# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

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

**For the fiscal year ended December 31, 2001**

**Commission file number 1-10962**

# Callaway Golf Company

*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **95-3797580** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**2180 Rutherford Road**

**Carlsbad, CA 92008**
**(760) 931-1771**
*(Address, including zip code, and telephone number, including area code, of principal executive offices)*

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, $.01 par value per share<br>Preferred Share Purchase Rights | New York Stock Exchange |

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

**None**

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

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

As of February 28, 2002, the aggregate market value of the Registrant’s Common Stock held by nonaffiliates of the Registrant was $1,243,166,852 based on the closing sales price of the Registrant’s Common Stock as reported on the New York Stock Exchange. Such amount was calculated by excluding all shares held by directors and executive officers and the Company’s grantor stock trust without conceding that any of the excluded parties are “affiliates” of the Registrant for purposes of the federal securities laws.

As of March 19, 2002, the number of shares of the Registrant’s Common Stock outstanding was 78,150,824, and there were no shares of the Registrant’s Preferred Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Parts I, II and IV incorporate certain information by reference from the Registrant’s Annual Report to Shareholders for the fiscal year ended December 31, 2001.

Parts I and III incorporate certain information by reference from the Registrant’s definitive Proxy Statement for the annual meeting of shareholders to be held on May 6, 2002, as filed with the Commission on March 21, 2002 pursuant to Regulation 14A, which information is incorporated herein by reference.

***Important Notice:*** *Statements made in this report that relate to future plans, events, financial results or performance 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 Part I, Item 1, "Certain Factors Affecting Callaway Golf Company" of this report, 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 should also be aware that while the Company from time to time does communicate with securities analysts, it is against the Company's policy to disclose to them any material non-public information or other confidential commercial information. Furthermore, the Company has a policy against issuing or confirming financial forecasts or projections issued by analysts and any reports issued by such analysts are not the responsibility of the Company. Investors should not assume that the Company agrees with any report issued by any analyst or with any statements, projections, forecasts or opinions contained in any such report.*

***Callaway Golf Company Trademarks:*** *The following marks and phrases, among others, are trademarks of Callaway Golf Company: Big Bertha — Biggest Big Bertha — Big Bertha C4 — C4 design — C design — CB1 — CTU 30 — Callaway — Callaway Golf — Callaway Hickory Stick — Dawn Patrol — Daytripper — Demonstrably Superior and Pleasingly Different — Deuce — Divine Nine — Dual Force — Enjoy the Game — ERC — ERC II — Ely Would — Ginty — Great Big Bertha — HX — Hawk Eye — Heavenwood — Little Bertha — Odyssey — RCH — Rossie — Rule 35 — S2H2 — Steelhead — Steelhead Plus — Stronomic — TriForce — TriHot — Tru Bore — Tubular Lattice Network — Tungsten Injected — VFT — War Bird — White Hot — World's Friendliest — X-12 — X-14 — X-SPANN*

## PART I

### Item 1. *Business*

Callaway Golf Company (the “Company” or “Callaway Golf”) was incorporated in California in 1982 and reincorporated in Delaware on July 1, 1999. The Company has the following direct wholly-owned operating subsidiaries: Callaway Golf Sales Company, Callaway Golf Europe Ltd., Callaway Golf K.K, Callaway Golf Korea Ltd., Callaway Golf Canada Ltd. and Callaway Golf South Pacific PTY Ltd. During 2000, the Company consolidated its golf ball and golf club operations, and in connection with such consolidation, it merged its wholly-owned subsidiary, Callaway Golf Ball Company, into the Company.

The Company, together with its subsidiaries, designs, develops, manufactures and markets high quality, innovative golf clubs (drivers, fairway woods, irons, wedges and putters) and golf balls. The Company also sells golf accessories such as golf bags, golf gloves, golf headwear, travel covers and bags, golf towels and golf umbrellas. The Company generally sells its products to golf retailers, directly and through its wholly-owned subsidiaries, and to third party distributors. The Company’s products are sold in the United States and throughout 107 countries around the world. The Company’s products are designed for the enjoyment of both amateur and professional golfers. Golfers generally purchase the Company’s products on the basis of performance, ease of use and appearance. In addition, the Company licenses its trademarks and service marks in exchange for a royalty fee to third parties for use on products such as golf apparel and other golf related products, such as headwear, travels bags, golf towels and umbrellas.

During 2001, the Company’s founder, Ely Callaway, passed away. Mr. Callaway had served as the Company’s Chairman of the Board of Directors since 1982 until his passing. In addition, Mr. Callaway had also served as the Company’s Chief Executive Officer for approximately 17 of the 19 years prior to his passing. In 2001, Ronald A. Drapeau was appointed Chairman, President and Chief Executive Officer of the Company. Mr. Drapeau had previously held the position of Senior Executive Vice President, Manufacturing.

### Golf Ball Company

In 1996, the Company formed Callaway Golf Ball Company for the purpose of designing, manufacturing and selling golf balls. In February 2000, Callaway Golf Ball Company released its new Rule 35 golf balls. These golf balls were the product of more than three years of research and development. During its first year of operations, the Company’s golf ball operations had net sales of approximately $34.0 million and a loss before income taxes of approximately $45.9 million. This loss was greater than the Company had anticipated. On December 29, 2000, Callaway Golf Ball Company was merged into Callaway Golf Company. During 2001, the Company released its CB1 and CTU 30 golf balls and continued to improve production efficiencies. As a result, in 2001, the Company’s golf ball operations improved significantly with net sales of approximately $54.9 million and a loss before income taxes of approximately $17.9 million. To date, however, the Company’s golf ball business has had a significant negative impact on the Company’s cash flows, financial position and results of operations. Until the Company’s golf ball operations become profitable, the Company’s cash flows, financial position and results of operations will continue to be negatively affected. For additional risks related to the Company’s golf ball operations, see below, “Certain Factors Affecting Callaway Golf Company.”

### Financial Information about Segments and Geographic Areas

Information regarding the Company’s segments and geographic areas in which the Company operates is contained in Note 14 to the Consolidated Financial Statements (“Consolidated Financial Statements”) in the Company’s Annual Report to Shareholders for the year ended December 31, 2001 (“2001 Annual Report to Shareholders”), which note is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

### Restructuring

During the fourth quarter of 1998, the Company recorded a restructuring charge of $54.2 million resulting from a number of cost reduction actions and operational improvements. For additional information regarding the actions taken in connection with, and the effect of, such restructuring, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Restructuring” and Note 12 to the Consolidated Financial Statements in the 2001 Annual Report to Shareholders, both of which are incorporated herein by this reference and are included as part of Exhibit 13.1 to this Form 10-K.

**Products**

The Company designs, manufactures and sells premium golf clubs, putters, golf balls and related accessories. The Company designs its products to be technologically-advanced and in this regard invests a considerable amount in research and development each year. The Company’s credo is to develop products that are “demonstrably superior and pleasingly different.” The Company’s products are designed for golfers of all skill levels, both amateur and professional.

The following table sets forth the contribution to net sales attributable to the principal product groups for the periods indicated (dollars in thousands).

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2001 | | 2000 | | 1999 | |
| Woods | $392,945 | 48% | $403,000 | 48% | $429,011 | 60% |
| Irons | 248,872 | 30% | 299,912 | 36% | 221,303 | 31% |
| Balls | 54,853 | 7% | 33,964 | 4% | — | 0% |
| Putters, accessories and other | 119,493 | 15% | 100,751 | 12% | 68,724 | 9% |
| Net Sales | $816,163 | 100% | $837,627 | 100% | $719,038 | 100% |

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

*Drivers and Fairway Woods.* As shown in the table above, the Company’s drivers and fairway woods have historically been the product group that has produced the greatest amount of sales for the Company. The Company’s principal models of drivers and fairway woods to be sold in 2002 are as follows:

- *Big Bertha ERC II Forged Titanium Drivers.* Big Bertha ERC II Forged Titanium Drivers, including the ERC II Pro Spec Drivers, are made of forged titanium and sold at a premium price. Big Bertha ERC II Drivers were introduced in late 2000 and sold during 2001 as well. As discussed below, Big Bertha ERC II Drivers conform to the Rules of Golf as published by the Royal and Ancient Golf Club of St. Andrews (“R&A”), but do not conform to the Rules of Golf as published by the United States Golf Association (“USGA”). For that reason, in 2002 they will be marketed primarily outside the United States, although they will be available to retailers and consumers in the United States who are not deterred by the USGA’s actions.

- *Big Bertha ERC Fairway Woods.* Big Bertha ERC Fairway Woods are also made of forged titanium. They are new for 2002, and are sold at a premium price. Unlike ERC II Drivers, ERC Fairway Woods conform to the Rules of Golf as published everywhere in the world. The Company intends to offer them for sale in all markets.

- *Big Bertha C4 Drivers.* While most premium drivers in the golf industry have clubheads made of metal (generally either steel or titanium), the Big Bertha C4 Driver has a clubhead made of *Compression-Cured Carbon Composite (“C4”)* material. This is the first golf club the Company has offered using this material. It is believed that this material permits designs and constructions that can improve performance for most golfers. The Company first began delivery of significant quantities of this product in 2002. It, too, is sold at a premium price. Big Bertha C4 Drivers conform with the Rules of Golf everywhere in the world, and are being offered for sale in all markets.

- *Big Bertha Hawk Eye VFT Drivers and Fairway Woods.* Big Bertha Hawk Eye VFT Drivers and Fairway Woods are the Company’s primary cast titanium metal woods for 2002. They were sold in 2001 as well. They are priced less than the Company’s forged titanium and “C4” woods, but higher than the Company's stainless steel woods. Big Bertha Hawk Eye VFT Drivers and Fairway Woods conform with the Rules of Golf everywhere in the world, and are being offered for sale in all markets.

- *Big Bertha Steelhead III Drivers and Fairway Woods.* Big Bertha Steelhead III Drivers and Fairway Woods are the Company's primary stainless steel woods for 2002. The Company first began delivery of significant quantities of this product in 2002. They were designed to replace the Company's Big Bertha Steelhead Plus Stainless Steel Drivers and Fairway Woods which were sold during 2001. While still premium priced for their category, these are the lowest priced woods in the Company's major product line. Big Bertha Steelhead III Drivers and Fairway Woods conform to the Rules of Golf everywhere in the world, and are being offered for sale in all markets.

The Company's drivers and fairway woods are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers.

*Irons.* As shown in the table above, the Company's irons have historically generated a significant percentage of the Company's overall sales. All of the Company's iron models conform with the Rules of Golf as published everywhere in the world. In addition, all of the Company's iron models include associated wedges. The Company's principal models of irons to be sold in 2002 are as follows:

- *Hawk Eye VFT Tungsten Injected Titanium Irons.* Hawk Eye VFT Tungsten Injected Titanium Irons are the Company's primary titanium irons for 2002, and are the Company's highest priced irons. They incorporate an oversized body made of cast titanium with a proprietary "tungsten weight matrix" to improve performance. They were sold in 2001 as well.

- *Big Bertha Irons.* Big Bertha Irons are the Company's newest model of stainless steel irons. The Company first began delivery of significant quantities of these irons in 2002. While they are a premium priced stainless steel iron, they are priced below the Hawk Eye VFT Tungsten Injected Titanium Irons. They incorporate a unique design that maximizes performance for most golfers.

- *Big Bertha Steelhead X-14 Stainless Steel Irons.* Big Bertha Steelhead X-14 Stainless Steel Irons, including the Steelhead X-14 Pro Series line, are the Company's best selling irons ever. Like the Big Bertha Irons, they are made of cast stainless steel and are priced at a premium level for irons made from this material. They were sold in 2001 as well.

The Company's irons are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers.

*Golf Balls.* As shown in the table above, the Company did not begin selling golf balls until 2000 when it released its Rule 35 golf balls. All of the Company's golf ball lines are offered in a "Red" ("more distance") and a "Blue" ("more spin") version. The Company's principal golf ball models to be sold in 2002 are as follows:

- *HX Golf Balls.* HX Golf Balls are three-piece golf balls that incorporate a solid core, a polymer boundary layer, and a very thin, cast, thermoset urethane cover. The surface geometry of the cover incorporates a unique Tubular Lattice Network (i.e. a system of crisscrossing tubes that form a series of hexagons and pentagons) rather than a traditional dimple design. The Company first began delivery of significant quantities of these balls in 2002. HX Golf Balls are the Company's highest priced golf balls.

- *CTU 30 Golf Balls.* CTU 30 Golf Balls are also three-piece golf balls incorporating a solid core, a polymer boundary layer, and a very thin, cast, thermoset urethane cover. Unlike the HX Golf Balls, the CTU 30 Golf Balls incorporate a more traditional dimple pattern. The CTU 30 Golf Balls were designed to replace the Rule 35 Golf Balls, which they did in late 2001. CTU 30 Golf Balls are sold at a premium price that is below that for the HX Golf Balls, but above that for the CB1 Golf Balls.

- *CB1 Golf Balls.* CB1 Golf Balls are two-piece golf balls that incorporate a solid core and a polymer cover. These balls were introduced in 2001.

*Putters, Accessories and Other.* As shown in the table above, the Putters, Accessories and Other product group makes a significant contribution to the Company's overall sales. Most of the sales from this product group are from sales of putters and accessories, including golf bags.

- *Putters.* The Company primarily sells Odyssey branded putters, including the TriHot, White Hot and Dual Force Putters. The putters sold in 2002 will include a few new putters that were not sold in 2001, including the Company's White Hot 2-Ball Putter. The Company's putters are available in a variety of styles and shafts to accommodate the preferences and skill levels of all golfers.

- *Accessories.* The Company also sells golf-related accessories such as golf bags, golf gloves, golf headwear, travel covers and bags, golf towels and golf umbrellas.

All of the Company's golf clubs and golf balls described above are believed to conform to the Rules of Golf as published by the USGA and the R&A, except for the Company's ERC II and ERC II Pro Spec Drivers. These two products do not conform to the Rules of Golf as published by the USGA because they exceed a COR (coefficient of restitution) limitation adopted by the USGA in 1998. They fully conform to the Rules of Golf as published by the R&A. Although it did not conform to the Rules of Golf as published by the USGA, the Company has offered and continues to offer the ERC II Driver for sale in the United States for those who do not play under the USGA's Rules. The Company believes it was the first large, premium brand golf equipment company to sell non-conforming equipment in the United States. By undertaking this approach, the Company hoped to expand participation in the game of golf in the United States by making the game more enjoyable and accessible for more people, including those who play golf primarily for fun, enjoyment and recreation. For further discussion of the risks and benefits of this strategy, see below, "Certain Factors Affecting Callaway Golf Company — Conformance with the Rules of Golf."

**Product Design and Development**

Product design at Callaway Golf is a result of the integrated efforts of its product management, research and development, manufacturing and sales departments, all of which work together to generate new ideas for golf equipment. The Company has not limited itself in its research efforts by trying to duplicate designs that are traditional or conventional and believes it has created an environment in which new ideas are valued and explored. In 2001, 2000 and 1999, the Company expended on research and development $32.7 million, $34.6 million and $34.0 million, respectively. The Company intends to continue to invest substantial amounts in its research and development activities in 2002 and beyond in connection with its development of new golf club and golf ball products.

Callaway Golf has the ability to create and modify golf club designs by using computer aided design ("CAD") software, computer aided manufacturing ("CAM") software and computer numerical control ("CNC") milling equipment. CAD software enables designers to develop computer models of new clubhead and shaft designs. CAM software is then used by engineers to translate the digital output from CAD computer models so that physical prototypes can be produced. Through the use of this technology, Callaway Golf has been able to accelerate the design, development and testing of new golf clubs. In addition, the Company's sophisticated CAD/CAM design, tooling, ball prototyping and indoor testing equipment, together with the Company's predictive computer modeling capability, allows it to develop and test prototype golf balls in a relatively short cycle time.

**Sales and Marketing**

***Sales in the United States***

Approximately 54%, 54% and 58% of the Company's net sales were derived from sales for distribution within the United States in 2001, 2000 and 1999, respectively. The Company targets both on-course and off-course golf retailers who sell professional quality golf products and provide a level of customer service appropriate for the sale of such products. No one customer that distributes golf clubs or balls in the United States accounted for more than 6% of the Company's revenues in 2001, 2000 or 1999.

The Company's golf club, golf ball and accessory sales in the United States are made and supported by full-time regional field representatives, in-house telephone salespersons and customer service representatives. Each geographic region is covered by both a field representative and a telephone salesperson who work together to initiate and maintain relationships with customers through frequent telephone calls and in-person visits. The Company believes that this tandem approach of utilizing field representatives and telephone salespersons provides the Company a competitive advantage.

In addition, the sales representatives call on corporate customers who want their corporate logo placed on the Company's golf balls or putters. The Company imprints the logos on its golf balls and putters in the same facility in which it manufactures them, thereby retaining control over the quality of the process and final product. The Company also pays an agency fee to certain on-and off-course professionals and retailers with whom it has a relationship for corporate sales that originate through such professionals and retailers.

The Company also has a separate team of manufacturing and customer service representatives that focus on the Company's custom club sales.

***Sales Outside of the United States***

Approximately 46%, 46% and 42% of the Company's net sales were derived from sales for distribution outside of the United States in 2001, 2000 and 1999, respectively. The majority of the Company's international sales were made through its foreign subsidiaries and the rest through third party distributors. The Company does business (either directly or through its subsidiaries and distributors) in more than 107 countries around the world. The Company's management believes that controlling the distribution of its products in certain major markets in the world has been and will be an element in the future growth and success of the Company. The Company has been actively pursuing the acquisition of distribution rights in certain key countries in Europe, Asia and elsewhere around the world. The Company continued this strategy in the beginning of 2001 with the acquisition of distribution rights in Australia, New Zealand, Italy, Portugal and Spain.

As a result of these acquisitions, the Company sells its products throughout Europe through its subsidiary Callaway Golf Europe Ltd. The Company sells its products in Japan through its subsidiary Callaway Golf K.K. The Company sells its products in Korea through its subsidiary Callaway Golf Korea Ltd. The Company sells its products in Canada through its subsidiary, Callaway Golf Canada Ltd. The Company sells its products in Australia and New Zealand through its subsidiary Callaway Golf South Pacific PTY Ltd.

In addition to sales through its subsidiaries, the Company also has third party distribution arrangements covering sales of the Company's products in 68 foreign countries, including Singapore and Hong Kong, South Africa and various countries in South America. Prices of golf clubs and balls for sales by distributors outside of the United States generally receive an export pricing discount to compensate international distributors for selling, advertising and distribution costs. A change in the Company's relationship with significant distributors could negatively impact the volume of the Company's international sales.

Conducting business outside of the United States subjects the Company to foreign currency exchange rate risks. See below, "Certain Factors Affecting Callaway Golf Company — Foreign Currency Risks."

**Advertising and Promotion**

Within the United States, the Company has focused its advertising efforts mainly on a combination of television commercials primarily during golf telecasts and printed advertisements in national magazines, such as *Golf Digest, Golf Magazine, Golf World* and *Sports Illustrated's Golf Plus.* Advertising of the Company's products outside of the United States is typically handled by the Company's subsidiaries (in coordination with U.S. direction) as well as distributors and resellers of the products in a particular country.

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

The Company’s advertising, promotional and endorsement related expenses, including compensation to professional golfers, were approximately $91.7 million, $77.7 million and $55.4 million for 2001, 2000 and 1999, respectively.

**Competition**

The golf club markets in which the Company does business are highly competitive, and are served by a number of well-established and well-financed companies with recognized brand names, as well as new companies with popular products. With respect to metal woods and irons, the Company’s major domestic competitors are Taylor Made, Titleist and Ping. In 2002, Nike began selling golf clubs that will compete with the Company’s products. For putters, the Company’s major domestic competitors are Ping and Titleist. In addition, several manufacturers in Japan have announced their plans to expand their club business in the United States. The Company believes that it is the leader, or one of the leaders, in every golf club market in which it competes.

The premium golf ball business is also highly competitive with a number of well-established and well-financed competitors, including Titleist, Spalding, Sumitomo Rubber Industries (Srixon), Bridgestone (Precept), Maxfli and others. In addition, there have been several recent entrants into the golf ball market, including Nike. These competitors have established market share in the golf ball business, with Titleist having an estimated market share in excess of 50% of the premium golf ball business. In addition, several manufacturers in Japan have announced their plans to increase their golf ball business in the United States.

For both golf clubs and golf balls, the Company generally competes on the basis of technology, price, quality, performance and customer service. For risks relating to competition, see below, “Certain Factors Affecting Callaway Golf — Competition.”

**Handling of Materials**

In the ordinary course of its manufacturing process, the Company uses paints and chemical solvents which are stored on-site. The waste created by use of these materials is transported off-site on a regular basis by registered waste haulers. As a standard procedure, a comprehensive audit of the treatment, storage, and disposal facility with which the Company contracts for the disposal of hazardous waste is performed annually by the Company. To date, the Company has not experienced any material environmental compliance problems, although there can be no assurance that such problems will not arise in the future.

**Intellectual Property**

The Company is the owner of over 1,800 U.S. and foreign trademark registrations and over 500 U.S. and foreign patents relating to the Company’s products, product designs, manufacturing processes and research and development concepts. Other patent and trademark applications are pending and await registration. In addition, the Company owns various other protectable rights under copyright, trade dress, and other statutory and common laws. These rights are very important to the Company and the Company seeks to protect its intellectual property rights through the registration of trademarks and utility and design patents, the maintenance of trade secrets and the creation of trade dress. When necessary and appropriate, the Company enforces it rights through litigation against those who are infringing the Company’s rights.

In the United States, the Company’s patents are generally in effect for up to 20 years from the date of the filing of the patent application. The Company’s trademarks are generally valid as long as they are in use and their registrations are properly maintained and have not been found to become generic. See below, “Certain Factors Affecting Callaway Golf Company — Intellectual Property and Proprietary Rights.”

**Licensing**

In support of its golf club, golf ball and accessories business, the Company endeavors to enhance the value of the Callaway Golf Brand and its other trademarks and service marks through the licensing of such marks in exchange for a royalty fee. The Company's licensing activities not only provide valuable royalties but also are a valuable source of advertising and goodwill.

In 2001, the Company and Nordstrom, Inc. mutually terminated their prior licensing arrangement, which included men's and women's golf apparel, men's footwear, and sun and skin care products. Also in 2001, the Company entered into an exclusive licensing arrangement with Ashworth, Inc. for the creation of a complete line of men's and women's apparel for distribution in 2002 in the United States, Canada, Europe, Australia, New Zealand and South Africa. In addition, the Company entered into a long-term licensing agreement with Sanei International Co., Ltd. to create and sell Callaway Golf apparel in Japan beginning in 2003.

**Employees**

As of December 31, 2001, the Company and its subsidiaries had approximately 2,500 full-time employees, including approximately 700 employed in sales and marketing, approximately 200 employed in research and development and product engineering and approximately 1,300 employed in production. The remaining full-time employees are administrative and support staff.

