10.4 Consent to Jurisdiction. The Company and Indemnitee each hereby irrevocably consent to the jurisdiction of the courts of the State of California for all purposes in connection with any action or proceeding which arises out of or related to this Agreement and agree that any action instituted under this Agreement shall be brought only in the state courts of the State of California.

10.5 Choice of Law. This Agreement shall be governed by and its provisions construed in accordance with the internal laws of the State of Delaware, as applied to contracts between Delaware residents entered into and to be performed entirely within Delaware, and without regard to choice of law principles.

10.6 IRREVOCABLE ARBITRATION OF DISPUTES.

(a) INDEMNITEE AND THE COMPANY AGREE THAT ANY DISPUTE, CONTROVERSY OR CLAIM ARISING HEREUNDER OR IN ANY WAY RELATED TO THIS AGREEMENT, ITS INTERPRETATION, ENFORCEABILITY, OR APPLICABILITY THAT CANNOT BE RESOLVED BY MUTUAL AGREEMENT OF THE PARTIES SHALL BE SUBMITTED TO BINDING ARBITRATION. THIS INCLUDES, BUT IS NOT LIMITED TO, ALLEGED VIOLATIONS OF FEDERAL, STATE AND/OR LOCAL STATUTES, CLAIMS BASED ON ANY PURPORTED BREACH OF DUTY ARISING IN CONTRACT OR TORT, INCLUDING BREACH OF CONTRACT, BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING, VIOLATION OF PUBLIC POLICY, AND VIOLATION OF ANY STATUTORY, CONTRACTUAL OR COMMON LAW RIGHTS. THE PARTIES AGREE THAT ARBITRATION IS THE PARTIES' ONLY RECOURSE FOR SUCH CLAIMS AND HEREBY WAIVE THE RIGHT TO PURSUE SUCH CLAIMS IN ANY OTHER FORUM, UNLESS OTHERWISE PROVIDED BY LAW. ANY COURT ACTION INVOLVING A DISPUTE WHICH IS NOT SUBJECT TO ARBITRATION SHALL BE STAYED PENDING ARBITRATION OF ARBITRABLE DISPUTES.

(b) INDEMNITEE AND THE COMPANY AGREE THAT THE ARBITRATOR SHALL HAVE THE AUTHORITY TO ISSUE PROVISIONAL RELIEF. INDEMNITEE AND THE COMPANY FURTHER AGREE THAT EACH HAS THE RIGHT, PURSUANT TO CALIFORNIA CODE OF CIVIL PROCEDURE SECTION 1281.8, TO APPLY TO A COURT FOR A PROVISIONAL REMEDY IN CONNECTION WITH AN ARBITRABLE DISPUTE SO AS TO PREVENT THE ARBITRATION FROM BEING RENDERED INEFFECTIVE.

(c) ANY DEMAND FOR ARBITRATION SHALL BE IN WRITING AND MUST BE COMMUNICATED TO THE OTHER PARTY PRIOR TO THE EXPIRATION OF THE APPLICABLE STATUTE OF LIMITATIONS.

(d) THE ARBITRATION SHALL BE CONDUCTED PURSUANT TO THE PROCEDURAL RULES STATED IN THE COMMERCIAL RULES OF THE AMERICAN ARBITRATION ASSOCIATION ("AAA") IN SAN DIEGO. THE ARBITRATION SHALL BE CONDUCTED IN SAN DIEGO BY A FORMER OR RETIRED JUDGE OR ATTORNEY WITH AT LEAST 10 YEARS EXPERIENCE IN COMMERCIAL-RELATED DISPUTES, OR A NON-ATTORNEY WITH LIKE EXPERIENCE IN THE AREA OF DISPUTE, WHO SHALL HAVE THE POWER TO HEAR MOTIONS, CONTROL DISCOVERY, CONDUCT HEARINGS AND OTHERWISE DO ALL THAT IS NECESSARY TO RESOLVE THE MATTER. THE PARTIES MUST MUTUALLY AGREE ON THE ARBITRATOR. IF THE PARTIES CANNOT AGREE ON THE ARBITRATOR AFTER THEIR BEST EFFORTS, AN ARBITRATOR FROM THE AMERICAN ARBITRATION ASSOCIATION WILL BE SELECTED PURSUANT TO THE AMERICAN ARBITRATION ASSOCIATION NATIONAL RULES FOR RESOLUTION OF COMMERCIAL/BUSINESS DISPUTES. THE COMPANY SHALL PAY THE COSTS OF THE ARBITRATOR'S FEES.