The Company considers its employee relations to be good. None of the Company's employees are represented by unions. The Company's commitment to the development of new products and the seasonal nature of its business may result in fluctuations in production levels. The Company attempts to manage these fluctuations to maintain employee morale and avoid disruption. However, it is possible that such fluctuations could strain employee relations in the future.

**Certain Factors Affecting Callaway Golf Company**

The financial statements contained in Exhibit 13.1 of 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, however, 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 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 attacks on the World Trade Center and the Pentagon, the incidents of Anthrax poisoning and the military actions in Afghanistan) would likely have a significant adverse effect upon the Company's business. Such events would likely have an adverse effect upon an already fragile world economy (discussed below) and would likely adversely affect the level of demand for the Company's products as consumers' 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 deliver customer orders also could be materially adversely affected. Furthermore, such events have negatively impacted tourism. If this negative impact upon tourism continues, the Company's sales to retailers at resorts and other vacation destinations would 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 many of the Company’s key markets around the world 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 may not experience a corresponding improvement because the golf selling season would largely be over.

*Foreign Currency Risks.* Almost half of the Company’s sales are international sales. As a result, the Company conducts transactions in approximately 12 currencies worldwide. Conducting business in such various currencies increases the Company’s exposure to devaluations of foreign currencies relative to the U.S. dollar which adversely impacts the Company’s results of operations. The Company’s results 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 2002 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 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 2001. These hedging activities mitigated, but did not eliminate, the negative effects of foreign currency fluctuations on the hedged transactions that occurred during such period. Despite the Company’s successful hedge transactions, decreases in foreign currency exchange rates adversely impacted net sales for the year ended December 31, 2001 by approximately $32.9 million (as measured by applying 2000 exchange rates to 2001 net sales). If the Company does not successfully hedge future transactions, the adverse effects of foreign currency devaluations would increase. (See below Item 7A, Quantitative and Qualitative Disclosures about Market Risk).

*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, 2000 or 2001. In fact, Golf Datatech reports that the number of rounds played declined 9 out of 12 months in 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 or it can grow its already significant market share.

*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.

*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 need to produce and sell golf balls in large volumes to cover its costs and become profitable in 2002. Although the Company’s golf ball operations have shown significant improvement during 2001, 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 access to alternative power supplies for certain of its operations, and believes that these measures could 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 uninterrupted 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 expected 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 market price for electricity in California dropped significantly. As a result, the Company was unable to resell the excess supply of electricity at favorable rates and thus the net cost of the electricity used in the Company's business was higher than expected. In November 2001, the Company terminated its long-term supply contract and is currently purchasing wholesale energy through the Company's energy service provider under short-term contracts. If energy rates were once again to increase significantly, the Company's energy costs would increase significantly and adversely affect the Company's results of operations.

*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 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, in 2002 Nike began marketing and selling golf clubs that will compete with the Company's products, and several manufacturers in Japan have announced plans to expand their businesses in the United States. 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 other competitors, including Nike and Taylor Made, that have introduced or will introduce golf ball designs that directly compete with the Company's products, and several manufacturers in Japan have announced their plans to expand their businesses in the United States. 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 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 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. This aerodynamic technology is reflected in 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 addition, the Company's 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 C4 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

C4 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.

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 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 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 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 Spec) Forged Titanium Driver are believed to be "conforming" under the Rules of Golf as published by the USGA and RCGA (the Company's ERC Fairway Woods are conforming). 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 ERC II Drivers are non-conforming under the Rules of Golf as published by the R&A, then the Company believes its sales of 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 was ruled to be non-conforming by the USGA. To the Company's knowledge, it was the first large, premium brand golf equipment company to sell non-conforming equipment in the U.S. By undertaking this approach, the Company hoped 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 believed 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 proved to be risky. The USGA 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 was reinforced by further announcements by the USGA. A significant number of U.S. retailers declined to carry the ERC II Driver. It also appears at this time that a significant number of U.S. golfers have decided 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 hurt sales of ERC II Drivers in the U.S., and may have injured sales of other, conforming products, or otherwise damaged the brand. These negative effects will materially limit U.S. sales of ERC II Drivers in 2002 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 there is a change in attitude and a large number of American golfers who do not play in tournaments subject to the USGA's Rules 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 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 and is allocating 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 resulted in a decrease in usage of the Company's clubs by professional golfers in 2001 and could result in a further decrease in 2002. The Company continues to evaluate from time to time whether to implement programs that reward usage of the Company's products. 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 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. 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.* 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.

*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, would 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.

**Item 2. *Properties.***

The Company and its subsidiaries conduct operations in both owned and leased properties, located primarily near the Company's headquarters in Carlsbad, California. The eight buildings utilized in the Company's Carlsbad operations include corporate offices, manufacturing, research and development, warehousing and distribution facilities, and comprise approximately 735,000 square feet of space. Seven of these properties, representing approximately 585,000 square feet of space, are owned by the Company; an additional property, representing approximately 150,000 square feet of space, is leased. In addition, the Company and its subsidiaries conduct certain international operations outside of the United States, located in the United Kingdom, Canada, Japan, Australia and Korea, in leased facilities comprising approximately 165,000 square feet. The Company believes that its facilities currently are adequate to meet its requirements.

**Item 3.** ***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 that one or more claims of potential infringement could lead to litigation, the need to obtain licenses, the need to alter a product to avoid infringement, or some other action or loss by the Company.

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 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 the 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. Among other remedies, 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 December 31, 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 4.** ***Submission of Matters to a Vote of Securities Holders.***

None.

**Executive Officers of the Registrant**

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

| Name | Age | Position(s) Held |
| --- | --- | --- |
| Ronald A. Drapeau | 55 | Chairman, President and Chief Executive Officer |
| Richard C. Helmstetter | 60 | Senior Executive Vice President, Chief of New Products |
| Steven C. McCracken | 51 | Senior Executive Vice President, Chief Legal Officer and Secretary |
| Bradley J. Holiday | 48 | Executive Vice President and Chief Financial Officer |
| Michael W. McCormick | 39 | Executive Vice President, Global Sales |
| Robert A. Penicka | 39 | Executive Vice President, Manufacturing |
| Ian B. Rowden | 42 | Executive Vice President and Chief Marketing Officer |

*Ronald A. Drapeau*, is Chairman, President and Chief Executive Officer of the Company. Prior to becoming President and Chief Executive Officer in May 2001, Mr. Drapeau served as Senior Executive Vice President, Manufacturing of the Company since February 1999. He was President and Chief Executive Officer of Odyssey Golf, Inc., a wholly-owned subsidiary of the Company, from August 1997 until its dissolution in December 1999. Mr. Drapeau served as Executive Vice President of the Company from August 1997 to February 1999, and served as a consultant to the Company from November 1996 to August 1997. From April 1993 to September 1996, Mr. Drapeau served as Chief Executive Officer of Lynx Golf, Inc., a subsidiary of Zurn Industries, Inc., and served as Senior Vice President and Chief Financial Officer of Zurn Industries, Inc. from 1992 to 1993. He is a 1969 graduate of Bentley College.

*Richard C. Helmstetter*, is Senior Executive Vice President, Chief of New Products of the Company and has served his current term in such capacity since August 2000. He served as Senior Executive Vice President, Chief of New Golf Club Products since January 1998 and previously served as Senior Executive Vice President, Chief of New Products from April 1993 to January 1998. Mr. Helmstetter served as President from 1990 to 1993 and as Executive Vice President from 1986 to 1990. From 1967 to 1986, Mr. Helmstetter served as President of Adam Ltd., a pool cue manufacturing and merchandising company which he founded and operated in Japan. During 1982 and 1983, Mr. Helmstetter also consulted extensively for several Japanese, European and American companies, including Bridgestone Corporation's strategic planning group. Mr. Helmstetter is a 1966 graduate of the University of Wisconsin.

*Steven C. McCracken*, is Senior Executive Vice President, Chief Legal Officer and Secretary of the Company and has served in such capacity since August 2000. He served as Executive Vice President, Licensing and Chief Legal Officer from April 1997 to August 2000. He has served as an Executive Vice President since April 1996 and served as General Counsel from April 1994 to April 1997. He served as Vice President from April 1994 to April 1996. He has served as Secretary since April 1994. Prior to joining the Company, Mr. McCracken was a partner at Gibson, Dunn & Crutcher for 11 years, and had been in the private practice of law for over 18 years. During part of that period, he provided legal services to the Company.

Mr. McCracken received a B.A., magna cum laude, from the University of California at Irvine in 1972 and a J.D. from the University of Virginia in 1975.

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

*Michael W. McCormick*, is Executive Vice President, Global Sales of the Company and has served in such capacity since January 10, 2000. Previously, he had been with Nike, Inc. since 1992, serving as Eastern Regional Sales Manager; Director of Golf Sales, Southern Regional Sales Manager; and Director of National Sales. From 1989 to 1992 he was Vice President Operations and Merchandising for Las Vegas Golf and Tennis, a nationally recognized franchisor of golf club and golf ball retailers. Mr. McCormick owned and operated a golf equipment retail store in Tucson, Arizona, from 1985 to 1988.

*Robert A. Penicka*, is Executive Vice President, Manufacturing of the Company and has served in such capacity since June 2001. Prior to becoming Executive Vice President, Manufacturing, Mr. Penicka served as Senior Vice President, Golf Ball Manufacturing from December 2000 until June 2001. He previously held the positions of Senior Vice President of Golf Ball Manufacturing, Senior Vice President of Golf Club Manufacturing and Vice President of Manufacturing Technology. Mr. Penicka joined Callaway Golf in 1997 when the Company acquired Odyssey Golf. At Odyssey Golf, Mr. Penicka served as Vice President of Manufacturing, based in Chicago. Prior to entering the golf business, he spent eight years with General Electric Company and six years at Harman International Industries in Indianapolis as Vice President of Manufacturing for its automotive OEM business. Mr. Penicka graduated from Ohio State University in 1984.

*Ian B. Rowden*, is Executive Vice President and Chief Marketing Officer of the Company and has served in such capacity since September 2001. Prior to becoming Chief Marketing Officer, Mr. Rowden served as Executive Vice President, Global Advertising since October 2000. Prior to joining Callaway Golf, Mr. Rowden served as Vice President and Director of Worldwide Advertising for The Coca-Cola Company in Atlanta. Prior to moving to Atlanta with Coca-Cola in 1996, Mr. Rowden served as Vice President of Marketing for Coca-Cola's China Division in Hong Kong from 1993 to 1995. He began his career with the Coca-Cola Company in Australia in the early 1980s, holding various sales and marketing positions. Mr. Rowden left Coca-Cola in 1988 to serve as General manager, Marketing of the Power Brewing Company in Brisbane and later became a director and managing partner of DDB Needham, Sydney. He returned to Coca-Cola in 1992 as Vice President of Marketing for the Company's South Pacific Region based in Sydney Australia.

Information with respect to the Company's employment agreements with Messrs. Drapeau, Helmstetter, McCracken, McCormick and Rowden is contained in the Company's definitive Proxy Statement under the caption "Compensation of Executive Officers — Employment Agreements and Termination of Employment Arrangements," as filed with the Securities and Exchange Commission on March 21, 2002 pursuant to Regulation 14A, which information is incorporated herein by this reference. In addition, the Company currently has employment agreements with Messrs. Holiday and Penicka for terms expiring on December 31, 2002.

## PART II

### Item 5. *Market for Registrant's Common Equity and Related Stockholder Matters.*

Information in response to Item 5 is contained on page 59 of the Company's 2001 Annual Report to Shareholders, which information is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

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

Information in response to Item 6 is contained on page 28 of the Company's 2001 Annual Report to Shareholders, which information is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

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

Information in response to Item 7 is contained on pages 29 through 37 of the Company's 2001 Annual Report to Shareholders, which information is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

**Item 7A.** ***Quantitative and Qualitative Disclosures About Market Risk.***

Information in response to Item 7A is contained on pages 37 through 38 of the Company's 2001 Annual Report to Shareholders, which information is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

**Item 8.** ***Financial Statements and Supplementary Data.***

Information in response to Item 8 is contained on pages 39 though 57 of the Company's 2001 Annual Report to Shareholders, which information is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

**Item 9.** ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

Information in response to Item 9 is contained on page 58 of the Company's 2001 Annual Report to Shareholders, which information is incorporated herein by this reference and is included as part of Exhibit 13.1 to this Form 10-K.

## PART III

**Item 10.** ***Directors and Executive Officers of the Registrant.***

Certain information concerning the Company's executive officers is included under the caption "Executive Officers of the Registrant" following Part I, Item 4 of this Form 10-K.

**Section 16(a) Beneficial Ownership Reporting Compliance**

The information required by Item 10 has been included in the Company's definitive Proxy Statement under the captions "Board of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" as filed with the Commission on March 21, 2002 pursuant to Regulation 14A, which information is incorporated herein by this reference.

**Item 11.** ***Executive Compensation.***

The Company maintains employee benefit plans and programs in which its executive officers are participants. Copies of certain of these plans and programs are set forth or incorporated by reference as Exhibits to this Report. Information required by Item 11 has been included in the Company's definitive Proxy Statement under the captions "Compensation of Executive Officers," "Report of the Compensation and Management Succession Committee and the Stock Option Committee (Employee Plans) of the Board of Directors," "Performance Graph" and "Board of Directors," as filed with the Commission on March 21, 2002 pursuant to Regulation 14A, which information is incorporated herein by this reference.

**Item 12.** ***Security Ownership of Certain Beneficial Owners and Management.***

The information required by Item 12 has been included in the Company's definitive Proxy Statement under the caption "Beneficial Ownership of the Company's Securities," as filed with the Commission on March 21, 2002 pursuant to Regulation 14A, which information is incorporated herein by this reference.

**Item 13.** ***Certain Relationships and Related Transactions.***

The information required by Item 13 has been included in the Company's definitive Proxy Statement under the captions "Compensation of Executive Officers — Compensation Committee Interlocks and Insider Participation" as filed with the Commission on March 21, 2002 pursuant to Regulation 14A, which information is incorporated herein by this reference.

**PART IV**

**Item 14.** ***Exhibits, Financial Statement Schedules, and Reports on Form 8-K.***

(a) *Documents filed as part of this report:*

1. *Financial Statements.* The following consolidated financial statements of Callaway Golf Company and its subsidiaries required to be filed pursuant to Part II, Item 8 of this Form 10-K, are incorporated by reference to pages 39 through 57 of the 2001 Annual Report to Shareholders:

Consolidated Balance Sheets at December 31, 2001 and 2000

Consolidated Statements of Operations for the three years ended December 31, 2001

Consolidated Statements of Cash Flows for the three years ended December 31, 2001

Consolidated Statements of Shareholders' Equity for the three years ended December 31, 2001

Notes to Consolidated Financial Statements

Reports of Independent Public Accountants

2. *Financial Statement Schedule.*

Reports of Independent Public Accountants on Financial Statement Schedule

Schedule II — Consolidated Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or notes thereto

3. *Exhibits.*

A copy of any of the following exhibits will be furnished to any beneficial owner of the Company's Common Stock, or any person from whom the Company solicits a proxy, upon written request and payment of the Company's reasonable expenses in furnishing any such exhibit. All such requests should be directed to the Company's Director of Investor Relations at Callaway Golf Company, 2180 Rutherford Road, Carlsbad, CA 92008.

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| 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 ("Commission") on July 1, 1999 (file no. 1-10962). |
| 3.2 | First Amended and Restated Bylaws, effective August 17, 2001, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, as filed with the Commission on November 14, 2001 (file no. 1-10962). |
| 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). |

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| 4.2 | Rights Agreement by and between the Company and Chemical Mellon Shareholder Services as Rights Agent dated as of June 21, 1995, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1995, as filed with the Commission on August 12, 1995 (file no. 1-10962). |
| 4.3 | First Amendment to Rights Agreement, effective June 22, 2001, by and between Callaway Golf Company and Mellon Investor Services, LLC.† |
| 4.4 | Certificate of Determination of Rights, Preferences, Privileges and Restrictions of Series A Junior Participating Preferred Stock, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, as filed with the Commission on August 12, 1995 (file no. 1-10962). |
| | ***Executive Compensation Contracts/Plans*** |
| 10.1 | Executive Officer Employment Agreement, entered into as of September 1, 2000, between the Company and Ronald A. Drapeau, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, as filed with the Commission on November 14, 2000 (file no. 1-10962). |
| 10.2 | First Amendment to Executive Officer Employment Agreement, effective May 15, 2001, by and between the Company and Ronald A. Drapeau, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, as filed with the Commission on November 14, 2001 (file no. 1-10962). |
| 10.3 | Executive Officer Employment Agreement, entered into as of January 1, 2000, by and between the Company and Ely Callaway, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, as filed with the Commission on August 14, 2000 (file no. 1-10962). |
| 10.4 | First Amendment to Executive Officer Employment Agreement, effective as of November 13, 2000, by and between the Company and Ely Callaway, incorporated herein by reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962). |
| 10.5 | Executive Officer Employment Agreement by and between the Company and Richard Helmstetter entered into as of January 1, 1998, incorporated herein by this reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 1997, as filed with the Commission on March 31, 1998 (file no. 1-10962). |
| 10.6 | Executive Officer Employment Agreement, entered into as of September 1, 2000, between the Company and Steven C. McCracken, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, as filed with the Commission on November 14, 2000 (file no. 1-10962). |
| 10.7 | Executive Officer Employment Agreement, entered into as of July 13, 2000, between the Company and Bradley J. Holiday, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, as filed with the Commission on November 14, 2000 (file no. 1-10962). |
| 10.8 | Executive Officer Employment Agreement, entered into as of September 1, 2000, between the Company and Michael W. McCormick, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, as filed with the Commission on November 14, 2000 (file no. 1-10962). |
| 10.9 | Executive Officer Employment Agreement, entered into as of June 1, 2001, by and between the Company and Robert A. Penicka, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, as filed with the Commission on August 14, 2001 (file no. 1-10962). |
| 10.10 | Executive Officer Employment Agreement, entered into as of September 1, 2000, between Callaway Golf Europe Ltd., a United Kingdom corporation and wholly-owned subsidiary of the Company, and Ian B. Rowden, incorporated herein by reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962). |

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| 10.11 | Assignment of and First Amendment to Executive Officer Employment Agreement entered into as of October 16, 2000 between the Company and Ian B. Rowden, incorporated herein by reference to the corresponding exhibit to the Company’s Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962). |
| 10.12 | Executive Officer Employment Agreement, entered into as of January 1, 2000, between the Company and Charles J. Yash, incorporated herein by this reference to the corresponding exhibit in the Company’s Annual Report on Form 10-K for the year ended December 31, 1999, as filed with the Commission on December 31, 1999 (file no. 1-10962). |
| 10.13 | First Amendment to Executive Officer Employment Agreement, effective November 13, 2000, by and between the Company and Charles J. Yash, incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, as filed with the Commission on May 15, 2001 (file no. 1-10962). |
| 10.14 | Stock Option Agreement by and between the Company and Charles J. Yash dated as of May 10, 1996, incorporated herein by this reference to the corresponding exhibit in the Company’s Registration Statement on Form S-8, as filed with the Commission on July 11, 1996 (file no. 333-5721). |
| 10.15 | Resignation and Consulting Agreement with Mutual Releases, entered into as of May 31, 2001, by and between the Company and Charles J. Yash, incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, as filed with the Commission on August 14, 2001 (file no. 1-10962). |
| 10.16 | Release by Charles J. Yash, effective May 31, 2001, incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, as filed with the Commission on August 14, 2001 (file no. 1-10962). |
| 10.17 | Employment Agreement, entered into as of January 1, 2000, between the Company and Bruce Parker, incorporated herein by this reference to the corresponding exhibit in the Company’s Annual Report on Form 10-K for the year ended December 31, 1999, as filed with the Commission on December 31, 1999 (file no. 1-10962). |
| 10.18 | Form of Tax Indemnification Agreement, incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 1995, as filed with the Commission on August 12, 1995 (file no. 1-10962). |
| 10.19 | Amendment No. 1 to Form of Tax Indemnification Agreement, incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the period ended September 30, 1996, as filed with the Commission on November 13, 1996 (file no. 1-10962). |
| 10.20 | Callaway Golf Company Executive Deferred Compensation Plan (as amended and restated, effective August 22, 2000), incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, as filed with the Commission on November 14, 2000 (file no. 1-10962). |
| 10.21 | Callaway Golf Company 1998 Executive Non-Discretionary Bonus Plan, incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 1997, as filed with the Commission on May 15, 1997 (file no. 1-10962). |
| 10.22 | 1991 Stock Incentive Plan (as amended and restated August 2000).† |
| 10.23 | Amended and Restated 1996 Stock Option Plan (as amended and restated May 3, 2000), incorporated herein by this reference to the corresponding exhibit to the Company’s Quarterly Report on Form 10-Q for the period ended June 30, 2000, as filed with the Commission on August 14, 2000 (file no. 1-10962). |
| 10.24 | Callaway Golf Company 1998 Stock Incentive Plan (as amended and restated August 2000).† |
| 10.25 | Callaway Golf Company Non-Employee Directors Stock Option Plan (as amended and restated August 2000).† |
| 10.26 | Callaway Golf Company 2001 Non-Employee Directors Stock Option, incorporated herein by this reference to Appendix A to the Company’s definitive Proxy Statement on Schedule 14A filed with the Commission on March 27, 2000 (file no. 1-10962). |

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| 10.27 | Indemnification Agreement by and between Callaway Golf Company and William C. Baker dated as of July 1, 1999, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962). |
| 10.28 | Indemnification Agreement, effective June 7, 2001, by and between the Company and Ronald S. Beard, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, as filed with the Commission on November 14, 2001 (file no. 1-10962). |
| 10.29 | Indemnification Agreement by and between Callaway Golf Company and Vernon E. Jordan, Jr. dated as of July 1, 1999, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962). |
| 10.30 | Indemnification Agreement by and between Callaway Golf Company and Yotaro Kobayashi dated as of July 1, 1999, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962). |
| 10.31 | Indemnification Agreement by and between Callaway Golf Company and Aulana L. Peters dated as of July 1, 1999, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962). |
| 10.32 | Indemnification Agreement by and between Callaway Golf Company and Richard L. Rosenfield dated as of July 1, 1999, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962). |
| 10.33 | Indemnification Agreement by and between Callaway Golf Company and William A. Schreyer dated as of July 1, 1999, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962). |
| | ***Other Contracts*** |
| 10.34 | Master Energy Purchase and Sale Agreement and related Confirmation letter, each entered into as of April 12, 2001, by and between Enron Energy Services, Inc. and the Company, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, as filed with the Commission on August 14, 2001 (file no. 1-10962). |
| 10.35 | Amended and Restated Credit Agreement dated as of February 10, 1999, among Callaway Golf Company, as Borrower, the other credit parties signatory thereto, as Credit Parties, the Lenders signatory thereto from time to time and General Electric Capital Corporation, as Agent and Lender, incorporated herein by this reference to the corresponding exhibit to the Company's Current Report on Form 8-K dated February 25, 1999, as filed with the Commission on February 25, 1999 (file no. 1-10962). |
| 10.36 | First Amendment to Amended and Restated Credit Agreement, dated as of April 28, 2000, by and among Callaway Golf Company, the other credit parties signatory to the Amended and Restated Credit Agreement, the lenders signatory to this Amendment, and General Electric Corporation, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000, as filed with the Commission on May 15, 2000 (file no. 1-10962). |
| 10.37 | Second Amendment and Limited Waiver to Amended and Restated Credit Agreement, dated December 29, 2000, by Callaway Golf Company, the other credit parties to the Amended and Restated Credit Agreement, the lenders signatory to this Amendment and General Electric Company, incorporated herein by reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962). |

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| 10.38 | Third Amendment and Limited Waiver to Amended and Restated Credit Agreement, dated as of March 19, 2001, by Callaway Golf Company, the other credit parties to the Amended and Restated Credit Agreement, the lenders signatory to this Amendment and General Electric Company, incorporated herein by reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, as filed with the Commission on May 15, 2001 (file no. 1-10962). |
| 10.39 | Receivables Transfer Agreement dated as of February 10, 1999, by and among Callaway Golf Sales Company and Odyssey Golf, Inc, incorporated herein by this reference to the corresponding exhibit to the Company's Current Report on Form 8-K dated February 25, 1999, as filed with the Commission on February 25, 1999 (file no. 1-10962). |
| 10.40 | Receivables Transfer Agreement dated as of February 10, 1999, by and among Callaway Golf Company, as Parent Guarantor, Callaway Golf Sales Company, as the CGS Originator and as Servicer, and Golf Funding Corporation, incorporated herein by this reference to the corresponding exhibit to the Company's Current Report on Form 8-K dated February 25, 1999, as filed with the Commission on February 25, 1999 (file no. 1-10962). |
| 10.41 | Receivables Purchase and Servicing Agreement dated as of February 10, 1999, by and among Golf Funding Corporation, as Seller, Redwood Receivables Corporation, as Purchaser, Callaway Golf Sales Company, as Servicer, and General Electric Capital Corporation, as Operating Agent and Collateral Agent, incorporated herein by this reference to the corresponding exhibit to the Company's Current Report on Form 8-K dated February 25, 1999, as filed with the Commission on February 25, 1999 (file no. 1-10962). |
| 10.42 | First Amendment to Receivables Transfer Agreement, dated as of April 28, 2000, among Callaway Golf Sales Company, Callaway Golf Company and Golf Funding Corporation, Redwood Receivables Corporation and General Electric Corporation, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000, as filed with the Commission on May 15, 2000 (file no. 1-10962). |
| 10.43 | Second Amendment and Limited Waiver to Receivables Transfer Agreement and First Amendment to Annex X, dated December 29, 2000, by and among Callaway Golf Sales Company, Callaway Golf Company, Callaway Golf Funding Corporation, Redwood Receivables Corporation, and General Electric Corporation, incorporated herein by reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962). |
| 10.44 | Limited Waiver to Receivables Transfer Agreement, dated as of March 19, 2001, by and among Callaway Golf Funding, the Company, Callaway Golf Sales Company, Redwood Receivables Corporation and General Electric Corporation, incorporated herein by this reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, as filed with the Commission on May 15, 2001 (file no. 1-10962). |
| 10.45 | Trust Agreement between Callaway Golf Company and Sanwa Bank California, as Trustee, for the benefit of participating employees, dated July 14, 1995, incorporated herein by this reference to the corresponding exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995, as filed with the Commission on November 14, 1995 (file no. 1-10962). |
| 10.46 | Amendment No. 1 to Trust Agreement, effective as of June 29, 2001, by Callaway Golf Company with the consent of Arrowhead Trust Incorporated.† |
| 10.47 | Assignment and Assumption Agreement, effective as of April 24, 2000, by and among Callaway Golf Company, Sanwa Bank California and Arrowhead Trust Incorporated, incorporated herein by reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962). |
| 10.48 | Loan Forgiveness Agreement effective as of March 8, 1999, by and among Callaway Golf Company and Callaway Golf Media Ventures, LLC., incorporated herein by this reference to the corresponding exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 1998, as filed with the Commission on March 31, 1999 (file no. 1-10962). |

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| 10.49 | Membership Interest Purchase Agreement effective as of March 8, 1999, by and among Callaway Golf Company and Callaway Editions, Inc., incorporated herein by this reference to the corresponding exhibit to the Company’s Annual Report on Form 10-K for the year ended December 31, 1998, as filed with the Commission on March 31, 1999 (file no. 1-10962). |
| 10.50 | Loan Termination Agreement effective as of March 10, 1999, by and among Callaway Golf Company and Callaway Golf Media Ventures, LLC., incorporated herein by this reference to the corresponding exhibit to the Company’s Annual Report on Form 10-K for the year ended December 31, 1998, as filed with the Commission on March 31, 1999 (file no. 1-10962). |
| 10.51 | Trademark License Agreement effective as of March 9, 1999, by and between Callaway Golf Company and Callaway Golf Media Ventures, LLC., incorporated herein by this reference to the corresponding exhibit to the Company’s Annual Report on Form 10-K for the year ended December 31, 1998, as filed with the Commission on March 31, 1999 (file no. 1-10962). |
| 13.1 | Portions of the Company’s 2001 Annual Report to Shareholders (with the exception of the information incorporated by reference specifically in this Report on Form 10-K, the 2001 Annual Report to Shareholders is not deemed to be filed as a part of this Report on Form 10-K).† |
| 16.1 | Letter dated June 19, 2001 from PricewaterhouseCoopers LLP to the Commission, incorporated herein by this reference to the corresponding exhibit to the Company’s Current Report on Form 8-K dated June 15, 2002, as filed with the Commission on June 20, 2001 (file no. 1-10962). |
| 21.1 | List of Subsidiaries.† |
| 23.1 | Consent of Arthur Andersen LLP.† |
| 23.2 | Consent of PricewaterhouseCoopers LLP.† |
| 24.1 | Form of Power of Attorney.† |
| 99.1 | Letter dated March 21, 2002 from the Company to the Commission.† |

† Included in this Report

(b) *Reports on Form 8-K:*

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CALLAWAY GOLF COMPANY

By: /s/ RONALD A. DRAPEAU

Ronald A. Drapeau
*Chairman, President and Chief Executive Officer*

Date: March 20, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities, and as of the dates, indicated.

| Signature | Title | Dated as of |
|---|---|---|
| **Principal Executive Officer:** | | |
| /s/ RONALD A. DRAPEAU<br>Ronald A. Drapeau | Chairman of the Board, President and Chief Executive Officer | March 20, 2002 |
| **Principal Financial Officer:** | | |
| /s/ BRADLEY J. HOLIDAY<br>Bradley J. Holiday | Executive Vice President and Chief Financial Officer | March 20, 2002 |
| **Principal Accounting Officer:** | | |
| /s/ DENNIS R. SECOR<br>Dennis R. Secor | Vice President and Controller | March 20, 2002 |
| **Directors:** | | |
| *<br>William C. Baker | Director | March 20, 2002 |
| *<br>Ronald S. Beard | Director | March 20, 2002 |
| *<br>Vernon E. Jordan, Jr. | Director | March 20, 2002 |
| *<br>Yotaro Kobayashi | Director | March 20, 2002 |
| *<br>Richard L. Rosenfield | Director | March 20, 2002 |
| *By: /s/ BRADLEY J. HOLIDAY<br>Bradley J. Holiday,<br>Attorney-in-fact | | |

**REPORTS OF INDEPENDENT PUBLIC ACCOUNTANTS ON**

**FINANCIAL STATEMENT SCHEDULE**

To the Board of Directors

of Callaway Golf Company:

We have audited in accordance with auditing standards generally accepted in the United States, the consolidated financial statements as of and for the year ended December 31, 2001 included in Exhibit 13.1 of this Form 10-K, and have issued our report thereon dated January 15, 2002 (except with respect to the matter discussed in Note 17, as to which the date is February 11, 2002). Our audit was made for the purpose of forming an opinion on those statements taken as a whole. The schedule listed in Item 14(a)(2) of this Form 10-K is the responsibility of the Company’s management and is presented for purposes of complying with the Securities and Exchange Commission’s rules and is not a part of the basic financial statements. The information in the schedule as of and for the year ended December 31, 2001 has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic consolidated financial statements taken as a whole.

/s/ Arthur Andersen LLP

San Diego, California
January 15, 2002

To the Board of Directors

of Callaway Golf Company:

Our audits of the consolidated financial statements referred to in our report dated March 19, 2001 appearing in the 2001 Annual Report to Shareholders of Callaway Golf Company (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in Item 14(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PricewaterhouseCoopers LLP

San Diego, California
March 19, 2001

**CALLAWAY GOLF COMPANY**

**CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS**

**For the Three Year Period Ended December 31, 2001**

| Date | Allowance for Doubtful Accounts | Reserve for Obsolete Inventory | Reserve for Warranty Expense | Valuation Allowance for Deferred Tax Asset |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Balance, December 31, 1998 | $ 9,939 | $ 36,848 | $ 35,815 | $ 1,759 |
| Provision | 655 | 2,649 | 18,023 | 2,919 |
| Write-off, net | (5,303) | (24,503) | (17,733) | (488) |
| Balance, December 31, 1999 | 5,291 | 14,994 | 36,105 | 4,190 |
| Provision | 4,615 | 3,372 | 17,675 | 135 |
| Write-off, net | (3,679) | (10,646) | (14,417) | (2,971) |
| Balance, December 31, 2000 | 6,227 | 7,720 | 39,363 | 1,354 |
| Provision | (412) | 4,392 | 9,527 | 1,459 |
| Write-off, net | (658) | (4,976) | (14,026) | (49) |
| Balance, December 31, 2001 | $ 5,157 | $ 7,136 | $ 34,864 | $ 2,764 |

## EXHIBIT INDEX

| Exhibit Number | Description of Exhibit |
|---|---|
| 4.3 | First Amendment to Rights Agreement, effective June 22, 2001, by and between Callaway Golf Company and Mellon Investor Services, LLC. |
| 10.22 | 1991 Stock Incentive Plan (as amended and restated August 2000). |
| 10.24 | Callaway Golf Company 1998 Stock Incentive Plan (as amended and restated August 2000). |
| 10.25 | Callaway Golf Company Non-Employee Directors Stock Option Plan (as amended and restated August 2000). |
| 10.46 | Amendment No. 1 to Trust Agreement, effective as of June 29, 2001, by Callaway Golf Company with the consent of Arrowhead Trust Incorporated. |
| 13.1 | Portions of the Company's 2001 Annual Report to Shareholders (with the exception of the information incorporated by reference specifically in this Report on Form 10-K, the 2001 Annual Report to Shareholders is not deemed to be filed as a part of this Report on Form 10-K). |
| 21.1 | List of Subsidiaries. |
| 23.1 | Consent of Arthur Andersen LLP. |
| 23.2 | Consent of PricewaterhouseCoopers LLP. |
| 24.1 | Form of Power of Attorney. |
| 99.1 | Letter dated March 21, 2002 from the Company to the Commission. |

EXHIBIT 4.3

# FIRST AMENDMENT TO RIGHTS AGREEMENT

This First Amendment to Rights Agreement (this "Amendment") is made effective as of June 22, 2001 ("Effective Date"), by and between Callaway Golf Company, a Delaware corporation (the "Company") and Mellon Investor Services LLC, a New Jersey limited liability company (formerly ChaseMellon Shareholder Services, L.L.C.), as Rights Agent ("the Rights Agent").

## BACKGROUND

A. The Company and Rights Agent are parties to that certain Rights Agreement, dated June 21, 1995 (the "Agreement");

B. On or about July 1, 1999, the Company reincorporated in, and is now organized and existing under the laws of, the State of Delaware; and

C. The Company and Rights Agent desire to amend the Agreement to provide that the applicable governing law for the Agreement shall be Delaware law and applicable federal law.

## AMENDMENT

NOW, THEREFORE, from and after the Effective Date, the Agreement is hereby amended as follows:

1. Section 32 of the Agreement is hereby deleted in its entirety and replaced with the following:

> "32. Governing Law.
>
> This Agreement, and each Right and each Rights Certificate issued hereunder, shall be deemed to be a contract made under the laws of the State of Delaware and for all purposes shall be governed by and construed in accordance with the laws of such State applicable to contracts made and to be performed entirely within such State and applicable federal law."

2. After the Effective Date, each reference in the Agreement to the "Agreement" shall mean and refer to the Agreement as amended hereby. Except as provided in this Amendment, the Agreement and all related documents shall remain in full force and effect and are ratified and confirmed.

IN WITNESS WHEREOF, this Amendment has been executed, and shall be effective, as of the Effective Date.

| CALLAWAY GOLF COMPANY | MELLON INVESTOR SERVICES LLC |
| --- | --- |
| By: /s/ RONALD A. DRAPEAU | By: /s/ MARTHA O. MIJANGO |
| Ronald A. Drapeau<br>President and Chief Executive Officer | Martha O. Mijango<br>Assistant Vice President |

EXHIBIT 10.22

# CALLAWAY GOLF COMPANY
# 1991 STOCK INCENTIVE PLAN
(as Amended and Restated - August 15, 2000)

## 1. PURPOSES OF THE PLAN

The purposes of this Stock Incentive Plan ("Plan") of Callaway Golf Company, a Delaware corporation (the "Company"), are to enable the Company to attract, retain and motivate their officers, directors, key employees and consultants with compensatory arrangements and benefits that make use of or are measured by Company stock so as to provide for or increase the proprietary interests of such persons in the Company or to align their interests with those of the Company's shareholders.

## 2. PLAN AWARDS

To carry out the purposes of the Plan, the Company will from time to time enter into various arrangements with persons eligible to participate therein and confer various benefits upon them. The following such arrangements or benefits are authorized under the Plan if their terms and conditions are not inconsistent with the provisions of the Plan: Stock Options, Restricted Stock, Sales of Securities, Stock Bonuses, Performance Shares, Performance Units, Stock Appreciation Rights, Phantom Stock, Dividend Equivalents and Other Stock-Based Benefits. Such arrangements and benefits pursuant to the Plan are sometimes herein referred to as "Awards." The authorized categories of benefits for which Awards may be granted are defined as follows:

Stock Options: A Stock Option is a right granted under the Plan to purchase a specified number of shares of Common Stock at such exercise price, at such times, and on such other terms and conditions as are specified in the Award. A Stock Option may but need not (a) provide for the payment of some or all of the option exercise price in cash or by promissory note or by delivery of previously owned shares (including the technique known as "pyramiding") or other property or by withholding some of the shares which are being purchased; (b) include arrangements to facilitate the grantee's ability to borrow funds for payment of the exercise price; or (c) be an Incentive Stock Option.

Restricted Stock: Restricted Stock is Common Stock sold under the Plan (other than through the exercise of a Stock Option) at a substantial discount from its Fair Market Value or at its par value, but subject during specified periods of time to such restrictions on its transferability and repurchase rights as are expressed in the Award and as may constitute a substantial condition of forfeiture while in effect.

Sales of Securities: A Sale of Securities is a sale under the Plan of unrestricted shares of Common Stock or of debt or other securities which are convertible into shares of Common Stock upon such terms and conditions as may be established in the terms of the Award.

Stock Bonuses: A Stock Bonus is the issuance or delivery of unrestricted or restricted shares of Common Stock under the Plan as a bonus for services rendered or for any other valid consideration under applicable law.

Performance Shares: A Performance Share is an Award that represents a fixed number of shares of Common Stock which vests at a specified time or over a period of time in accordance with performance criteria established in connection with the granting of the Award. Such criteria may measure the performance of the grantee, of the business unit in which the grantee is employed, or of the Company, or a combination of any of the foregoing. The vested portion of the Award is payable to the grantee either in the shares it represents or in cash in an amount equal to the Fair Market Value of those shares on the date of vesting, or a combination thereof, as specified in the

Award.

Performance Units: A Performance Unit is an Award that represents a fixed amount of cash which vests at a specified time or over a period of time in accordance with performance criteria established in connection with the granting of the Award. Such criteria may measure the performance of the grantee, of the business unit in which the grantee is employed, or of the Company or a combination of any of the foregoing. The vested portion of the Award is payable to the grantee either in cash or in shares valued at their Fair Market Value on the date of vesting, or a combination thereof, as specified in the Award.

Stock Appreciation Rights: A Stock Appreciation Right is a right granted under the Plan to receive a payment that is measured with reference to the amount by which the Fair Market Value of a specified number of shares of Common Stock appreciates from a specified date, such as the date of grant of the Award, to the date of exercise. Payment of a Stock Appreciation Right may be made in cash or in shares valued at their Fair Market Value on the date of exercise, or combination thereof, as specified in the Award. A Stock Appreciation Right may but need not be granted in tandem with a Stock Option and require the surrender of that Stock Option or a portion thereof in connection with the exercise of the Stock Appreciation Right.

Phantom Stock: Phantom Stock is a cash bonus granted under the Plan measured by the Fair Market Value of a specified number of shares of Common Stock on a specified date, or measured by the excess of such Fair Market Value over a specified minimum, which may but need not include a Dividend Equivalent.

Dividend Equivalents: A Dividend Equivalent is a right granted under the Plan to receive an amount in cash equivalent to the dividends that are paid, if any, on a specified number of shares of Common Stock during a certain period of time.

Other Stock-Based Benefits: An Other Stock-Based Benefit is any arrangement granted under the Plan not otherwise described above which (a) by its terms might involve the issuance or sale of Common Stock or (b) involves a benefit that is measured, in whole or in part, by the value, appreciation, dividend yield or other features attributable to a specified number of shares of Common Stock.

An Award may consist of one such arrangement or benefit or two or more of them in tandem or in the alternative. Subject to the provisions of the Plan, any Award granted pursuant to the Plan may contain such additional terms and provisions as those administering the Plan for the Company may consider appropriate. Among other things, any such Award may but need not also provide for (i) the satisfaction of any applicable tax withholding obligation by the retention of shares to which the grantee would otherwise be entitled or by the grantee's delivery of previously owned shares or other property and (ii) acceleration of vesting, lapse of restrictions, cash settlement or other adjustment to the terms of the Award in the event of a merger, sale of assets or change of control of the Company.

## 3. STOCK SUBJECT TO THE PLAN

The kind and maximum number of shares of stock that may be sold or issued under the Plan, whether upon exercise of Stock Options or in settlement of other Awards, shall be 10,000,000 shares of Common Stock (this number reflects all stock splits through August 15, 2000, and is subject to further adjustments set forth hereinbelow). If the outstanding shares of stock of the class then subject to the Plan are increased or decreased, or are changed into or are exchanged for a different number or kind of shares or securities or other forms of consideration, as a result of one or more recapitalizations, restructurings, reclassifications, stock splits, reverse stock splits, stock dividends or the like, appropriate adjustments shall be made in the number and/or kind of shares or securities or other forms of consideration which may thereafter be sold or issued under the Plan and for which Awards (including Incentive Stock Options) may thereafter be granted and for which outstanding Awards previously granted under the Plan may thereafter be exercised or settled.

If, on or before termination of the Plan, any shares of Common Stock subject to an Award shall not be issued or transferred and shall cease to be issuable or transferable for any reason, or if such shares shall have been reacquired by the Company pursuant to restrictions imposed on such shares under the Plan or the terms of an Award, the shares not so issued or transferred and the shares so reacquired shall no longer be charged against the limitation provided for in this Section 3 and may be again made the subject of Awards under this Plan. The shares of stock sold or issued under the Plan may be obtained from the Company's authorized but unissued shares, from reacquired or treasury shares, or from outstanding shares acquired in the market or from private sources.

4. ADMINISTRATION OF THE PLAN

(a) The Plan shall be administered by the Board of Directors of the Company (the "Board') or, in the discretion of the Board, a committee appointed thereby (the "Committee '). Subject to the provisions of the Plan, the Board, or the Committee, shall have full and final authority in its discretion to select the eligible persons to whom Awards shall be granted hereunder, to grant such Awards, to determine the terms and provisions of such Awards and the number of shares to be sold or issued pursuant thereto. The Board (and the Committee) shall also be empowered with full and final authority to adopt, amend, and rescind such rules and regulations as, in its opinion, may be advisable in the administration of the Plan. The Board or the Committee, as the case may be, may delegate to Company officers or others in authority with respect to any Awards that may be granted to Employees who are not then officers of the Company or subject to Section 16 of the 1934 Act, subject to applicable legal requirements. The interpretation and construction by the Board or the Committee of any term or provision of the Plan or of any Award granted thereunder shall be final and binding upon all participants in the Plan.

(b) Pursuant to the authority described above, the Board or the Committee may adopt such amendments to, and rules and regulations governing, the Plan as may be considered advisable for purposes of compliance with applicable federal or state securities laws. The Board of Directors has established the following rules applicable to all Awards made pursuant to the Plan: No Award granted hereunder (other than an Award expressly granting unrestricted shares) may be transferred by the grantee except (i) by will or the laws of descent and distribution, (ii) upon dissolution of marriage pursuant to a qualified domestic relations order or division of community or marital property or (iii) with the express written approval of the Board or Committee in its sole discretion. No such permitted transfer shall, by itself, affect any vesting restrictions which then apply to the Award. Persons who are subject to Section 16 of the 1934 Act are also subject to the restrictions on transferability set forth in Section 7(a) of the Plan.

(c) The Company may assist any person to whom an Award is granted hereunder (including any officer or eligible director of the Company) in the payment of the purchase price or other amounts payable in connection with the receipt or exercise of that Award, by lending such amounts to such person on such terms and at such rates of interest and upon such security (if any) as shall be approved by the Board or the Committee.

5. PERSONS ELIGIBLE TO PARTICIPATE

Directors, officers and key employees of the Company shall be eligible for the grant of Awards under the Plan at the discretion of the Board or Committee provided -that no director of the Company who is not also an employee of the Company shall be eligible to receive any Award hereunder. Non-employee consultants to the Company who are deemed by the Board or Committee to be of such significance to the Company that Awards hereunder are appropriate in the interest of the Company shall also be eligible on ad hoc basis for the grant of Awards hereunder.

6. PLAN EFFECTIVENESS AND DURATION

The Plan shall become effective as of the date designated by the Board, and shall continue (unless earlier terminated by the Board) until its expiration as set forth below; provided that this Plan shall be submitted for the approval of each class of capital stock eligible to vote on matters submitted to a vote of the Company's shareholders as soon as reasonably practicable; and provided further that any Awards granted prior to such shareholder approval shall be considered subject to such approval. Unless previously terminated, the Plan will expire ten years after its effective date, but such expiration shall not affect any Award previously made or granted which is then outstanding.

7. SECTION 16 PERSONS

Notwithstanding any other provision herein, any Award granted hereunder to an officer or director of the Company who is then subject to Section 16 of the 1934 Act shall be subject to the following limitations:

(a) The Award may provide for the issuance of shares of Common Stock as a Stock Bonus for no consideration other than services rendered. In the event of an Award under which shares of Common Stock are or may in the future be issued for any other type of consideration, the amount of such consideration shall either (i) be equal to the amount required to be received by the Company in order to assure compliance with applicable state law or (ii) be equal to or greater than 50% of the Fair Market Value of such shares on the date of grant of such Award.