(e) THE ARBITRATION WILL BE DECIDED UPON A WRITTEN DECISION OF THE ARBITRATOR STATING THE ESSENTIAL FINDINGS AND CONCLUSIONS UPON WHICH THE AWARD IS BASED. THE ARBITRATOR SHALL HAVE THE AUTHORITY TO AWARD DAMAGES, IF ANY, TO THE EXTENT THAT THEY ARE AVAILABLE UNDER APPLICABLE LAW(S). THE ARBITRATION AWARD SHALL BE FINAL AND BINDING, AND MAY BE ENTERED AS A JUDGMENT IN ANY COURT HAVING COMPETENT JURISDICTION. EITHER PARTY MAY SEEK REVIEW PURSUANT TO CALIFORNIA CODE OF CIVIL PROCEDURE SECTION 1286, ET SEQ.

(f) IT IS EXPRESSLY UNDERSTOOD THAT THE PARTIES HAVE CHOSEN ARBITRATION TO AVOID THE BURDENS, COSTS AND PUBLICITY OF A COURT PROCEEDING, AND THE ARBITRATOR IS EXPECTED TO HANDLE ALL ASPECTS OF THE MATTER, INCLUDING DISCOVERY AND ANY HEARINGS, IN SUCH A WAY AS TO MINIMIZE THE EXPENSE, TIME, BURDEN AND PUBLICITY OF THE PROCESS, WHILE ASSURING A FAIR AND JUST RESULT. IN PARTICULAR, THE PARTIES EXPECT THAT THE ARBITRATOR WILL LIMIT DISCOVERY BY CONTROLLING THE AMOUNT OF DISCOVERY THAT MAY BE TAKEN (E.G., THE NUMBER OF DEPOSITIONS OR INTERROGATORIES) AND BY RESTRICTING THE SCOPE OF DISCOVERY ONLY TO THOSE MATTERS CLEARLY RELEVANT TO THE DISPUTE. HOWEVER, AT A MINIMUM, EACH PARTY WILL BE ENTITLED TO AT LEAST ONE DEPOSITION AND SHALL HAVE ACCESS TO ESSENTIAL DOCUMENTS AND WITNESSES AS DETERMINED BY THE ARBITRATOR.

(g) THE PREVAILING PARTY SHALL BE ENTITLED TO AN AWARD BY THE ARBITRATOR OF REASONABLE ATTORNEYS' FEES AND OTHER COSTS REASONABLY INCURRED IN CONNECTION WITH THE ARBITRATION.

(h) THE PROVISIONS OF THIS SECTION SHALL SURVIVE THE EXPIRATION OR TERMINATION OF THE AGREEMENT, AND SHALL BE BINDING UPON THE PARTIES.

I HAVE READ SECTION 10.6 AND IRREVOCABLY AGREE TO ARBITRATE ANY DISPUTE IDENTIFIED ABOVE.

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(INDEMNITEE'S INITIALS)

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(COMPANY'S INITIALS)

10.7 Entire Agreement. The provisions of this Agreement contain the entire agreement between the parties. This Agreement may not be released, discharged, abandoned, changed or modified in any manner except by an instrument in writing signed by the parties.

10.8 Counterparts. This Agreement may be executed in counterparts, each of which shall constitute an original and all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereby have executed this Agreement to be effective as of the date first above written.

CALLAWAY GOLF COMPANY

Ronald A. Drapeau
President and Chief Executive Officer

INDEMNITEE

Ronald S. Beard