(b) Any derivative security (as defined in the rules and regulations of the Securities and Exchange Commission with respect to Section 16 of the 1934 Act) granted under this Plan shall be transferable by the recipient thereof only to the extent such transfer is not prohibited by Rule 16b-3 under Section 16 of the 1934 Act, by any other provision of this Plan or by any rule or regulation, adopted by the Board or Committee pursuant to the Plan.

8. AMENDMENT AND TERMINATION

The Board may amend, suspend or terminate the Plan, provided that no amendment of the Plan may, unless approved by the shareholders of the Company, increase the maximum number of shares that may be made subject to sale or issuance or may be sold or issued under the Plan, or alter the class of persons eligible to participate in the Plan. The Board may in its discretion determine, with respect to any amendments of the Plan (whether or not requiring shareholder approval under this Plan or applicable law), that such amendments shall become effective upon approval by the shareholders of the Company.

9. CERTAIN DEFINITIONS

The authorized categories of benefits for which Awards may be granted under this Plan are defined in Section 2 above. In addition, the following terms used in this Plan shall have the following meanings:

"Common Stock" is the Company's common stock, as constituted on the effective date of this Plan, and as thereafter adjusted as a result of any one or more events requiring adjustment of outstanding Awards under Section 3 above.

"Fair Market Value" of shares of stock shall be calculated (a) during such time as the Company is not a publicly-traded company, by the Board based on its good faith determination, and (b) at such times as the Company is publicly-traded, on the basis of the closing price of stock of that class on the day in question (or, if such day is not a trading day in the U.S. securities markets, on the nearest preceding trading day), as reported with respect to the principal market (or the composite of the markets, if more than one) in which such shares are then traded; or, if no such closing prices are reported, on the basis of the mean between the high bid and low asked prices that day on the principal market or national quotation system on which such shares are then quoted; or, if not so quoted, as furnished by a professional securities dealer making a market in such shares selected by the Board or the Committee; or if no such dealer is available, then the Fair Market Value shall be determined in good faith by the Board.

An "Incentive Stock Option" is a Stock Option that qualifies as an "incentive stock option" as defined under Section 422 (or any applicable successor provisions) of the Internal Revenue Code and that includes an express provision that it is intended to be an Incentive Stock Option.

A "Person" shall mean any individual, firm, partnership, corporation, trust, estate, association, group (as such term is used in Rule 13d-5 under the 1934 Act) or other entity, and shall include any successor (by merger or otherwise) to such entity.

A "Subsidiary" of the Company is any corporation, partnership or other entity in which the Company directly or indirectly owns 50% or more of the total combined power to cast votes in the election of directors, trustees, managing partners or similar officials.

The "1934 Act" means the Securities Exchange Act of 1934, as amended.

10. GOVERNING LAW

This Plan and any awards granted hereunder shall be governed by and construed in accordance with the internal laws of the State of Delaware and applicable federal law.

# CALLAWAY GOLF COMPANY

# 1998 STOCK INCENTIVE PLAN

(AS AMENDED AND RESTATED AUGUST 15, 2000)

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# CALLAWAY GOLF COMPANY
# 1998 STOCK INCENTIVE PLAN

## ARTICLE I
## PURPOSE OF PLAN

The Company has adopted this Plan to promote the interests of the Company and its shareholders by using investment interests in the Company to attract, retain and motivate employees and other persons, to encourage and reward their contributions to the performance of the Company, and to align their interests with the interests of the Company's shareholders. Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in Article VIII.

## ARTICLE II
## EFFECTIVE DATE AND TERM OF PLAN

### 2.1 TERM OF PLAN

This Plan became effective as of the Effective Date and shall continue in effect until the Expiration Date, at which time this Plan shall automatically terminate.

### 2.2 EFFECT ON AWARDS

Awards may be granted only during the Plan Term, but each Award granted during the Plan Term shall remain in effect after the Expiration Date until such Award has been exercised, terminated or expired in accordance with its terms and the terms of this Plan.

### 2.3 SHAREHOLDER APPROVAL

This Plan shall be approved by the Company's shareholders within 12 months after the Effective Date. The effectiveness of any Awards granted prior to such shareholder approval shall be subject to such shareholder approval.

## ARTICLE III
## SHARES SUBJECT TO PLAN

### 3.1 NUMBER OF SHARES

The maximum number of shares of Common Stock that may be issued pursuant to Awards shall be 500,000, subject to adjustment as set forth in Section 3.4.

### 3.2 SOURCE OF SHARES

The Common Stock to be issued under this Plan will be made available, at the discretion of the Board, either from authorized but unissued shares of Common Stock or from previously issued shares of Common Stock reacquired by the Company.

3.3 AVAILABILITY OF UNUSED

Shares of Common Stock subject to unexercised portions of any Award that expire, terminate or are canceled, and shares of Common Stock issued pursuant to an Award that are reacquired by the Company pursuant to the terms of the Award under which such shares were issued, will again become available for the grant of further Awards under this Plan.

3.4 ADJUSTMENT PROVISIONS

(a) If the outstanding shares of Common Stock are increased, decreased or exchanged for a different number or kind of shares or other securities, or if additional shares or new or different shares or other securities are distributed in respect of such shares of Common Stock (or any stock or securities received with respect to such Common Stock), including without limitation through merger, consolidation, sale or exchange of all or substantially all of the assets of the Company, reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split or spin-off, an appropriate and proportionate adjustment may be made in (1) the maximum number and kind of shares subject to this Plan as provided in Section 3.1, (2) the number and kind of shares or other securities subject to then outstanding Awards, and/or (3) the price for each share or other unit of any other securities subject to, or measurement criteria applicable to, then outstanding Awards.

(b) No fractional interests will be issued under this Plan resulting from any adjustments.

(c) To the extent any adjustments relate to stock or securities of the Company, such adjustments shall be made by the Administering Body, whose determination in that respect shall be final, binding and conclusive.

(d) The grant of an Award pursuant to this Plan shall not affect in any way the right or power of the Company to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or to consolidate or to dissolve, liquidate or sell, or transfer all or any part of its business or assets.

(e) No adjustment to the terms of an Incentive Stock Option shall be made unless such adjustment either (i) would not cause such Option to lose its status as an Incentive Stock Option or (ii) is agreed to in writing by the Administering Body and the Recipient.

3.5 RESERVATION OF SHARES

The Company will at all times reserve and keep available shares of Common Stock equaling at least the total number of shares of Common Stock issuable pursuant to outstanding Awards.

ARTICLE IV
ADMINISTRATION OF PLAN

4.1 ADMINISTERING BODY

(a) This Plan shall be administered by the Board or by a Committee of the Board appointed pursuant to Section 4.1(b).

(b) The Board in its sole discretion may from time to time appoint a Committee (which may be a subcommittee of an existing committee of the Board) of not less than two Board members to administer this Plan and, subject to applicable law, to exercise all of the powers, authority and discretion of the Board under this Plan. The Board may from time to time increase or decrease (but not below two) the number of members of the Committee, remove from membership on the Committee all or any portion of its members, and/or appoint such person or persons as it desires to fill any vacancy existing on the Committee, whether caused by removal, resignation or otherwise. The Board may disband the Committee at any time and revest in the Board the administration of this Plan.

4.2 AUTHORITY OF ADMINISTERING BODY

(a) Subject to the express provisions of this Plan, the Administering Body shall have the power to implement, (including the power to delegate such implementation to appropriate officers of the Company), interpret and construe this Plan and any Awards and Award Documents or other documents defining the rights and obligations of the Company and Recipients hereunder and thereunder, to determine all questions arising hereunder and thereunder, and to adopt and amend such rules and regulations for the administration hereof and thereof as it may deem desirable. The interpretation and construction by the Administering Body of any provisions of this Plan or of any Award or Award Document shall be conclusive and binding. Any action taken by, or inaction of, the Administering Body relating to this Plan or any Award or Award Document shall be within the absolute discretion of the Administering Body and shall be conclusive and binding upon all persons. Subject only to compliance with the express provisions hereof, the Administering Body may act in its absolute discretion in matters related to this Plan and any and all Awards and Award Documents.

(b) Subject to the express provisions of this Plan, the Administering Body may from time to time in its discretion select the Eligible Persons to whom, and the time or times at which, Awards shall be granted or sold, the nature of each Award, the number of shares of Common Stock or the number of rights that make up or underlie each Award, the exercise price and period for the exercise of each Award, and such other terms and conditions applicable to each individual Award as the Administering Body shall determine. The Administering Body may grant at any time new Awards to an Eligible Person who has previously received Awards or other grants (including other stock options) regardless of whether such prior Awards or such other grants are still outstanding, have previously been exercised as a whole or in part, or are canceled in connection with the issuance of new Awards. The Administering Body may grant Awards singly, in combination or in tandem with other Awards, as it determines in its discretion. The purchase price, exercise price, initial value and any and all other terms and conditions of the

Awards may be established by the Administering Body without regard to existing Awards or other grants.

(c) Any action of the Administering Body with respect to the administration of this Plan shall be taken pursuant to a majority vote of the authorized number of members of the Administering Body or by the unanimous written consent of its members; provided, however, that (i) if the Administering Body is the Committee and consists of two members, then actions of the Administering Body must be unanimous, and (ii) if the Administering Body is the Board, actions taken by the Board shall be valid if approved in accordance with applicable law.

4.3 NO LIABILITY

No member of the Board or the Committee or any designee thereof will be liable for any action or inaction with respect to this Plan or any Award or any transaction arising under this Plan or any Award, except in circumstances constituting bad faith of such member.

4.4 AMENDMENTS

(a) The Administering Body may, insofar as permitted by applicable law, rule or regulation, and subject to Section 4.4(c), from time to time suspend or discontinue this Plan or revise or amend it in any respect whatsoever, and this Plan as so revised or amended will govern all Awards hereunder, including those granted before such revision or amendment. Without limiting the generality of the foregoing, the Administering Body is authorized to amend this Plan to comply with or take advantage of amendments to applicable laws, rules or regulations, including the Securities Act, Exchange Act, the IRC or the rules of any exchange or interdealer quotation system upon which the Common Stock is listed or traded. No shareholder approval of any amendment or revision shall be required unless (i) such approval is required by this Plan or by applicable law, rule or regulation or (ii) an amendment or revision to this Plan would materially increase the number of shares subject to this Plan (as adjusted under Section 3.4).

(b) The Administering Body may, with the written consent of a Recipient, make such modifications in the terms and conditions of an Award as it deems advisable. Without limiting the generality of the foregoing, the Administering Body may, in its discretion with the written consent of the Recipient, at any time and from time to time after the grant of any Award accelerate or extend the vesting or exercise period of any Award as a whole or in part.

(c) Except as otherwise provided in this Plan or in the applicable Award Document, no amendment, revision, suspension or termination of this Plan or any outstanding Award may impair or adversely affect any rights or obligations under any Award theretofore granted without the written consent of the Recipient to whom such Award was granted.

4.5 OTHER COMPENSATION PLANS

The adoption of this Plan shall not affect any other stock option, incentive or other compensation plans in effect from time-to-time for the Company, and this Plan shall not preclude the Company from establishing any other forms of incentive or other compensation for employees, directors, advisors or consultants of the Company, whether or not approved by shareholders.

4.6 PLAN BINDING ON SUCCESSORS

This Plan shall be binding upon the successors and assigns of the Company.

4.7 REFERENCES TO SUCCESSOR STATUTES, REGULATIONS AND RULES

Any reference in this Plan to a particular statute, regulation or rule shall also refer to any successor provision of such statute, regulation or rule.

4.8 ISSUANCES FOR COMPENSATION PURPOSES ONLY

This Plan is intended to constitute an "employee benefit plan," as defined in Rule 405 promulgated under the Securities Act, and shall be administered accordingly.

4.9 INVALID PROVISIONS

In the event that any provision of this Plan is found to be invalid or otherwise unenforceable under any applicable law, such invalidity or unenforceability shall not be construed as rendering any other provisions contained herein invalid or unenforceable, and all such other provisions shall be given full force and effect to the same extent as though the invalid and unenforceable provision were not contained herein.

4.10 GOVERNING LAW

This Plan and any agreements hereunder shall be governed by and construed in accordance with the internal laws of the State of Delaware and applicable federal law.

## ARTICLE V
## GENERAL AWARD PROVISIONS

5.1 PARTICIPATION IN THE PLAN

(a) A person shall be eligible to receive grants of Awards under this Plan if, at the time of the grant of the Award, such person is an Eligible Person.

(b) Incentive Stock Options may be granted only to Eligible Persons meeting the employment requirements of Section 422 of the IRC.

(c) Notwithstanding anything to the contrary herein, the Administering Body may, in order to fulfill the purposes of this Plan, modify grants of Awards to Recipients who are foreign nationals or employed outside of the United States to recognize differences in applicable law, tax policy or local custom.

5.2 AWARD DOCUMENTS

(a) Each Award granted under this Plan shall be evidenced by an agreement duly executed on behalf of the Company and by the Recipient, or by a confirming memorandum issued by the Company to the Recipient, setting forth such terms and conditions applicable to the Award as the Administering Body may in its discretion determine. Awards will not be binding upon the Company, and Recipients will have no rights thereto, until such an agreement is entered into between the Company and the Recipient or such a memorandum is delivered by the Company to the Recipient, but an Award may have an effective date on or after the date of grant but prior to the date of such an agreement or memorandum. Award Documents may but need not be identical and shall comply with and be subject to the terms and conditions of this Plan, a copy of which shall be provided to each Recipient and incorporated by reference into each Award Document. Any Award Document may contain such other terms, provisions and conditions not inconsistent with this Plan as may be determined by the Administering Body.

(b) In case of any conflict between this Plan and any Award Document, this Plan shall control.

5.3 EXERCISE OF STOCK OPTIONS

No Stock Option shall be exercisable except in respect of whole shares, and fractional share interests shall be disregarded. A Stock Option shall be deemed to be exercised when the Secretary or other designated official of the Company receives written notice of such exercise from the Recipient, together with payment of the exercise price made in accordance with Section 5.4 and any amounts required under Section 5.11. Notwithstanding any other provision of this Plan, the Company and/or the Administering Body may impose, by rule and/or in Award Documents, such conditions upon the exercise of Stock Options (including without limitation conditions limiting the time of exercise to specified periods) as may be required to satisfy applicable regulatory requirements.

5.4 PAYMENT FOR AWARDS

(a) The exercise price or other payment for an Award shall be payable upon the exercise of a Stock Option or upon other purchase of shares pursuant to an Award granted hereunder by delivery of legal tender of the United States or payment of such other consideration as the Administering Body may from time to time deem acceptable in any particular instance.

(b) The Company may assist any person to whom an Award is granted hereunder (including without limitation any officer or director of the Company) in the payment of the purchase price, withholding taxes or other amounts payable in connection with the receipt or exercise of that Award, by lending such amounts to such person on such terms and at such rates of interest and upon such security (if any) as shall be approved by the Administering Body.

(c) The exercise price for Awards may be paid by delivery of Common Stock to the Company by or on behalf of the person exercising the Award and duly endorsed in blank or accompanied by stock powers duly endorsed in blank, with signatures guaranteed in accordance with the Exchange Act if required by the Company, or retained by the Company from the stock otherwise issuable upon exercise or surrender of vested and/or exercisable Awards or other equity Awards previously granted to the Recipient and being exercised (if applicable) (in either case valued at Fair Market Value as of the exercise date); or such other consideration as the

Administering Body may from time to time in the exercise of its discretion deem acceptable in any particular instance; provided, however, that (i) the Company and/or the Administering Body may allow exercise of an Award in a broker-assisted or similar transaction in which the exercise price is not received by the Company until promptly after exercise, and/or (ii) the Administering Body may allow the Company to loan the exercise price to the person entitled to exercise the Award, if the exercise will be followed by a prompt sale of some or all of the underlying shares and a portion of the sale proceeds is dedicated to full payment of the exercise price and amounts required pursuant to Section 5.11.

(d) Recipients will have no rights to the assistance described in Section 5.4(b) or to the exercise techniques described in Section 5.4(c), and the Company may offer or permit such assistance or techniques on an ad hoc basis to any Recipient without incurring any obligation to offer or permit such assistance or techniques on other occasions or to other Recipients.

5.5 NO EMPLOYMENT RIGHTS

Nothing contained in this Plan (or in Award Documents or in any other documents related to this Plan or to Awards granted hereunder) shall confer upon any Eligible Person or Recipient any right to continue in the employ of the Company or any Affiliated Entity or constitute any contract or agreement of employment or engagement, or interfere in any way with the right of the Company or any Affiliated Entity to reduce such person's compensation or other benefits or to terminate the employment or engagement of such Eligible Person or Recipient, with or without cause. Except as expressly provided in this Plan or in any statement evidencing the grant of an Award pursuant to this Plan, the Company shall have the right to deal with each Recipient in the same manner as if this Plan and any such statement evidencing the grant of an Award pursuant to this Plan did not exist, including without limitation with respect to all matters related to the hiring, discharge, compensation and conditions of the employment or engagement of the Recipient. Any questions as to whether and when there has been a termination of a Recipient's employment or engagement, the reason (if any) for such termination, and/or the consequences thereof under the terms of this Plan or any statement evidencing the grant of an Award pursuant to this Plan shall be determined by the Administering Body and the Administering Body's determination thereof shall be final and binding.

5.6 RESTRICTIONS UNDER APPLICABLE LAWS AND REGULATIONS

(a) All Awards granted under this Plan shall be subject to the requirement that, if at any time the Company shall determine, in its discretion, that the listing, registration or qualification of the shares subject to Awards granted under this Plan upon any securities exchange or interdealer quotation system or under any federal, state or foreign law, or the consent or approval of any government or regulatory body, is necessary or desirable as a condition of, or in connection with, the granting of such an Award or the issuance, if any, or purchase of shares in connection therewith, such Award may not be exercised as a whole or in part unless and until such listing, registration, qualification, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Company. During the term of this Plan, the Company will use its reasonable efforts to seek to obtain from the appropriate governmental and regulatory agencies any requisite qualifications, consents, approvals or authorizations in order to issue and sell such number of shares of its Common Stock as shall be sufficient to satisfy the requirements of this Plan. The inability of the Company to obtain any such qualifications, consents, approvals or authorizations shall relieve the Company of any liability in respect of the nonissuance or sale of such stock as to which such qualifications, consents, approvals or authorizations pertain.

(b) The Company shall be under no obligation to register or qualify the issuance of Awards or underlying securities under the Securities Act or applicable state securities laws. Unless the issuance of Awards and underlying securities have been registered under the Securities Act and qualified or registered under applicable state securities laws, the Company shall be under no obligation to issue any Awards or underlying securities unless the Awards and underlying securities may be issued pursuant to applicable exemptions from such registration or qualification requirements. In connection with any such exempt issuance, the Company may require the Recipient to provide a written representation and undertaking to the Company, satisfactory in form and scope to the Company and upon which the Company may reasonably rely, that such Recipient is acquiring such Awards and underlying shares for such Recipient's own account as an investment and not with a view to, or for sale in connection with, the distribution of any such securities, and that such person will make no transfer of the same except in compliance with any rules and regulations in force at the time of such transfer under the Securities Act and other applicable law, and that if shares of stock are issued without such registration, a legend to this effect (together with any other legends deemed appropriate by the Company) may be endorsed upon the securities so issued. The Company may also order its transfer agent to stop transfers of such securities. The Company may also require the Recipient to provide the Company such information and other documents as it may request in order to satisfy the Company as to the investment sophistication and experience of the Recipient and as to any other conditions for compliance with any such exemptions from registration or qualification.

5.7 ADDITIONAL CONDITIONS

Any Award may also be subject to such other provisions (whether or not applicable to any other Award or Recipient) as the Administering Body determines appropriate, including without limitation provisions to assist the Recipient in financing the purchase of Common Stock through the exercise of Stock Options, provisions for the forfeiture of or restrictions on resale or other disposition of shares of Common Stock acquired under any Award, provisions giving the Company the right to repurchase shares of Common Stock acquired under any Award in the event the Recipient elects to dispose of such shares, and provisions to comply with federal and state securities laws and federal and state income tax withholding requirements.

5.8 NO PRIVILEGES OF STOCK OWNERSHIP

Except as otherwise set forth herein, a Recipient or a permitted transferee of an Award shall have no rights as a shareholder with respect to any shares issuable or issued in connection with the Award until the date of the receipt by the Company of all amounts payable and performance by the Recipient of all obligations in connection with the exercise of the Award. Status as an Eligible Person shall not be construed as a commitment that any Award will be granted under this Plan to an Eligible Person or to Eligible Persons generally. No person shall have any right, title or interest in any fund or in any specific asset (including shares of capital stock) of the Company by reason of any Award granted hereunder. Neither this Plan (or any documents related hereto) nor any action taken pursuant hereto shall be construed to create a trust of any kind or a fiduciary relationship between the Company and any person. To the extent that any person acquires a right to receive an Award hereunder, such right shall be no greater than the right of any unsecured general creditor of the Company.

5.9 NONASSIGNABILITY

Unless the Administering Body shall otherwise determine on a case-by-case basis, no Award granted under this Plan shall be assignable or transferable except (i) by will or by the laws of descent and distribution, or (ii) subject to the final sentence of this Section 5.9, upon dissolution of marriage pursuant to a qualified domestic relations order. Unless the Administering Body shall otherwise determine on a case-by-case basis, during the lifetime of a Recipient, an Award granted to such person shall be exercisable only by the Recipient (or the Recipient's permitted transferee) or such person's guardian or legal representative. Notwithstanding the foregoing, (i) no Award owned by a Recipient subject to Section 16 of the Exchange Act may be assigned or transferred in any manner inconsistent with Rule 16b-3, and (ii) Incentive Stock Options (or other Awards subject to transfer restrictions under the IRC) may not be assigned or transferred in violation of Section 422(b)(5) of the IRC (or any comparable or successor provision) or the regulations thereunder, and nothing herein is intended to allow such assignment or transfer.

5.10 INFORMATION TO RECIPIENTS

(a) The Company shall determine what, if any, financial and other information shall be provided to Recipients and when such financial and other information shall be provided after giving consideration to applicable federal and state laws, rules and regulations, including without limitation applicable federal and state securities laws, rules and regulations.

(b) The furnishing of financial and other information that is confidential to the Company shall be subject to the Recipient's agreement that the Recipient shall maintain the confidentiality of such financial and other information, shall not disclose such information to third parties, and shall not use the information for any purpose other than evaluating an investment in the Company's securities under this Plan. The Company may impose other restrictions on the access to and use of such confidential information and may require a Recipient to acknowledge the Recipient's obligations under this Section 5.10(b) (which acknowledgment shall not be a condition to Recipient's obligations under this Section 5.10(b)).

5.11 WITHHOLDING TAXES

Whenever the granting, vesting or exercise of any Award, or the issuance of any shares upon exercise of any Award or transfer thereof, gives rise to tax or tax withholding liabilities or obligations, the Company shall have the right to require the Recipient to remit to the Company an amount sufficient to satisfy any federal, state and local withholding tax requirements arising in connection therewith. The Company may, in the exercise of its discretion, allow satisfaction of tax withholding requirements by accepting delivery of stock of the Company or by withholding a portion of the stock otherwise issuable in connection with an Award, in each case valued at Fair Market Value as of the date of such delivery or withholding.

5.12 LEGENDS ON AWARDS AND STOCK CERTIFICATES

Each Award Document and each certificate representing shares acquired upon vesting or exercise of an Award shall be endorsed with all legends, if any, required by applicable federal and state securities and other laws to be placed on the Award Document and/or the certificate. The determination of which legends, if any, shall be placed upon Award Documents or the certificates shall be made by the Company and such decision shall be final and binding.

5.13 EFFECT OF TERMINATION OF EMPLOYMENT ON AWARDS

(a) TERMINATION OF VESTING. Awards will be exercisable by a Recipient (or the Recipient's successor-in-interest) following such Recipient's termination of employment with the Company or any Affiliated Entity only to the extent that installments thereof had become exercisable on or prior to the date of such termination.

(b) ALTERATION OF VESTING AND EXERCISE PERIODS. Notwithstanding anything to the contrary herein, (i) the Administering Body may, in its discretion, designate shorter or longer periods for the vesting or exercise of any Award, or the lapse of transfer or other restrictions pertaining thereto, following a Recipient's termination of employment with the Company or any Affiliated Entity; provided, however, that any shorter periods determined by the Administering Body shall be effective only if provided for in the Award Document that evidences the grant to the Recipient of such Award or if such shorter period is agreed to in writing by the Recipient; and (ii) the Administering Body may, in its discretion, elect to accelerate the vesting of all or any portion of any Award that had not become exercisable on or prior to the date of such termination or to extend the vesting period beyond the date of such termination.

(c) LEAVE OF ABSENCE. In the case of any employee on an approved leave of absence, the Administering Body may make such provision respecting continuance of Awards granted to such employee as the Administering Body in its discretion deems appropriate.

5.14 LIMITS ON AWARDS TO ELIGIBLE PERSONS

Notwithstanding any other provision of this Plan, in order for the compensation attributable to Awards hereunder to qualify as Performance-Based Compensation, no one Eligible Person shall be granted any Awards with respect to more than 250,000 shares of Common Stock in any one calendar year. The limitation set forth in this Section 5.14 shall be subject to adjustment as provided in Section 3.4 or under Article VII, but only to the extent such adjustment would not affect the status of compensation attributable to Awards hereunder as Performance-Based Compensation.

ARTICLE VI
AWARDS

6.1 STOCK OPTIONS

(a) NATURE OF STOCK OPTIONS. Stock Options may be Incentive Stock Options or Nonqualified Stock Options.

(b) OPTION EXERCISE PRICE. The exercise price for each Stock Option shall be determined by the Administering Body as of the date such Stock Option is granted. The exercise price shall be no less than the Fair Market Value of the Common Stock subject to the Stock Option as of the date of grant. Subject to approval by the shareholders, the Administering Body may, with the consent of the Recipient and subject to compliance with statutory or administrative requirements applicable to Incentive Stock Options, amend the terms of any Stock Option to provide that the exercise price of the shares remaining subject to the Stock Option shall be reestablished at a price not less than 100% of the Fair Market Value of the Common Stock on the effective date of the amendment. No modification of any other term or provision of any Stock Option that is amended in accordance with the foregoing shall be required, although the Administering Body may, in its discretion, make such further modifications of any such Stock Option as are not inconsistent with this Plan.

(c) OPTION PERIOD AND VESTING. Stock Options granted hereunder shall vest and may be exercised as determined by the Administering Body, except that exercise of such Stock Options after termination of the Recipient's employment shall be subject to Section 5.13. Each Stock Option granted hereunder and all rights or obligations thereunder shall expire on such date as shall be determined by the Administering Body, but not later than l0 years after the date the Stock Option is granted and shall be subject to earlier termination as provided herein or in the Award Document. The Administering Body may, in its discretion at any time and from time to time after the grant of a Stock Option, accelerate vesting of such Stock Option as a whole or part by increasing the number of shares then purchasable, provided that the total number of shares subject to such Stock Option may not be increased. Except as otherwise provided herein, a Stock Option shall become exercisable, as a whole or in part, on the date or dates specified by the Administering Body and thereafter shall remain exercisable until the expiration or earlier termination of the Stock Option.

(d) TERMINATION. Unless determined otherwise by the Administering Body in its sole discretion, Stock Options shall expire on the earliest of (i) one year from the date on which the Recipient ceases to be an Eligible Person for any reason other than death; (ii) one year from the date of the Recipient's death; or (iii) with respect to each installment of such Stock Option, the fifth anniversary of the vesting date of such installment. If a Recipient who is an employee of the Company or any Affiliated Entity ceases for any reason to be such an employee, that portion of the Stock Option that has not yet vested shall terminate, unless the Administering Body accelerates the vesting schedule in its sole discretion (in which case, the Administering Body may impose whatever conditions it considers appropriate on the accelerated portion). Stock Options granted to a Recipient who is not such an employee may be made subject to such other termination provisions as determined appropriate by the Administering Body.

(e) SPECIAL PROVISIONS REGARDING INCENTIVE STOCK OPTIONS.

(i) Notwithstanding anything in this Section 6.1 to the contrary, the exercise price and vesting period of any Stock Option intended to qualify as an Incentive Stock Option shall comply with the provisions of Section 422 of the IRC and the regulations thereunder. As of the Effective Date, such provisions require, among other matters, that (A) the exercise price must not be less than the Fair Market Value of the underlying stock as of the date the Incentive Stock Option is granted, and not less than 110% of the Fair Market Value as of such date in the case of a grant to a Significant Shareholder; and (B) that the Incentive Stock Option not be exercisable after the expiration of ten years from the date of grant of such Incentive Stock Option, or five years from the date of grant in the case of an Incentive Stock Option granted to a Significant Shareholder.

(ii) The aggregate Fair Market Value (determined as of the respective date or dates of grant) of the Common Stock for which one or more Stock Options granted to any Recipient under this Plan (or any other option plan of the Company or any of its subsidiaries or affiliates) may for the first time become exercisable as Incentive Stock Options under the federal tax laws during any one calendar year shall not exceed $100,000.

(iii) Any Options granted as Incentive Stock Options pursuant to this Plan that for any reason fail or cease to qualify as such shall be treated as Nonqualified Stock Options.

6.2 PERFORMANCE AWARDS

(a) GRANT OF PERFORMANCE AWARDS. The Administering Body shall determine in its discretion the performance criteria (which need not be identical and may be established on an individual or group basis) governing Performance Awards, the terms thereof, and the form and time of payment of Performance Awards.

(b) PAYMENT OF PERFORMANCE AWARDS. Upon satisfaction of the conditions applicable to a Performance Award, payment will be made to the Recipient in shares of Common Stock valued at Fair Market Value.

6.3 RESTRICTED STOCK

(a) AWARD OF RESTRICTED STOCK. The Administering Body shall determine the Purchase Price (if any), the terms of payment of the Purchase Price, the restrictions upon the Restricted Stock, and when such restrictions shall lapse.

(b) REQUIREMENTS OF RESTRICTED STOCK. All shares of Restricted Stock granted or sold pursuant to this Plan will be subject to the following conditions:

(i) NO TRANSFER. The shares may not be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of, alienated or encumbered until the restrictions are removed or expire;

(ii) CERTIFICATES. The Company may require that the certificates representing Restricted Stock granted or sold to a Recipient pursuant to this Plan remain in the physical custody of an escrow holder or the Company until all restrictions are removed or expire;

(iii) RESTRICTIVE LEGENDS. Each certificate representing Restricted Stock granted or sold to a Recipient pursuant to this Plan will bear such legend or legends making reference to the restrictions imposed upon such Restricted Stock as the Company deems necessary or appropriate to enforce such restrictions; and

(iv) OTHER RESTRICTIONS. The Administering Body may impose such other conditions on Restricted Stock as the Administering Body may deem advisable, including, without limitation, restrictions under the Securities Act, under the Exchange Act, under the requirements of any stock exchange or interdealer quotation system upon which such Restricted Stock or shares of the same class are then listed or traded and under any blue sky or other securities laws applicable to such shares.

(c) LAPSE OF RESTRICTIONS. The restrictions imposed upon Restricted Stock will lapse in accordance with such terms or other conditions as are determined by the Administering Body.

(d) RIGHTS OF RECIPIENT. Subject to the provisions of Section 6.3(b) and any restrictions imposed upon the Restricted Stock, the Recipient will have all rights of a shareholder with respect to the Restricted Stock granted or sold to such Recipient under this Plan, including, without limitation, the right to vote the shares and receive all dividends and other distributions paid or made with respect thereto.

(e) TERMINATION OF EMPLOYMENT. Unless the Administering Body in its discretion determines otherwise, if a Recipient's employment with the Company or any Affiliated Entity terminates for any reason, all of the Recipient's Restricted Stock remaining subject to restrictions on the date of such termination of employment shall be repurchased by the Company at the Purchase Price (if any) paid by the Recipient to the Company, without interest or premium, and otherwise returned to the Company without consideration.

6.4 STOCK APPRECIATION RIGHTS

(a) GRANTING OF STOCK APPRECIATION RIGHTS. The Administering Body may at any time and from time to time approve the grant to Eligible Persons of Stock Appreciation Rights, related or unrelated to Stock Options.

(b) STOCK APPRECIATION RIGHTS RELATED TO OPTIONS.

(i) A Stock Appreciation Right granted in connection with a Stock Option granted under this Plan will entitle the holder of the related Stock Option, upon exercise of the Stock Appreciation Right, to surrender such Stock Option, or any portion thereof to the extent previously vested but unexercised, with respect to the number of shares as to which such Stock Appreciation Right is exercised, and to receive payment of an amount computed pursuant to

Section 6.2(b)(iii). Such Stock Option will, to the extent surrendered, then cease to be exercisable.

(ii) A Stock Appreciation Right granted in connection with a Stock Option hereunder will be exercisable only when, and only to the extent that, the related Stock Option is exercisable, will not be transferable except to the extent that such related Stock Option may be transferable, will not expire later than the underlying Stock Option, and will be exercisable only when the Fair Market Value of the Common Stock subject to the underlying Stock Option exceeds the exercise price of such Stock Option.

(iii) Upon the exercise of a Stock Appreciation Right related to a Stock Option, the Recipient will be entitled to receive payment of an amount determined by multiplying (A) the difference obtained by subtracting the exercise price of a share of Common Stock specified in the related Stock Option from the Fair Market Value of a share of Common Stock on the date of exercise of such Stock Appreciation Right (or as of such other date or as of the occurrence of such event as may have been specified in the instrument evidencing the grant of the Stock Appreciation Right), by (B) the number of shares as to which such Stock Appreciation Right is exercised.

(c) STOCK APPRECIATION RIGHTS UNRELATED TO OPTIONS

The Administering Body may grant Stock Appreciation Rights unrelated to Stock Options to Eligible Persons. Section 6.2(b)(iii) shall be used to determine the amount payable at exercise under such Stock Appreciation Right, except that in lieu of the exercise price specified in the related Stock Option, the initial base amount specified in the Award shall be used.

(d) LIMITS

Notwithstanding the foregoing, the Administering Body, in its discretion, may place a dollar limitation on the maximum amount that will be payable upon the exercise of a Stock Appreciation Right under this Plan.

(e) PAYMENTS

Payment of the amount determined under the foregoing provisions may be made solely in whole shares of Common Stock valued at their Fair Market Value on the date of exercise of the Stock Appreciation Right or, alternatively, at the sole discretion of the Administering Body, in cash or in a combination of cash and shares of Common Stock as the Administering Body deems advisable. The Administering Body has full discretion to determine the form in which payment of a Stock Appreciation Right will be made and to consent to or disapprove the election of a Recipient to receive cash in full or partial settlement of a Stock Appreciation Right. If the Administering Body decides to make full payment in shares of Common Stock, and the amount payable results in a fractional share, payment for the fractional share will be made in cash.

6.5 STOCK PAYMENTS.

The Administering Body may approve Stock Payments of the Company's Common Stock to any Eligible Person for all or any portion of the compensation (other than base salary) or other payment that would otherwise become payable by the Company to the Eligible Person in cash.

6.6 DIVIDEND EQUIVALENTS

The Administering Body may grant Dividend Equivalents to any Recipient who has received a Stock Option, Stock Appreciation Right or other Award denominated in shares of Common Stock. Dividend Equivalents may be paid in cash, Common Stock or other Awards; the amount of Dividend Equivalents paid other than in cash shall be determined by the Administering Body by application of such formula as the Administering Body may deem appropriate to translate the cash value of dividends paid to the alternative form of payment of the Dividend Equivalent. Dividend Equivalents shall be computed as of each dividend record date and shall be payable to recipients thereof at such time as the Administering Body may determine. Notwithstanding the foregoing, the payment of a Dividend Equivalent with respect to a Stock Option intended to constitute Performance-Based Compensation shall not be contingent upon the exercise of such Stock Option.

6.7 STOCK BONUSES

The Administering Body may issue shares of Common Stock to Eligible Persons as bonuses for services rendered or for any other valid consideration on such terms and conditions as the Administering Body may determine.

6.8 STOCK SALES

The Administering Body may sell to Eligible Persons shares of Common Stock on such terms and conditions as the Administering Body may determine.

6.9 PHANTOM

The Administering Body may grant Awards of Phantom Stock. Phantom Stock is a cash bonus granted under this Plan measured by the Fair Market Value of a specified number of shares of Common Stock on a specified date, or measured by the excess of such Fair Market Value over a specified minimum, which may but need not include a Dividend Equivalent.

6.10 OTHER STOCK-BASED BENEFITS

The Administering Body is authorized to grant Other Stock-Based Benefits. Other Stock-Based Benefits are any arrangements granted under this Plan not otherwise described above that (a) by their terms might involve the issuance or sale of Common Stock or (b) involve a benefit that is measured, as a whole or in part, by the value, appreciation, dividend yield or other features attributable to a specified number of shares of Common Stock.

6.11 TERMINATION OF EMPLOYMENT

Except as otherwise provided for in this Plan or determined by the Administering Body in its discretion, all Awards granted to a Recipient, and all of such Recipient's rights thereunder, shall terminate upon termination for any reason of such Recipient's employment with the Company or any Affiliated Entity.

## ARTICLE VII
## REORGANIZATIONS

### 7.1 CORPORATE TRANSACTIONS NOT INVOLVING A CHANGE IN CONTROL

If the Company shall consummate any Reorganization not involving a Change of Control in which holders of shares of Common Stock are entitled to receive in respect of such shares any securities, cash or other consideration (including without limitation a different number of shares of Common Stock), each Award outstanding under this Plan shall thereafter be exercisable, in accordance with this Plan, only for the kind and amount of securities, cash and/or other consideration receivable upon such Reorganization by a holder of the same number of shares of Common Stock as are subject to that Award immediately prior to such Reorganization, and any adjustments will be made to the terms of the Award in the sole discretion of the Administering Body as it may deem appropriate to give effect to the Reorganization.

### 7.2 CORPORATE TRANSACTIONS INVOLVING A CHANGE IN CONTROL

As of the effective time and date of any Change in Control, this Plan and any then outstanding Awards (whether or not vested) shall automatically terminate unless (a) provision is made in writing in connection with such transaction for the continuance of this Plan and for the assumption of such Awards, or for the substitution for such Awards of new awards covering the securities of a successor entity or an affiliate thereof, with appropriate adjustments as to the number and kind of securities and exercise prices, in which event this Plan and such outstanding Awards shall continue or be replaced, as the case may be, in the manner and under the terms so provided; or (b) the Board otherwise shall provide in writing for such adjustments as it deems appropriate in the terms and conditions of the then-outstanding Awards (whether or not vested), including without limitation (i) accelerating the vesting of outstanding Awards and/or (ii) providing for the cancellation of Awards and their automatic conversion into the right to receive the securities, cash or other consideration that a holder of the shares underlying such Awards would have been entitled to receive upon consummation of such Change in Control had such shares been issued and outstanding immediately prior to the effective date and time of the Change in Control (net of the appropriate option exercise prices). If, pursuant to the foregoing provisions of this Section 7.2, this Plan and the Awards shall terminate by reason of the occurrence of a Change in Control without provision for any of the actions described in clause (a) or (b) hereof, then any Recipient holding outstanding Awards shall have the right, at such time immediately prior to the consummation of the Change in Control as the Board shall designate, to exercise the Recipient's Awards to the full extent not theretofore exercised, including any installments which have not yet become vested.

## ARTICLE VIII
## DEFINITIONS

Capitalized terms used in this Plan and not otherwise defined shall have the meanings set forth below:

"ADMINISTERING BODY" means the Board as long as no Committee has been appointed and is in effect and shall mean the Committee as long as the Committee is appointed and in effect.

"AFFILIATED ENTITY" means any Parent Corporation or Subsidiary Corporation.

"APPLICABLE DIVIDEND PERIOD" means (i) the period between the date a Dividend Equivalent is granted and the date the related Stock Option, Stock Appreciation Right, or other Award is exercised, terminates, or is converted to Common Stock, or (ii) such other time as the Administering Body may specify in the written instrument evidencing the grant of the Dividend Equivalent.

"AWARD" means any Stock Option, Performance Award, Restricted Stock, Stock Appreciation Right, Stock Payment, Stock Bonus, Stock Sale, Phantom Stock, Dividend Equivalent, or Other Stock-Based Benefit granted or sold to an Eligible Person under this Plan.

"AWARD DOCUMENT" means the agreement or confirming memorandum setting forth the terms and conditions of an Award.

"BOARD" means the Board of Directors of the Company.

"CHANGE IN CONTROL" means the following and shall be deemed to occur if any of the following events occur:

(a) Any Person becomes the beneficial owner (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of thirty percent (30%) or more of either the then outstanding shares of Common Stock or the combined voting power of the Company's then outstanding securities entitled to vote generally in the election of directors; or

(b) Individuals who, as of the effective date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board of Directors of the Company, provided that any individual who becomes a director after the effective date hereof whose election, or nomination for election by the Company's Shareholders, is approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered to be a member of the Incumbent Board unless that individual was nominated or elected by any Person having the power to exercise, through beneficial ownership, voting agreement and/or proxy, twenty percent (20%) or more of either the outstanding shares of Common Stock or the combined voting power of the Company's then outstanding voting securities entitled to vote generally in the election of directors, in which case that individual shall not be considered to be a member of the Incumbent Board unless such individual's election or nomination for election by the Company's Shareholders is approved by a vote of at least two-thirds of the directors then comprising the Incumbent Board; or

(c) Consummation by the Company of the sale or other disposition by the Company of all or substantially all of the Company's assets or a reorganization or merger or consolidation of the Company with any other person, entity or corporation, other than

(i) a reorganization or merger or consolidation that would result in the voting securities of the Company outstanding immediately prior thereto (or, in the case of a reorganization or merger or consolidation that is preceded or accomplished by an acquisition or series of related acquisitions by any Person, by tender or exchange offer or otherwise, of voting securities representing five percent (5%) or more of the combined voting power of all securities of the Company, immediately prior to such acquisition or the first acquisition in such series of acquisitions) continuing to represent, either by remaining outstanding or by being converted into voting securities of another entity, more than fifty percent (50%) of the combined voting power of the voting securities of the Company or such other entity outstanding immediately after such reorganization or merger or consolidation (or series of related transactions involving such a reorganization or merger or consolidation), or

(ii) a reorganization or merger or consolidation effected to implement a recapitalization or reincorporation of the Company (or similar transaction) that does not result in a material change in beneficial ownership of the voting securities of the Company or its successor; or

(d) Approval by the Shareholders of the Company or any order by a court of competent jurisdiction of a plan of liquidation of the Company.

"COMMISSION" means the Securities and Exchange Commission.

"COMMON STOCK" means the common stock of the Company, as constituted on the Effective Date of this Plan, and as thereafter adjusted as a result of any one or more events requiring adjustment of outstanding Awards under Section 3.4 above.

"COMPANY" means Callaway Golf Company, a Delaware corporation.

"COMMITTEE" means the committee appointed by the Board to administer this Plan pursuant to Section 4.1.

"DIVIDEND EQUIVALENT" means a right granted by the Company under Section 6.6 to a holder of a Stock Option, Stock Appreciation Right or other Award denominated in shares of Common Stock to receive from the Company during the Applicable Dividend Period payments equivalent to the amount of dividends payable to holders of the number of shares of Common Stock underlying such Stock Option, Stock Appreciation Right, or other Award.

"EFFECTIVE DATE" means February 18, 1998, which is the date this Plan was adopted by the Board.

"ELIGIBLE PERSON" shall include directors, officers, employees, consultants and advisors of the Company or of any Affiliated Entity.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

"EXCHANGE ACT" means the Securities Exchange Act of 1934, as amended.

"EXPIRATION DATE" means the 10th anniversary of the Effective Date.

"FAIR MARKET VALUE" of a share of the Company's capital stock as of a particular date shall be (i) if the stock is listed on an established stock exchange or exchanges (including for this purpose, the Nasdaq National Market), the closing price of the stock quoted for such date as reported in the Transactions Index of each such exchange, as published in The Wall Street Journal and determined by the Administering Body, or, if no closing price was quoted in any such Index for such date, then as of the next preceding date on which such a closing price was quoted; or (ii) if the stock is not then listed on an exchange or the Nasdaq National Market, the average of the closing bid and asked prices per share for the stock in the over-the-counter market as quoted on The Nasdaq Small Cap Market on such date (in the case of (i) or (ii), subject to adjustment as and if necessary and appropriate to set an exercise price not less than 100% of the fair market value of the stock on the date an option is granted); or (iii) if the stock is not then listed on an exchange or quoted in the over-the-counter market, an amount determined in good faith by the Administering Body; provided, however, that (A) when appropriate, the Administering Body, in determining Fair Market Value of capital stock of the Company, may take into account such other factors as it may deem appropriate under the circumstances and (B) if the stock is traded on the Nasdaq Small Cap Market and both sales prices and bid and asked prices are quoted or available, the Administering Body may elect to determine Fair Market Value under either clause (i) or (ii) above. Notwithstanding the foregoing, the Fair Market Value of capital stock for purposes of grants of Incentive Stock Options shall be determined in compliance with applicable provisions of the IRC. The Fair Market Value of rights or property other than capital stock of the Company means the fair market value thereof as determined by the Committee on the basis of such factors as it may deem appropriate.

"INCENTIVE STOCK OPTION" means a Stock Option that qualifies as an incentive stock option under Section 422 of the IRC, or any successor statute thereto.

"IRC" means the Internal Revenue Code of 1986, as amended.

"NONQUALIFIED STOCK OPTION" means a Stock Option that is not an Incentive Stock Option.

"OTHER STOCK-BASED BENEFITS" means an Award granted under Section 6.9 of this Plan.

"PARENT CORPORATION" means any Parent Corporation as defined in Section 424(e) of the IRC.

"PAYMENT EVENT" means the event or events giving rise to the right to payment of a Performance Award.

"PERFORMANCE AWARD" means an Award payable in Common Stock that vests and becomes payable over a period of time upon attainment of performance criteria established in connection with the grant of the Award.

"PERFORMANCE-BASED COMPENSATION" means performance-based compensation as described in Section 162(m) of the IRC. If the amount of compensation an Eligible Person will receive under any Award is not based solely on an increase in the value of Common Stock after the date of grant or award, the Committee, in order to qualify an Award as performance-based compensation under Section 162(m) of the IRC, can condition the grant, award, vesting, or exercisability of such an Award on the attainment of a preestablished, objective performance goal. For this purpose, a preestablished, objective performance goal may include one or more of the following performance criteria: (a) cash flow, (b) earnings per share (including earning before interest, taxes, depreciation and amortization), (c) return on equity, (d) total Shareholder return, (e) return on capital, (f) return on assets or net assets, (g) income or net income, (h) operating income or net operating income, (i) operating margin, (j) return on operating revenue, and (k) any other similar performance criteria.

"PERSON" means any person, entity or group, within the meaning of Section 13(d) or 14(d) of the Exchange Act, but excluding (i) the Company and its subsidiaries, (ii) any employee stock ownership or other employee benefit plan maintained by the Company that is qualified under ERISA and (iii) an underwriter or underwriting syndicate that has acquired the Company's securities solely in connection with a public offering thereof.

"PHANTOM STOCK" means an Award granted under Section 6.9 of this Plan.

"PLAN" means this 1998 Stock Incentive Plan of the Company.

"PLAN TERM" means the period during which this Plan remains in effect (commencing the Effective Date and ending on the Expiration Date).

"PURCHASE PRICE" means the purchase price (if any) to be paid by a Recipient for Restricted Stock as determined by the Committee (which price shall be at least equal to the minimum price required under applicable laws and regulations for the issuance of Common Stock which is nontransferable and subject to a substantial risk of forfeiture until specific conditions are met).

"RECIPIENT" means an Eligible Person who has received an Award under this Plan.

"REORGANIZATION" means any merger, consolidation or other reorganization.

"RESTRICTED STOCK" means Common Stock that is the subject of an Award made under Section 6.3 and that is nontransferable and subject to a substantial risk of forfeiture until specific conditions are met, as set forth in this Plan and in any statement evidencing the grant of such Award.

"RULE 16b-3" means Rule 16b-3 under the Exchange Act.

"SECURITIES ACT" means the Securities Act of 1933, as amended.

"SIGNIFICANT SHAREHOLDER" is an individual who, at the time a Stock Option is granted to such individual under this Plan, owns more than ten percent (10%) of the combined voting power of all classes of stock of the Company or of any Parent Corporation or Subsidiary Corporation (after application of the attribution rules set forth in Section 424(d) of the IRC).

"STOCK APPRECIATION RIGHT" means a right granted under Section 6.4 to receive a payment that is measured with reference to the amount by which the Fair Market Value of a specified number of shares of Common Stock appreciates from a specified date, such as the date of grant of the Stock Appreciation Right, to the date of exercise.

"STOCK BONUS" means an issuance or delivery of unrestricted or restricted shares of Common Stock under Section 6.7 of this Plan as a bonus for services rendered or for any other valid consideration under applicable law.

"STOCK PAYMENT" means a payment in shares of the Company's Common Stock to replace all or any portion of the compensation (other than base salary) that would otherwise become payable to a Recipient.

"STOCK OPTION" means a right to purchase stock of the Company granted under Section 6.1 of this Plan.

"STOCK SALE" means a sale of Common Stock to an Eligible Person under Section 6.8 of this Plan.

"SUBSIDIARY CORPORATION" means any Subsidiary Corporation as defined in Section 424(f) of the IRC.

# CALLAWAY GOLF COMPANY
# NON-EMPLOYEE DIRECTORS STOCK OPTION PLAN

(AS AMENDED AND RESTATED AUGUST 15, 2000)

## ARTICLE I
## GENERAL

1. ADOPTION. This Callaway Golf Company Non-Employee Directors Stock Option Plan (the "PLAN") is effective as of September 1, 1992, subject to approval by the Board of Directors and shareholders of Callaway Golf Company (the "COMPANY").

2. PURPOSE. The Plan is designed to promote the interests of the Company and its shareholders by using investment interests in the Company to attract and retain highly qualified independent directors.

3. ADMINISTRATION. The Plan shall be administered by the Company, which shall have the power to construe the Plan, to determine all questions arising under the Plan, to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable, and otherwise to carry out the terms of the Plan. The interpretation and construction by the administrator of any provisions of the Plan or of any option granted under the Plan shall be final. Notwithstanding the foregoing, the administrator shall have no authority or discretion as to the selection of persons eligible to receive options granted under the Plan, the number of shares covered by options granted under the Plan, the timing of such grants, or the exercise price of options granted under the Plan, which matters are specifically governed by the provisions of the Plan.

4. ELIGIBLE DIRECTORS. A person shall be eligible to receive grants of options under this Plan (an "ELIGIBLE DIRECTOR") if, at the time of the option's grant, he or she is a duly elected or appointed member of the Company's Board of Directors, but is not then otherwise an employee of the Company or any of its subsidiaries or affiliates and has not been an employee of the Company or any of its subsidiaries or affiliates since the beginning of the Company's preceding fiscal year.

5. SHARES OF COMMON STOCK SUBJECT TO THE PLAN AND GRANT LIMIT. The shares that may be issued upon exercise of options granted under the Plan shall be authorized and unissued shares of the Company's Common Stock. The aggregate number of shares that may be issued upon exercise of options granted under the Plan shall not exceed 840,000 shares of Common

Stock, subject to adjustment in accordance with Article III, and no individual may receive options under the Plan to purchase more than 120,000 shares of the Company's Common Stock, subject to adjustment in accordance with Article III.

6. AMENDMENT OF THE PLAN. The Company's Board of Directors may, insofar as permitted by law, from time to time suspend or discontinue the Plan or revise or amend it in any respect whatsoever, except that no such amendment shall alter or impair or diminish any rights or obligations under any option theretofore granted under the Plan without the consent of the person to whom such option was granted. In addition, without further shareholder approval, the Plan may not be amended so as to increase the number of shares subject to the Plan (as adjusted under Article III), increase the number of shares for which an option or options may be granted to any optionee (as adjusted under Article III), change the class of persons eligible to receive options under the Plan, provide for the grant of options having an exercise price per option share less than the exercise price specified in the Plan, or extend the final date upon which options may be granted under the Plan. Under no circumstances may the provisions of the Plan that provide for the amounts, price, and timing of option grants be amended more than once every six months, other than to comport with changes in the Internal Revenue Code, ERISA, or the rules thereunder.

7. TERM OF PLAN. Options may be granted under the Plan until September 1, 2002, whereupon the Plan will terminate. Notwithstanding the foregoing, each option granted under the Plan shall remain in effect until such option has been exercised or terminated in accordance with its terms and the terms of the Plan.

8. GRANTS BEFORE SHAREHOLDER APPROVAL. Option grants made before this Plan has been approved by the Company's shareholders shall be made subject to and effective only upon such approval.

9. RESTRICTIONS. All options granted under the Plan shall be subject to the requirement that, if at any time the Company shall determine, in its discretion, that the listing, registration or qualification of the shares subject to options granted under the Plan upon any securities exchange or under any state or federal law, or the consent or approval of any government regulatory body, is necessary or desirable as a condition of, or in connection with, the granting of such an option or the issuance, if any, or purchase of shares in connection therewith, such option may not be exercised in whole or in part unless such listing, registration, qualification, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Company.

As Amended and Restated August 15, 2000

10. NONASSIGNABILITY. No option granted under the Plan shall be assignable or transferable by the grantee except by will or by the laws of descent and distribution or pursuant to a qualified domestic relations order (as defined by the Internal Revenue Code of 1986, as amended). During the lifetime of the optionee, the option shall be exercisable only by the optionee, and no other person shall acquire any rights therein.

11. WITHHOLDING TAXES. Whenever shares of Common Stock are to be issued upon exercise of an option granted under the Plan, the administrator shall have the right to require the optionee to remit to the Company an amount sufficient to satisfy any federal, state and local withholding tax requirements prior to the delivery of any certificate or certificates for such shares. The administrator may, in the exercise of its discretion, allow satisfaction of tax withholding requirements by accepting delivery of stock of the Company or by withholding a portion of the Common Stock otherwise issuable upon exercise of an option.

12. DEFINITION OF "FAIR MARKET VALUE." For purposes of the Plan, the term "FAIR MARKET VALUE," when used in reference to the value of a share of the Company's Common Stock on the date an option is granted under the Plan, shall be: (a) if the Common Stock is listed on an established stock exchange or exchanges, the mean between the highest and lowest sale prices of the Common Stock quoted in the Transactions Index of each such exchange as averaged with such mean price as reported on any and all other exchanges, as published in "The Wall Street Journal" and determined by the Company, or, if no sale price was quoted in any such Index for such date, then as of the next preceding date on which such a sale price was quoted, provided that the mean on such preceding date is not less than 100% of the fair market value of the Common Stock on the date the option is granted; or, (b) if the Common Stock is not then listed on an exchange, the average of the closing bid and asked prices per share for the Common Stock in the over-the-counter market as quoted on NASDAQ on such date; or, (c) if the Common Stock is not then listed on an exchange or quoted on NASDAQ, an amount determined in good faith by the Company.

13. RIGHTS AS A SHAREHOLDER. An optionee or a transferee of an option shall have no rights as a shareholder with respect to any shares issuable or issued upon exercise of the option until the date of the receipt by the Company of all amounts payable in connection with exercise of the option, including the exercise price and any amounts required by the Company pursuant to Section 11 of Article I.

14. PURCHASE FOR INVESTMENT. Unless the shares of Common Stock to be issued upon exercise of an option granted under the Plan have been

effectively registered under the Securities Act of 1933 as now in force or hereafter amended, the Company shall be under no obligation to issue any shares of Common Stock covered by any option unless the person who exercises such option, in whole or in part, shall give a written representation and undertaking to the Company which is satisfactory in form and scope to counsel to the Company and upon which, in the opinion of such counsel, the Company may reasonably rely, that he or she is acquiring the shares of Common Stock issued to him or her pursuant to such exercise of the option for his or her own account as an investment and not with a view to, or for sale in connection with, the distribution of any such shares of Common Stock, and that he or she will make no transfer of the same except in compliance with any rules and regulations in force at the time of such transfer under the Securities Act of 1933, or any other applicable law, and that if shares of Common Stock are issued without such registration, a legend to this effect may be endorsed upon the securities so issued.

15. GOVERNING LAW. This Plan and any stock options granted hereunder shall be governed by and construed in accordance with the internal laws of the State of Delaware and applicable federal law.

## ARTICLE II
## STOCK OPTIONS

1. GRANTS OF INITIAL OPTIONS.

(a) Each Eligible Director who becomes an Eligible Director in 1992 shall, upon first becoming an Eligible Director, receive a one-time grant of an option to purchase up to 80,000 shares of the Company's Common Stock at an exercise price of $2.50 per share, subject to (i) vesting as set forth in Section 4 of Article II, and (ii) adjustment as set forth in Article III.

(b) Each Eligible Director who becomes an Eligible Director from January 1, 1993 through April 17, 1996 shall, upon first becoming an Eligible Director, receive a one-time grant of an option to purchase up to 80,000 shares of the Company's Common Stock at an exercise price per share equal to 75% of the fair market value of the Company's Common Stock on the date of his or her election to the Board, subject to (i) vesting as set forth in Section 4 of Article II, and (ii) adjustment as set forth in Article III.

(c) Each Eligible Director who becomes an Eligible Director from April 18, 1996 through August 17, 1999 shall, upon first becoming an Eligible Director, receive a one-time grant of an option to purchase up to 80,000 shares of the Company's Common Stock at an exercise price per share equal to the fair market value of the Company's Common Stock on the date of his or her election to the Board, subject to (i) vesting as set forth in Section 4 of Article II, and (ii) adjustment as set forth in Article III.

(d) Each Eligible Director who becomes an Eligible Director after August 17, 1999 shall, upon first becoming an Eligible Director, receive a one-time grant of an option to purchase up to 20,000 shares of the Company's Common Stock at an exercise price per share equal to the fair market value of the Company's Common Stock on the date of his or her election to the Board, subject to (i) vesting as set forth in Section 4 of Article II, and (ii) adjustment as set forth in Article III.

(e) Options granted under Sections 1(a) through 1(d) of this Article II are "INITIAL OPTIONS" for purposes hereof.

2. GRANTS OF ADDITIONAL AND SPECIAL OPTIONS.

(a) Prior to January 1, 2000, on each even-numbered (i.e. 2nd, 4th, 6th, 8th, 10th) anniversary of an Eligible Director's election to the Board, if the Eligible Director has served as a director since his or her election and is continuing as a director for at least another year, such Eligible Director shall automatically be granted an "ADDITIONAL OPTION" to purchase up to 8,000 shares of the Company's Common Stock at an exercise price equal to the fair market value of the Company's Common Stock on the date of grant, subject to (i) vesting as set forth in Section 4 of Article II, and (ii) adjustment as set forth in Article III.

(b) Beginning January 1, 2000, on each anniversary of an Eligible Director's election to the Board, if the Eligible Director has served as a director since his or her election and is continuing as a director for at least another year, such Eligible Director shall automatically be granted an "ADDITIONAL OPTION" to purchase up to 4,000 shares of the Company's Common Stock at an exercise price equal to the fair market value of the Company's Common Stock on the date of grant, subject to (i) vesting as set forth in Section 4 of Article II and (ii) adjustment as set forth in Article III.

(c) Each Eligible Director who has an odd-numbered (i.e. 1st, 3rd, 5th, 7th) anniversary in 1999 shall receive a "SPECIAL OPTION" on August 17, 1999 to purchase up to 4,000 shares of the Company's Common Stock at an exercise price equal to the fair market value of the Company's Common Stock on the date of grant, subject to (i) vesting as set forth in Section 4 of Article II, and (ii) adjustment as set forth in Article III.

(d) No individual may receive aggregate Additional Options and Special Options to purchase more than 40,000 shares of the Company's Common Stock pursuant to this Section.

3. EXERCISE PRICE. The option exercise price shall be payable upon the exercise of an option in legal tender of the United States or such other consideration as the administrator may deem acceptable, including without limitation stock of the Company (delivered by or on behalf of the person exercising the option or retained by the Company from the Common Stock otherwise issuable upon exercise), provided, however, that the administrator may, in the exercise of its discretion, (i) allow exercise of an option in a broker-assisted or similar transaction in which the exercise price is not received by the Company until immediately after exercise, and/or (ii) allow the Company to loan the exercise price to the person entitled to exercise the option, if the exercise will be followed by an immediate sale of some or all of the underlying shares and a portion of the sales proceeds is dedicated to full payment of the exercise price. Upon proper exercise, the Company shall deliver to the person entitled to exercise the option or his or her designee a certificate or certificates for the shares of Common Stock to which the option pertains.

4. VESTING AND EXERCISE.

(a) Initial Options shall vest and become exercisable 50% upon the first anniversary of the grant date, if the optionee has remained an Eligible Director for the entire period from the date of grant to the first anniversary thereof, and 50% upon the second anniversary of the grant date, if the optionee has remained an Eligible Director for the entire period from the date of grant to the second anniversary thereof.

(b) Prior to January 1, 2000, Additional Options shall vest and become exercisable 50% upon the first anniversary of the grant date, if the optionee has remained an Eligible Director for the entire period from the date of grant to the first anniversary thereof, and 50% upon the second anniversary of the grant date, if the optionee has remained an Eligible Director for the entire period from the date of grant to the second anniversary thereof. Beginning January 1, 2000, Additional Options shall vest and become exercisable 100% two years from the grant date if the optionee has remained an Eligible Director for the entire period from the date of grant to the vesting date.

(c) Each Special Option shall vest and become exercisable 100% on the second anniversary date of the Eligible Director's election to the Board that occurs following the grant date if the optionee has remained an Eligible Director for the entire period from the date of grant to the vesting date.

5. OPTION AGREEMENTS. Each option granted under the Plan shall be evidenced by an option agreement duly executed on behalf of the Company and by the Eligible Director to whom such option is granted and stating the number of shares of Common Stock issuable upon exercise of the option, the exercise price, the time during which the option is exercisable, and the times at which the options vest and become exercisable. Such option agreements may but need not be identical and shall comply with and be subject to the terms and conditions of the Plan, a copy of which shall be provided to each option recipient and incorporated by reference into each option agreement. Each option agreement may contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the administrator.

6. TERM OF OPTIONS AND EFFECT OF TERMINATION. Notwithstanding any other provision of the Plan, no Initial Options, Additional Options or Special Options shall be exercisable after the expiration of ten years from the effective date of their grant. In the event that any outstanding option under the Plan expires by reason of lapse of time or is otherwise terminated without exercise for any reason, then the shares of Common Stock subject to any such option which have not been issued pursuant to the exercise of the option shall again become available in the pool of shares of Common Stock for which options may be granted under the Plan. In the event that the holder of any option granted under this Plan shall cease to be a director of the Company for any reason, all options granted under this Plan to such holder shall be exercisable, to the extent already exercisable at the date such holder ceases to be a director, for a period of one year after that date (or, if sooner, until the expiration of the option according to its terms), and shall then terminate. In the event of the death of an optionee while such optionee is a director of the Company or within the period after termination of such status during which he or she is permitted to exercise an option, such option may be exercised by any person or persons designated by the optionee on a Beneficiary Designation Form adopted by the administrator for such purpose or, if there is no effective Beneficiary Designation Form on file with the Company, by the executors or administrators of the optionee's estate or by any person or persons who shall have acquired the option directly from the optionee by his or her will or the applicable laws of descent and distribution.

ARTICLE III
RECAPITALIZATIONS AND REORGANIZATIONS

1. ANTI-DILUTION ADJUSTMENTS. The number of shares of Common Stock available for issuance upon exercise of options granted under the Plan, the maximum number of shares for which options granted under the Plan may be exercised by any individual, the number of shares for which each option (issued and unissued) can be exercised, and the exercise price per share of options (issued and unissued) shall be proportionately adjusted for any increase or decrease in the number of issued and outstanding shares of Common Stock resulting from a subdivision or consolidation of shares or the payment of a stock dividend or any other increase or decrease in the number of issued and outstanding shares of Common Stock effected without receipt of consideration by the Company. All share amounts and exercise prices set forth in this amended plan document have been restated to take into account, and give full effect to, any and all stock splits implemented since the adoption and approval of the Plan by shareholders on April 29, 1993 and before April 17, 1996.

2. CORPORATE TRANSACTIONS. If the Company shall be the surviving corporation in any merger or consolidation, each outstanding option shall pertain to and apply to the securities to which a holder of the same number of shares of Common Stock that are subject to that option would have been entitled. A dissolution or liquidation or change in control of the Company, or a merger or consolidation in which the Company is not the surviving corporation, shall cause each outstanding option to terminate, unless the agreement of merger or consolidation shall otherwise provide; provided that, in the event such dissolution, liquidation, change in control, merger or consolidation will cause outstanding options to terminate, each optionee shall have the right immediately prior to such dissolution, liquidation, merger or consolidation or upon such change in control to exercise his or her option or options in whole or in part without regard to any vesting requirements. For purposes hereof, a "change in control" shall be the acquisition by any person or entity of beneficial ownership of 50% or more of the Company's outstanding voting securities.

3. DETERMINATION BY THE COMPANY. To the extent that the foregoing adjustments relate to stock or securities of the Company, such adjustments shall be made by the administrator, whose determination in that respect shall be final, binding and conclusive. The grant of an option pursuant to the Plan shall not affect in any way the right or power of the Company to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or to consolidate or to dissolve, liquidate or sell, or transfer all of any part of its business or assets.

As Amended and Restated August 15, 2000

EXHIBIT 10.46

# GRANTOR STOCK TRUST

## AMENDMENT NO. 1
## TO
## TRUST AGREEMENT

This Amendment No. 1 to Trust Agreement is made and entered into effective as of June 29, 2001, by Callaway Golf Company, a Delaware corporation ("Callaway Golf").

## BACKGROUND

A. Effective on or about July 14, 1995, Callaway Golf and Sanwa Bank California ("Sanwa") entered into a certain Trust Agreement (the "Trust Agreement") establishing the Callaway Golf Company Grantor Stock Trust.

B. Effective on or about August 24, 2000, Sanwa assigned to Arrowhead Trust Incorporated, California, a California trust company ("Arrowhead" or "Trustee"), all of Sanwa's right, and Arrowhead assumed all of Sanwa's obligations, under the Trust Agreement.

C. Callaway Golf, pursuant to Section 14.1 of the Trust Agreement, desires to amend the Trust Agreement upon the following terms.

## AGREEMENT

In consideration of the foregoing Background, Callaway Golf does hereby amend the Trust Agreement as follows:

1. Section 1.1 of the Trust Agreement is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

> 1.1 "Administrator" or "Administrators" shall refer to the Committee or other person or entity charged with responsibility for overseeing and administering the Plans and provisions of Benefits.

2. Section 1.8 of the Trust Agreement is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

> 1.8 "Committee" shall mean such committee as the Board of Directors shall appoint from time to time to administer the Trust.

3. Section 1.11 of the Trust Agreement is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

1.11 "Director" shall mean the Senior Vice President of Human Resources.

4. Section 1.12 is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

1.12. "Eligible Participant" shall mean a Participant who is an Employee who as of the dates upon which Eligible Participants are determined, either (a) holds an unexercised option with respect to Company Stock granted to him or her pursuant to any Stock Option Plan or (b) elected to purchase stock pursuant to a Stock Purchase Plan within the 12 month period proceeding such date.

5. Section 1.20 is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

1.20. "Stock Option Plan" shall mean any plan of the Company listed on Schedule A from time to time pursuant to which options to purchase the Company's Common Stock have been granted or may be granted.

6. Section 1.21 is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

1.21. "Stock Purchase Plan" shall mean the Company's 1999 Employee Stock Purchase Plan or such other employee stock purchase plan as may be listed on Schedule A from time to time by the Company.

7. The last sentence of Section 2.1 is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

2.1 The Trustee, and any Successor Trustee appointed pursuant to Section 11 hereof or resulting under Subsection 19.4 hereof, shall at all times be a bank, trust company or other financial institution that is neither a subsidiary of nor other firm related by direct or indirect stock ownership to the Company.

8. The first sentence of Section 4.1.2 is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

4.1.2. From time to time, the Trustee shall have the ability, upon direction of the Committee, to borrow funds from the Company for the purpose of acquiring shares of Company Stock and/or to issue one or more notes to the Company (together with such other consideration as is required by applicable law) in exchange for shares of Company Stock.

9. The following new sentence shall be added to the end of Section 4.2.12:

> "With respect to any shares of Company Stock, the Trustee, in lieu of a stock certificate, may elect to establish a book-entry accrual with the Company's transfer agent."

10. Section 4.2.14 is hereby deleted in its entirety, and in lieu thereof, the following shall be inserted:

> Pursuant to the direction of the Committee as to all aspects of the transaction, including, without limitation, interest rate and term, to undertake a borrowing sufficient to enable the Trust to acquire Company Stock from the Company.

11. Sections 16.1, 16.2 and 16.3 are hereby deleted in their entirety, and in lieu thereof, the following shall be inserted:

> Section 16. Communications.
>
> 16.1 To the Company, Board of Directors and Committee. Communications to the Company, the Board of Directors and the Committee shall be addressed to:
>
> Callaway Golf Company
> 2180 Rutherford Road
> Carlsbad, California 92008-8815
> Attention: Chief Financial Officer
>
> with a copy to:
>
> Callaway Golf Company
> 2180 Rutherford Road
> Carlsbad, California 92008-8815
> Attention: Chief Legal Officer
>
> provided, however, that upon the Company's written request, such communications shall be sent to such other address as the Company may specify.
>
> 16.2 To the Trustee. Communications to the Trustee shall be addressed to:
>
> Arrowhead Trust
> Attention: Mable Pascascio
> Trust Officer
> 24 Executive Park, Suite 125
> Irvine, Ca 92614

provided, however, that upon the Trustee's written request, such communications shall be sent to such other address as the Trustee may specify.

16.3 To a Participant. Communications to a Participant or to his or her Beneficiaries shall be addressed to the Participant or his or her Beneficiaries, respectively, at the address indicated on the Company's payroll records at the time of the communication.

12. Schedule A to the Trust Agreement is hereby deleted in its entirety, and in lieu thereof, the Schedule A-(R1) attached hereto shall be inserted.

13. After the date of this Amendment, each reference in the Trust Agreement to "this Agreement," "hereunder," "hereof," "herein" or words of like import, shall mean and refer to the Trust Agreement as amended hereby. The Trust Agreement, as amended hereby, shall remain in full force and effect in accordance with its terms and is hereby ratified and confirmed. In addition, each reference to "Sanwa" or "Sanwa Bank" shall be deemed to be a reference to Trustee.

14. This Amendment may be executed in counterparts, each of which shall be deemed to be an original, and all such separate counterparts shall together constitute but one and the same instrument.

15. This Amendment shall be governed by and construed in accordance with the laws of the State of California.

IN WITNESS WHEREOF, the undersigned have executed this Amendment No. 1 to Trust Agreement as of the date first above written.

CALLAWAY GOLF COMPANY:

By: /s/ RONALD A. DRAPEAU
---------------------
Print Name: Ronald A. Drapeau
Print Title: President and Chief Executive Officer

SCHEDULE A -- (R1)

Plans

1991 Stock Incentive Plan
1995 Employee Stock Incentive Plan
1996 Stock Option Plan
Plan 1998 Stock Incentive Plan
1999 Employee Stock Purchase Plan
401(k) Plan
Executive Deferred Compensation Plan
Medical and Health Insurance Plan
Dental Insurance Plan
Vision Plan
Regular Salary and Overtime
Trust to fund any of the above mentioned Plans.

Consent

The undersigned, Arrowhead Trust Incorporated, effective as of June 29, 2001, pursuant to Section 14.1 of that certain Trust Agreement dated July 14, 1995, does hereby consent to the foregoing Amendment No. 1 to Trust Agreement.

ARROWHEAD TRUST INCORPORATED:

By: /s/ MABLE PASCASCIO
-------------------
Print Name: Arrowhead Trust Inc.
Mable Pascascio
Print Title: Trust Officer

SELECTED FINANCIAL DATA(1)

| (IN THOUSANDS, EXCEPT PER SHARE DATA) | | | | | YEAR ENDED DECEMBER 31, |
|---|---|---|---|---|---|
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| Statement of Operations Data: | | | | | |
| Net sales | $ 816,163 | $ 837,627 | $ 719,038 | $ 703,060 | $ 848,941 |
| Cost of sales | 411,585 | 440,119 | 384,265 | 410,341 | 408,345 |
| Gross profit | 404,578 | 397,508 | 334,773 | 292,719 | 440,596 |
| Selling, general and administrative expenses | 259,364 | 240,874 | 221,043 | 241,775 | 189,109 |
| Research and development expenses | 32,697 | 34,579 | 34,002 | 36,848 | 30,298 |
| Restructuring (credits) expenses | -- | -- | (5,894) | 54,235 | -- |
| Sumitomo transition expenses | -- | -- | 5,713 | -- | -- |
| Litigation settlement | -- | -- | -- | -- | 12,000 |
| Income (loss) from operations | 112,517 | 122,055 | 79,909 | (40,139) | 209,189 |
| Interest and other income, net | 7,149 | 8,791 | 9,182 | 3,911 | 4,586 |
| Interest expense | (1,552) | (1,524) | (3,594) | (2,671) | (10) |
| Unrealized energy derivative losses | (19,922) | -- | -- | -- | -- |
| Income (loss) before income taxes and cumulative effect of accounting change | 98,192 | 129,322 | 85,497 | (38,899) | 213,765 |
| Income tax provision (benefit) | 39,817 | 47,366 | 30,175 | (12,335) | 81,061 |
| Income (loss) before cumulative effect of accounting change | 58,375 | 81,956 | 55,322 | (26,564) | 132,704 |
| Cumulative effect of accounting change | -- | (957) | -- | -- | -- |
| Net income (loss) | $ 58,375 | $ 80,999 | $ 55,322 | $ (26,564) | $ 132,704 |
| Earnings (loss) per common share: | | | | | |
| Basic | | | | | |
| Income (loss) before cumulative effect of accounting change | $ 0.84 | $ 1.17 | $ 0.79 | $ (0.38) | $ 1.94 |
| Cumulative effect of accounting change | -- | (0.01) | -- | -- | -- |
| Net income (loss) | $ 0.84 | $ 1.16 | $ 0.79 | $ (0.38) | $ 1.94 |
| Diluted | | | | | |
| Income (loss) before cumulative effect of accounting change | $ 0.82 | $ 1.14 | $ 0.78 | $ (0.38) | $ 1.85 |
| Cumulative effect of accounting change | -- | (0.01) | -- | -- | -- |
| Net income (loss) | $ 0.82 | $ 1.13 | $ 0.78 | $ (0.38) | $ 1.85 |
| Dividends paid per share | $ 0.28 | $ 0.28 | $ 0.28 | $ 0.28 | $ 0.28 |

| (IN THOUSANDS) | | | | | DECEMBER 31, |
|---|---|---|---|---|---|
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| Balance Sheet Data: | | | | | |
| Cash and cash equivalents | $ 84,263 | $ 102,596 | $ 112,602 | $ 45,618 | $ 26,204 |
| Marketable securities | $ 6,422 | $ -- | $ -- | $ -- | $ -- |
| Working capital | $ 252,817 | $ 233,163 | $ 205,198 | $ 139,598 | $ 209,402 |
| Total assets | $ 647,602 | $ 630,934 | $ 616,783 | $ 655,827 | $ 561,714 |
| Long-term liabilities | $ 31,379 | $ 9,884 | $ 11,575 | $ 18,723 | $ 7,905 |
| Total shareholders' equity | $ 514,349 | $ 511,744 | $ 499,934 | $ 453,096 | $ 481,425 |

(1) This information should be read in conjunction with the information set forth below in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the "Notes to Consolidated Financial Statements."

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

## RESULTS OF OPERATIONS

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to provisions for warranty, uncollectible accounts receivable, inventory obsolescence, restructuring costs and market value estimates of derivative instruments. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

## YEARS ENDED DECEMBER 31, 2001 AND 2000

For the year ended December 31, 2001, net sales decreased $21.4 million (3%) to $816.2 million from $837.6 million in the prior year. The decrease is due to a decline in the sales of irons and metal woods, partially offset by an increase in sales of golf balls, putters and accessories. This decline was also the result of the timing of the launch of the Company's new products. The Company did not begin selling its 2002 products in significant quantities in 2001 and thus did not repeat the late-season launch of new products that occurred in 2000.

The decline in iron sales of $51.0 million (17%) to $248.9 million represents a decrease in both unit and dollar sales. A decline was expected as the Company's products generally sell better in their first year after introduction and 2001 was the second year in the life cycle of the Big Bertha Steelhead X-14 Stainless Steel Irons. Declines in other older iron models such as the Hawk Eye Tungsten Injected irons were partially offset by the introduction of the Hawk Eye VFT Irons in the second half of the year.

The sales of metal woods decreased $10.1 million (2%) to $392.9 million. Similar to the decline in iron sales, this decline represents a decrease in both unit and dollars sales and is primarily attributable to a decline in sales of Big Bertha Steelhead Plus Stainless Steel Metal Woods, which were introduced in January 2000. The decline in metal woods was partially offset by net increases generated by the introduction of the Big Bertha Hawk Eye VFT Metal Woods and ERC II Forged Titanium Drivers which more than offset the decrease in sales of their predecessors, Great Big Bertha Hawk Eye Metal Woods and ERC Forged Titanium Drivers, respectively.

The increase in golf ball sales of $20.9 million (62%) to $54.9 million was primarily due to the introduction of the CB1 and CTU 30 golf balls during 2001. Sales of putters, accessories and other products increased $18.8 million (18%) to $119.5 million in 2001 due primarily to increased sales of Odyssey putters and golf bags in 2001.

The Company believes the overall decline in net sales is primarily due to poor weather conditions, a general decline in the number of golf rounds played during the year, aggressive competitive pricing strategies in the industry, economic concerns among retailers and customers in many of the Company's key markets around the world, the disruption in consumer spending following the September 11th tragedy, and the United States Golf Association's actions in the United States against the Big Bertha ERC II Forged Titanium 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 during 2001 as compared to 2000. As compared to the year ended December 31, 2000, a decline in foreign currency exchange rates adversely impacted net sales for the year ended December 31, 2001 by approximately $32.9 million, as measured by applying 2000 exchange rates to 2001 net sales.

During 2001, net sales in the United States decreased $7.1 million (2%) to $444.1 million as compared to net sales during 2000. Overall, the Company's net sales in regions outside the United States decreased $14.3 million (4%) to $372.1 million during 2001 as compared to 2000. Had exchange rates during 2001 been the same as exchange rates during 2000, overall net sales in regions outside of the United States would have been approximately 9% higher than reported in 2001. Net sales by regions outside of the United States in 2001 are as follows:

IN MILLIONS, EXCEPT PERCENT DATA

| | Net Sales | Dollar Growth | Percent Growth |
|---|---|---|---|
| Japan | $130.7 | $ 8.7 | 7% |
| Europe | 118.4 | (7.1) | (6%) |
| Rest of Asia including Korea | 63.9 | (18.5) | (22%) |
| Rest of World | 59.1 | 2.6 | 5% |
| | $372.1 | $(14.3) | |

The Company acquired certain of its distribution rights in the Europe and Rest of World regions in the first quarter of 2001 and therefore began selling directly to retailers rather than to a third party distributor.

For the year ended December 31, 2001, gross profits increased to $404.6 million from $397.5 million in 2000 and as a percentage of net sales increased to 50% in 2001 from 47% in 2000. This improvement in gross profit is a result of a shift in club product mix away from lower yielding iron products to higher yielding wood products. Golf ball product profit margins improved during 2001 as compared to 2000, as a result of increased sales volume, plant utilization and production yields. The profit margin was also favorably affected by an $8.1 million reduction in the Company's warranty expense during 2001 as compared to 2000. The Company has observed a downward trend in actual costs over the past two years associated with warranty claims due to improved product engineering and manufacturing processes combined with a reduction of costs associated with resolving claims. Accordingly, the Company reduced its warranty accrual rate during 2001. The Company believes that its warranty accrual is adequate to cover future claims and will continue to monitor the warranty accrual rate. The Company may adjust the warranty accrual rate from time to time based on various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty.

Selling expenses in 2001 increased to $188.3 million from $170.5 million in 2000. As a percentage of net sales, these expenses increased to 23% in 2001 from 20% in 2000. The increase is primarily due to increases in advertising costs and promotional expenses of $9.6 million and $5.8 million, respectively, associated with the Company's new product launches, the rollout of new fitting cart systems and store-in-store project, and other demand creation initiatives.

General and administrative expenses increased to $71.1 million in 2001 from $70.3 million in 2000. As a percentage of net sales, these expenses increased to 9% in 2001 from 8% in 2000. The increase is primarily attributed to $4.0 million of higher employee compensation costs including severance charges, $3.7 million of increased costs due primarily to the consolidation of facilities and $2.9 million of increased legal expenses, partially offset by decreases in depreciation and bad debt expenses of $3.5 million and $5.1 million, respectively.

Research and development expenses in 2001 decreased to $32.7 million from $34.6 million in 2000. As a percentage of net sales, these expenses remained constant at 4% of net sales. The dollar decrease is due to a decrease in depreciation expense and employee costs.

Interest and other income decreased to $7.1 million in 2001 from $8.8 million in 2000. This decrease is primarily attributable to a decrease in interest income of $4.7 million associated with lower average cash balances, and lower interest rates, in 2001 as compared with 2000, and realized losses of $2.1 million generated from the sale of the Company's excess energy supply, partially offset by a $2.7 million increase in foreign currency transaction gains, a $1.5 million increase in realized marketable securities gains, and a $0.6 million increase in royalty income. Interest expense remained relatively constant in 2001 at $1.6 million compared to $1.5 million in 2000.

Unrealized energy derivative losses totaled $19.9 million in 2001 as a result of the Company's long-term energy supply contract which was entered into during 2001. The unrealized losses were generated by the decline in electricity rates through November, 2001. The Company did not have a similar contract in 2000. See "Supply of Electricity and Energy Contracts" below.

During 2001, the Company recorded a provision for income taxes of $39.8 million and recognized a decrease in deferred taxes of $5.1 million. During 2001, the Company realized $14.5 million in tax benefits related to the exercise of stock options. The provision for income tax as a percentage of income before taxes was 41% in 2001 as compared with 37% in 2000. The effective tax rate was higher in 2001 as compared to 2000 primarily as a result of the increased utilization of tax credits in 2000 and the unrealized energy derivative losses recognized during 2001.

Net income for 2001 decreased 28% to $58.4 million from $81.0 million in 2000. Earnings per diluted share during the year decreased 27% to $0.82 in 2001 as compared to $1.13 in 2000. During 2001, the Company recorded a non-cash charge of $14.2 million after-tax or $0.20 per diluted share, as a result of the change in estimated market value of the Company's energy supply contract. Excluding this non-cash energy supply contract charge, the Company's net income for 2001 as compared to 2000 would have decreased 10% to $72.6 million and diluted earnings per share would have decreased 10% to $1.02.

YEARS ENDED DECEMBER 31, 2000 AND 1999

For the year ended December 31, 2000, net sales increased $118.6 million, or 16%, to $837.6 million from $719.0 million in the prior year. The increase is attributable to an increase in sales of irons, golf balls and other products, including putters and accessories, partially offset by a decrease in sales of metal woods. The increase in sales of irons of 40% to $299.9 million represents an increase in both unit and dollar sales and is primarily attributable to sales of Great Big Bertha Hawk Eye Tungsten Injected Titanium Irons, which were not sold in significant quantities during 1999. Also contributing to the increase in sales of irons were sales of Big Bertha Steelhead X-14 Stainless Steel Irons, which were introduced in January 2000, and which generated higher revenues during 2000 than its predecessor, Big Bertha X-12 Stainless Steel Irons, did in 1999. This increase includes sales of $34.0 million of its Rule 35 golf balls during 2000. This product was not sold during 1999. The overall decrease in sales of metal woods of 3% to $403.0 million represents a decrease in both unit and dollar sales of titanium and non-current metal woods, partially offset by an increase in unit and dollar sales of stainless steel metal woods. The overall decrease in sales of metal woods is primarily attributable to sales of non-current products during 1999, which did not occur in significant quantities during the comparable period of 2000, and to a decrease in sales of Great Big Bertha Hawk Eye Titanium Metal Woods during 2000 as compared with 1999, the year in which they were introduced. However, sales of ERC Forged Titanium Drivers, which began shipping in significant quantities in the second quarter of 2000, and initial shipments of the Company's newly-introduced ERC II Forged Titanium Drivers and Big Bertha Hawk Eye VFT Titanium Metal Woods, which began shipping in limited quantities in December 2000, partially offset the decrease in sales of titanium metal woods. Also partially offsetting the decrease in sales of titanium metal woods was an increase in sales of stainless steel metal woods attributable to the January 2000 introduction of Big Bertha Steelhead Plus Stainless Steel Metal Woods, which generated higher revenue in 2000 than their predecessor, Big Bertha Steelhead Stainless Steel Metal Woods, did in 1999.

Net sales reflect the effect of a reclassification of shipping revenues from selling expenses. This reclassification, which added $5.5 million to net sales in 2000 and $4.6 million in 1999 was required by Emerging Issues Task Force Issue No. 00-10 ("EITF 00-10"), and did not result in a change in the Company's earnings or earnings per share for any period.

During 2000, sales in the United States increased $32.8 million (8%) to $451.2 million as compared to net sales during 1999. Overall, the Company's sales in regions outside the United States increased $85.8 million (29%) to $386.4 million during 2000 as compared to 1999. Overall sales in regions outside of the U.S. in 2000 as compared to 1999 were not significantly impacted by fluctuations in foreign currency exchange rates. Net sales by regions outside of the United States are as follows:

IN MILLIONS, EXCEPT PERCENT DATA

| | Net Sales | Dollar Growth | Percent Growth |
|---|---|---|---|
| Japan | $122.0 | $ 66.1 | 118% |
| Europe | 125.5 | 9.8 | 9% |
| Rest of Asia including Korea | 82.4 | 9.3 | 13% |
| Rest of World | 56.5 | 0.6 | 1% |
| | $386.4 | $ 85.8 | |

Net sales in Japan increased significantly because the Company began selling directly to customers in 2000 rather than through a distributor, as in prior years.

For the year ended December 31, 2000, gross profits increased to $397.5 million from $334.8 million in 2000 and as a percentage of net sales remained constant at 47%. Overall gross profit was adversely affected in 2000 by lower margins associated with manufacturing the Company's new golf balls which resulted primarily from low plant utilization and production yields. This effect was offset by improvements in golf club product margins. This improvement is primarily attributable to reductions in manufacturing labor and overhead expenses, favorable product mix primarily related to sales of ERC Forged Titanium Drivers and the negative effect on 1999 gross profits that resulted from close-out sales at substantially reduced prices.

Selling expense in 2000 increased to $170.5 million from $128.6 million in 1999, and as a percentage of net sales increased to 20% from 18%. These amounts include the reclassification of shipping revenue and expense, which were previously recorded in selling expense. The effect of this reclassification reduced selling expense by $5.7 million in 2000 and $3.3 million in 1999. The overall increase in selling expense was primarily attributable to incremental expenses associated with the launch of the Company's Rule 35 golf balls and with expanded golf club sales activity in the Company's Japanese subsidiary. Prior to 2000, Callaway Golf products were sold in Japan through a third party distributor. Expenses related to product endorsement also contributed to the increase.

General and administrative expense decreased to $70.3 million in 2000 from $92.5 million in 1999, and as a percentage of net sales decreased to 8% from 13%. This decrease is primarily attributable to the shifting of $18.4 million of costs associated with the Company's golf ball pre-production period from general and administrative expense in 1999 to cost of goods sold in 2000, as these costs were related to production of golf balls in 2000. Also contributing to the decrease were reductions in legal and consulting fees and in depreciation expense of $3.2 million and $1.0 million, respectively. The overall decrease was partially offset by an increase in bad debt expense of $4.4 million associated with the write-off of uncollectible accounts.

Research and development expense was $34.6 million in 2000 as compared with $34.0 million in 1999, and as a percentage of net sales decreased to 4% from 5%. The nominal dollar increase was primarily attributable to an increase in employee compensation and benefits.

Interest and other income decreased to $8.8 million in 2000 from $9.2 million in 1999. This decrease is primarily attributable to the 1999 receipt of $3.6 million of insurance proceeds related to the Company's deferred compensation plan. This decrease was partially offset by a $1.6 million increase in royalty income, a $0.6 million decrease in foreign currency transaction losses and a $0.7 million increase in interest income associated with higher average cash balances in 2000 as compared with 1999.

Interest expense decreased to $1.5 million in 2000 from $3.6 million in 1999. This decrease reflects a decline in interest expense in the amounts of $1.4 million associated with the interim finance agreement for pre-lease financing advances for the acquisition and installation costs of machinery and equipment and $0.7 million associated with debt balances on the Company's line of credit and accounts receivable securitization facilities. The line of credit and accounts receivable securitization facilities were not utilized in 2000 and the interim finance agreement was terminated in 1999.

During 2000, the Company recorded a provision for income taxes of $47.4 million and recognized a decrease in deferred taxes of $4.4 million. During 2000, the Company realized $6.8 million in tax benefits related to the exercise of stock options. The provision for income tax as a percentage of income before taxes was 37% in 2000 as compared with 35% in 1999. The Company's effective tax rate for 2000 reflects a benefit from the consolidation of Callaway Golf Ball Company with the Company.

The Company adopted Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101") in the fourth quarter of 2000 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 generally accepted accounting principles to revenue recognition in financial statements. As a result of the adoption of SAB No. 101, the Company recognized a cumulative effect adjustment of $1.0 million in the Consolidated Statement of Operations for the year ended December 31, 2000.

## LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2001, cash and cash equivalents decreased to $84.3 million from $102.6 million at December 31, 2000. The decrease primarily resulted from cash used in financing and investing activities of $74.0 million and $42.8 million, respectively, partially offset by cash provided by operating activities of $100.2 million. Cash flows used in financing activities are primarily attributable to the acquisition of treasury stock ($104.0 million) and the payment of dividends ($19.4 million), partially offset by proceeds from the exercise of employee stock options ($45.0 million) and purchases under the employee stock purchase plan ($5.7 million). Cash flows used in investing activities are primarily attributable to capital expenditures ($35.3 million). Cash flows provided by operating activities reflect decreases in accounts receivable ($3.2 million) and other assets ($5.6 million), as well as increases in accounts payable and accrued expenses ($3.9 million) and increases in accrued employee compensation and benefits ($2.8 million), partially offset by an increase in inventory ($37.1 million) and decreases in accrued warranty expense ($4.5 million) and income taxes payable ($1.6 million). The increase in inventory is primarily attributable to the Company's expanded new product introductions for 2002 and the timing of the launch of these new products. The Company did not begin selling its 2002 products in significant quantities in 2001 and thus did not repeat the late-season launch of new products that occurred in 2000.

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 trend 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 2001, the Company did not utilize either its Accounts Receivable Facility or its line of credit under the Amended Credit Agreement. At December 31, 2001, the Company had $120.0 million available under the Amended Credit Agreement, subject to meeting certain availability requirements under a borrowing base formula and other limitations. Also at December 31, 2001, there were no advances under the Accounts Receivable Facility, leaving up to $80.0 million available under this facility. See Notes 4 and 5 to the Consolidated 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 additional shares of 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 second half of 2001, the Company repurchased 5.0 million shares of its Common Stock at an average cost of $16.98 per share.

In December 1998, the Company entered into a master lease agreement for the acquisition and lease of machinery and equipment utilized in the Company's golf ball operations. By December 31, 1999, the Company had finalized its lease program and leased $50.0 million of equipment under the operating lease. On February 11, 2002, pursuant to the master lease agreement, the Company notified the lessor of its election to purchase the leased equipment in August 2002 for approximately $44.8 million plus the payment of approximately $5.2 million of lease termination fees.

In April 2001, the Company entered into a note payable as part of a licensing agreement for patent rights. The unsecured, interest-free note payable matures on December 31, 2003 and is payable in quarterly installments. The total amounts payable in 2002 and 2003 are $2.7 million and $3.3 million, respectively.

The Company has entered into long-term purchase agreements for various key raw materials. The purchase commitments covered by these agreements aggregate approximately $4.0 million per year for 2002 and 2003.

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 in the next twelve months. However, based upon its current operating plan, analysis of its consolidated financial position and projected future results of operations, the Company believes that its operating cash flows, together with its credit facilities, will be sufficient to finance current operating requirements, including planned capital expenditures and purchase commitments. There can be no assurance, however, that future industry specific or other developments, general economic trends or other matters, will not adversely affect the Company's operations or its ability to meet its future cash requirements (see "Certain Factors Affecting Callaway Golf Company" below).

Supply of Electricity and Energy Contracts

Beginning in the summer of 2000, the Company identified a future risk to ongoing operations as a result of the deregulation of the electricity market in California. In July 2000, the Company entered into a one-year supply agreement with Idaho Power Company ("Idaho Power"), a subsidiary of Idacorp, Inc., for the supply of electricity at $64 per megawatt hour. During the second quarter of 2001, Idaho Power advised the Company that it was unwilling to renew the contract upon expiration in July 2001 due to concerns surrounding the volatility of the California electricity market at that time.

As a result, in the second quarter of 2001, the Company entered into an agreement with Pilot Power Group, Inc. ("Pilot Power") as the Company's energy service provider and in connection therewith entered into a long-term, fixed-priced, fixed-capacity, energy supply contract ("Enron Contract") with Enron Energy Services, Inc. ("EESI"), a subsidiary of Enron Corporation, as part of a comprehensive strategy to ensure the uninterrupted supply of electricity while capping costs in the volatile California electricity market. The Enron Contract provided, subject to the other terms and conditions of the contract, for the Company to purchase nine megawatts of energy per hour from June 1, 2001 through May 31, 2006 (394,416 megawatts over the term of the contract). The total purchase price for such energy over the full contract term was approximately $43.5 million.

At the time the Company entered into the Enron Contract, nine megawatts per hour was in excess of the amount the Company expected to be able to use in its operations. The Company agreed to purchase this amount, however, in order to obtain a more favorable price than the Company could have obtained if the Company had purchased a lesser quantity. The Company expected to be able to sell any excess supply through Pilot Power.

Because the Enron Contract provided for the Company to purchase an amount of energy in excess of what it expected to be able to use in its operations, the Company accounted for the Enron Contract as a derivative instrument in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Enron Contract did not qualify for hedge accounting under SFAS No. 133. Therefore, the Company recognized changes in the estimated fair value of the Enron Contract currently in earnings. The estimated fair value of the Enron Contract was based upon a present value determination of the net differential between the contract price for electricity and the estimated future market prices for electricity as applied to the remaining amount of unpurchased electricity under the Enron Contract. Through September 30, 2001, the Company recorded unrealized pre-tax losses of $19.9 million ($7.7 million in the second quarter of 2001 and $12.2 million in the third quarter of 2001).

On November 29, 2001, the Company notified EESI that, among other things, EESI was in default of the Enron Contract and that based upon such default, and for other reasons, the Company was terminating the Enron Contract effective immediately. At the time of termination, the contract price for the remaining energy to be purchased under the Enron Contract through May 2006 was approximately $39.1 million.

On November 30, 2001, EESI notified the Company that it disagreed that it was in default of the Enron Contract and that it was prepared to deliver energy pursuant to the Enron Contract. However, on December 2, 2001, EESI, along with Enron Corporation and numerous other related entities, filed for bankruptcy. Since November 30, 2001, the parties have not been operating under the Enron Contract and Pilot Power has been providing energy to the Company from alternate suppliers.

As a result of the Company's notice of termination to EESI, and certain other automatic termination provisions under the Enron Contract, the Company believes that the Enron Contract has been terminated. As a result, the Company adjusted the estimated value of the Enron Contract through the date of termination, at which time the terminated Enron Contract ceased to represent a derivative instrument in accordance with SFAS No. 133. Because the Enron Contract is terminated and neither party to the contract is performing pursuant to the terms of the contract, the Company no longer records future valuation adjustments for changes in electricity rates. The Company continues to reflect on its balance sheet the derivative valuation account of $19.9 million at December 31, 2001, subject to periodic review, in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." In applying these accounting principles, the Company sought and received guidance from its auditors and others.

The Company believes the Enron Contract has been terminated, and as of March 8, 2002, EESI has not asserted any claim against the Company. There can be no assurance, however, that EESI or another party will not assert a future claim against the Company or that a bankruptcy court or arbitrator will not ultimately nullify the Company's termination of the Enron Contract. No provision has been made for contingencies or obligations, if any, under the Enron Contract beyond November 30, 2001.

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 2000, the Company paid $1.4 million related to its restructuring obligations, primarily rents associated with its former New York City facility. At December 31, 2000, there was no remaining reserve balance. The Company has a contingent liability related to the New York City facility (see Notes 11 and 12 to the Consolidated Financial Statements).

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, however, 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 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 attacks on the World Trade Center and the Pentagon, the incidents of Anthrax poisoning and the military actions in Afghanistan) would likely have a significant adverse effect upon the Company's business. Such events would likely have an adverse effect upon an already fragile world economy (discussed below) and would likely 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 deliver customer orders also could be materially adversely affected. Furthermore, such events have negatively impacted tourism. If this negative impact upon tourism continues, the Company's sales to retailers at resorts and other vacation destinations would 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 many of the Company's key markets around the world 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 may not experience a corresponding improvement because the golf selling season would largely be over.

FOREIGN CURRENCY RISKS Almost half of the Company's sales are international sales. As a result, the Company conducts transactions in approximately 12 currencies worldwide. Conducting business in such various currencies increases the Company's exposure to devaluations of foreign currencies relative to the U.S. dollar which adversely impacts the Company's results of operations. The Company's results 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 2002 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 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 2001. These hedging activities mitigated, but did not eliminate, the negative effects of foreign currency fluctuations on the hedged transactions that occurred during such period. Despite the Company's successful hedge transactions, decreases in foreign currency exchange rates adversely impacted net sales for the year ended December 31, 2001 by approximately $32.9 million (as measured by applying 2000 exchange rates to 2001 net sales). If the Company does not successfully hedge future transactions, the adverse effects of foreign currency devaluations would increase. (See below Item 3, Quantitative and Qualitative Disclosures about Market Risk -- Foreign Currency Fluctuations).

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, 2000 or 2001. In fact, Golf Datatech reports that the number of rounds played declined 9 out of 12 months in 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 or it can grow its already significant market share.

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.

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 need to produce and sell golf balls in large volumes to cover its costs and become profitable in 2002. Although the Company's golf ball operations have shown significant improvement during 2001, 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 access to alternative power supplies for certain of its operations, and believes that these measures could 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 uninterrupted 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 expected 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 market price for electricity in California dropped significantly. As a result, the Company was 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 was higher than expected. In November 2001, the Company terminated its long-term supply contract and is currently purchasing wholesale energy through the Company's energy service provider under short-term contracts. If energy rates were once again to increase significantly, the Company's energy costs would increase significantly and adversely affect the Company's results of operations.

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 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, in 2002 Nike began marketing and selling golf clubs that will compete with the Company's products, and several manufacturers in Japan have announced plans to expand their businesses in the United States. 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 other competitors, including Nike and Taylor Made, that have introduced or will introduce golf ball designs that directly compete with the Company's products, and several manufacturers in Japan have announced their plans to expand their businesses in the United States. 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 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 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. This aerodynamic technology is reflected in 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 addition, the Company's 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 C4 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 C4 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.

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 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 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 Spec) Forged Titanium Driver are believed to be "conforming" under the Rules of Golf as published by the USGA and RCGA (the Company's ERC Fairway Woods are conforming). 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 ERC II Drivers are non-conforming under the Rules of Golf as published by the R&A, then the Company believes its sales of 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 was ruled to be non-conforming by the USGA. To the Company's knowledge, it was the first large, premium brand golf equipment company to sell non-conforming equipment in the U.S. By undertaking this approach, the Company hoped 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 believed 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 proved to be risky. The USGA 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 was reinforced by further announcements by the USGA. A significant number of U.S. retailers declined to carry the ERC II Driver. It also appears at this time that a significant number of U.S. golfers have decided 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 hurt sales of ERC II Drivers in the U.S., and may have injured sales of other, conforming products, or otherwise damaged the brand. These negative effects will materially limit U.S. sales of ERC II Drivers in 2002 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 there is a change in attitude and a large number of American golfers who do not play in tournaments subject to the USGA's Rules 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 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 and is allocating 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 resulted in a decrease in usage of the Company's clubs by professional golfers in 2001 and could result in a further decrease in 2002. The Company continues to evaluate from time to time whether to implement programs that reward usage of the Company's products. 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 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. 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 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.

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, would 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.

Quantitative and Qualitative Disclosures About Market Risk
The Company uses derivative financial instruments for hedging purposes to limit its exposure to changes in foreign exchange rates. Transactions involving these financial instruments are with credit-worthy firms. 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 utilized a derivative commodity instrument, the Enron Contract, to manage electricity costs in the volatile California energy market during the period of June 2001 through November 2001. Pursuant to its terms, the Enron Contract was terminated and the Company has not entered into another long-term energy contract that would be considered a derivative commodity instrument. 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 -- Foreign Currency Risks).

FOREIGN CURRENCY FLUCTUATIONS In the normal course of business, the Company is exposed to foreign currency exchange rate risks that could impact the Company's results of operations. The Company's risk management strategy includes the use of derivative financial instruments, including forwards and purchased options to hedge certain of these exposures. The Company's objective is to offset gains and losses resulting from these exposures with gains and losses on the derivative contracts used to hedge them, thereby reducing volatility of earnings. The Company does not enter into any trading or speculative positions with regard to derivative instruments.

The Company is exposed to foreign currency exchange rate risk inherent primarily in its sales commitments, anticipated sales and assets and liabilities denominated in currencies other than the U.S. dollar. The Company transacts business in 12 currencies worldwide, of which the most significant to its operations are the European currencies, Japanese yen, Korean won, Canadian dollar, and Australian dollar. For most currencies, the Company is a net receiver of foreign currencies and, therefore, benefits from a weaker U.S. dollar and is adversely affected by a stronger U.S. dollar relative to those foreign currencies in which the Company transacts significant amounts of business.

The Company enters into foreign exchange contracts to hedge against exposure to changes in foreign currency exchange rates. Such contracts are designated at inception to the related foreign currency exposures being hedged, which include anticipated intercompany sales of inventory denominated in foreign currencies, payments due on intercompany transactions from certain wholly-owned foreign subsidiaries, and anticipated sales by the Company's wholly-owned European subsidiary for certain euro-denominated transactions. To achieve hedge accounting, contracts must reduce the foreign currency exchange rate risk otherwise inherent in the amount and duration of the hedged exposures and comply with established company risk management policies. Pursuant to its foreign exchange hedging policy, the Company may hedge anticipated transactions and certain firm commitments and the related receivables and payables 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 of minimizing variability in the Company's operating results arising from foreign exchange rate movements. Hedging contracts generally mature within twelve months.

At December 31, 2001 and 2000, the Company had approximately $157.0 million and $118.2 million, respectively, of foreign exchange contracts outstanding. Of the total contracts outstanding at December 31, 2001 and 2000, approximately $122.6 million and $107.8 million, respectively, were designated as cash flow hedges. The Company estimates the fair values of derivatives based on quoted market prices or pricing models using current market rates, and records all derivatives on the balance sheet at fair value. At December 31, 2001 and 2000, the net fair value of foreign currency-related derivatives designated as cash flow hedges or fair value hedges were recorded as net current assets of $8.8 million and net current liabilities of $1.6 million, respectively.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is initially recorded in accumulated other comprehensive income as a separate component of shareholders' equity and subsequently reclassified into earnings in the period during which the hedged transaction is recognized in earnings. The Company began utilizing cash flow hedges in the fourth quarter of 2000. During 2001 and 2000, the Company reclassified $2.9 million and $0, respectively, of gains into earnings related to the release of the effective portion of gains on contracts designated as cash flow hedges. As of December 31, 2001, the Company expects to reclassify $6.4 million of deferred net gains into earnings within the next twelve months. During 2001 and 2000, no gains or losses were reclassified into earnings as a result of the discontinuance of any cash flow hedges.

The ineffective gain or loss for derivative instruments that are designated and qualify as cash flow hedges is reported in "interest and other income, net" immediately. For foreign currency contracts designated as cash flow hedges, hedge effectiveness is measured 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 interest and other 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 the hedges to be highly effective. The effectiveness of each derivative is assessed monthly. During the years ended December 31, 2001 and 2000, a net gain of $2.0 million and a net loss of $0.2 million, respectively, were recorded in interest and other income, net representing the ineffective portion of the Company's derivative instruments.

At December 31, 2001 and 2000, the Company had approximately $34.4 million and $10.4 million of foreign contracts used to hedge balance sheet exposures outstanding. The gains and losses on foreign currency contracts used to hedge balance sheet exposures are recognized in interest and other income, net in the same period as the remeasurement gain and loss of the related foreign currency denominated assets and liabilities and thus offset these gains and losses. During 2001 and 2000, the Company recorded net realized and unrealized gains on contracts used to hedge balance sheet exposures of $4.5 million and $5.3 million, respectively.

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 December 31, 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 $15.3 million at December 31, 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 During the second quarter of 2001, the Company entered into the Enron Contract to manage electricity costs in the volatile California energy market. This derivative did not qualify for hedge accounting treatment under SFAS No. 133. Therefore, the Company recognized the changes in the estimated fair value of the contract based on current market rates as unrealized energy derivative losses. During the fourth quarter of 2001, the Company notified the energy supplier that, among other things, the energy supplier was in default of the energy supply contract and that based upon such default, and for other reasons, the Company was terminating the energy supply contract. As a result, the Company adjusted the estimated value of this contract through the date of termination, at which time the terminated contract ceased to represent a derivative instrument in accordance with SFAS No. 133. Because the contract is terminated and neither party to the contract is performing pursuant to the terms of the contract, the Company no longer records future valuation adjustments for changes in electricity rates. The Company continues to reflect the derivative valuation account on its balance sheet, subject to periodic review, in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." See "Supply of Electricity and Energy Contracts" above.

INTEREST RATE FLUCTUATIONS Additionally, the Company is exposed to interest rate risk from its Amended Credit Agreement and Accounts Receivable Facility (see Notes 4 and 5 to the Company's Consolidated Financial Statements) which are indexed to the London Interbank Offering Rate and Redwood Receivables Corporation Commercial Paper Rate. No amounts were advanced or outstanding under these facilities at December 31, 2001.

Notes 4 and 5 to the Company's Consolidated Financial Statements outline the principal amounts, if any, and other terms required to evaluate the expected cash flows and sensitivity to interest rate changes.

## CONSOLIDATED BALANCE SHEETS

| (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA) | 2001 | DECEMBER 31, 2000 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 84,263 | $ 102,596 |
| Marketable securities | 6,422 | -- |
| Accounts receivable, net | 48,653 | 58,836 |
| Inventories, net | 167,760 | 133,962 |
| Current deferred taxes | 27,266 | 29,354 |
| Other current assets | 20,327 | 17,721 |
| Total current assets | 354,691 | 342,469 |
| Property, plant and equipment, net | 133,250 | 134,712 |
| Intangible assets, net | 121,313 | 113,760 |
| Deferred taxes | 20,282 | 23,332 |
| Other assets | 18,066 | 16,661 |
| | $ 647,602 | $ 630,934 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 38,261 | $ 44,173 |
| Accrued employee compensation and benefits | 25,301 | 22,574 |
| Accrued warranty expense | 34,864 | 39,363 |
| Note payable, current portion | 2,374 | -- |
| Income taxes payable | 1,074 | 3,196 |
| Total current liabilities | 101,874 | 109,306 |
| Long-term liabilities: | | |
| Deferred compensation | 8,297 | 9,884 |
| Energy derivative valuation account | 19,922 | -- |
| Note payable, net of current portion | 3,160 | -- |
| Commitments and contingencies (Note 11) | | |
| Shareholders' equity: | | |
| Preferred Stock, $.01 par value, 3,000,000 shares authorized, none issued and outstanding at December 31, 2001 and 2000 | -- | -- |
| Common Stock, $.01 par value, 240,000,000 shares authorized, 82,694,173 shares and 78,958,963 shares issued at December 31, 2001 and 2000, respectively | 827 | 790 |
| Paid-in capital | 419,541 | 347,765 |
| Unearned compensation | (211) | (1,214) |
| Retained earnings | 388,609 | 349,681 |
| Accumulated other comprehensive loss | (4,399) | (6,096) |
| Less: Grantor Stock Trust held at market value, 10,764,690 shares and 5,300,000 shares at December 31, 2001 and 2000, respectively | (206,144) | (98,713) |
| | 598,223 | 592,213 |
| Less: Common Stock held in treasury, at cost, 4,939,000 shares and 4,815,241 shares at December 31, 2001 and 2000, respectively | (83,874) | (80,469) |
| Total shareholders' equity | 514,349 | 511,744 |
| | $ 647,602 | $ 630,934 |

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

Callaway Golf Company

CONSOLIDATED STATEMENTS OF OPERATIONS

| (IN THOUSANDS, EXCEPT PER SHARE DATA) | 2001 | | 2000 | | YEAR ENDED DECEMBER 31, 1999 | |
|---|---|---|---|---|---|---|
| Net sales | $ 816,163 | 100% | $ 837,627 | 100% | $ 719,038 | 100% |
| Cost of sales | 411,585 | 50% | 440,119 | 53% | 384,265 | 53% |
| Gross profit | 404,578 | 50% | 397,508 | 47% | 334,773 | 47% |
| Selling expenses | 188,306 | 23% | 170,541 | 20% | 128,565 | 18% |
| General and administrative expenses | 71,058 | 9% | 70,333 | 8% | 92,478 | 13% |
| Research and development expenses | 32,697 | 4% | 34,579 | 4% | 34,002 | 5% |
| Restructuring credits | -- | -- | -- | -- | (5,894) | (1%) |
| Sumitomo transition expenses | -- | -- | -- | -- | 5,713 | 1% |
| Income from operations | 112,517 | 14% | 122,055 | 15% | 79,909 | 11% |
| Interest and other income, net | 7,149 | | 8,791 | | 9,182 | |
| Interest expense | (1,552) | | (1,524) | | (3,594) | |
| Unrealized energy derivative losses | (19,922) | | -- | | -- | |
| Income before income taxes and cumulative effect of accounting change | 98,192 | 12% | 129,322 | 16% | 85,497 | 12% |
| Income taxes | 39,817 | | 47,366 | | 30,175 | |
| Income before cumulative effect of accounting change | 58,375 | | 81,956 | | 55,322 | |
| Cumulative effect of accounting change | -- | | (957) | | -- | |
| Net income | $ 58,375 | 7% | $ 80,999 | 10% | $ 55,322 | 8% |
| Earnings per common share: | | | | | | |
| Basic | | | | | | |
| Income before cumulative effect of accounting change | $ 0.84 | | $ 1.17 | | $ 0.79 | |
| Cumulative effect of accounting change | -- | | (0.01) | | -- | |
| | $ 0.84 | | $ 1.16 | | $ 0.79 | |
| Diluted | | | | | | |
| Income before cumulative effect of accounting change | $ 0.82 | | $ 1.14 | | $ 0.78 | |
| Cumulative effect of accounting change | -- | | (0.01) | | -- | |
| | $ 0.82 | | $ 1.13 | | $ 0.78 | |
| Common equivalent shares: | | | | | | |
| Basic | 69,809 | | 69,946 | | 70,397 | |
| Diluted | 71,314 | | 71,412 | | 71,214 | |

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

Callaway Golf Company

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| (IN THOUSANDS) | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ 58,375 | $ 80,999 | $ 55,322 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 37,467 | 40,249 | 39,877 |
| Non-cash compensation | 342 | 2,157 | 1,390 |
| Tax benefit from exercise of stock options | 14,520 | 6,806 | 2,377 |
| Non-cash energy derivative losses | 19,922 | -- | -- |
| Net non-cash foreign currency hedging gains | (4,748) | (1,410) | -- |
| Deferred taxes | 1,732 | 4,906 | 9,971 |
| Non-cash restructuring costs | -- | -- | (8,609) |
| Loss on disposal of assets | 1,824 | 342 | 315 |
| Changes in assets and liabilities, net of effects from acquisitions: | | | |
| Accounts receivable, net | 3,182 | (9,047) | 19,690 |
| Inventories, net | (37,147) | (39,402) | 51,092 |
| Other assets | 5,630 | (3,074) | (12,966) |
| Accounts payable and accrued expenses | 3,936 | 2,638 | 12,225 |
| Accrued employee compensation and benefits | 2,848 | 1,623 | 9,875 |
| Accrued warranty expense | (4,499) | 3,258 | 286 |
| Income taxes payable | (1,644) | 4,088 | (10,001) |
| Accrued restructuring costs | -- | (1,379) | (8,517) |
| Deferred compensation | (1,587) | (1,691) | 3,969 |
| Net cash provided by operating activities | 100,153 | 91,063 | 166,296 |
| Cash flows from investing activities: | | | |
| Capital expenditures | (35,274) | (28,386) | (56,244) |
| Acquisitions, net of cash acquired | (5,758) | (444) | (2,389) |
| Investment in marketable securities | (6,422) | -- | -- |
| Proceeds from sale of capital assets | 4,629 | 244 | 5,095 |
| Net cash used in investing activities | (42,825) | (28,586) | (53,538) |
| Cash flows from financing activities: | | | |
| Net payments on line of credit | -- | -- | (70,919) |
| (Payments on) proceeds from note payable | (1,168) | -- | 35,761 |
| Issuance of Common Stock | 50,651 | 28,233 | 9,009 |
| Acquisition of Treasury Stock | (104,049) | (80,469) | -- |
| Dividends paid, net | (19,447) | (19,538) | (19,760) |
| Proceeds from sale-leaseback of equipment | -- | 1,268 | -- |
| Net cash used in financing activities | (74,013) | (70,506) | (45,909) |
| Effect of exchange rate changes on cash and cash equivalents | (1,648) | (1,977) | 135 |
| Net (decrease) increase in cash and cash equivalents | (18,333) | (10,006) | 66,984 |
| Cash and cash equivalents at beginning of year | 102,596 | 112,602 | 45,618 |
| Cash and cash equivalents at end of year | $ 84,263 | $ 102,596 | $ 112,602 |
| Supplemental disclosures: | | | |
| Issuance of note payable for acquisition of intangible assets | $ 6,702 | $ -- | $ -- |
| Cancellation of restricted Common Stock | $ 992 | $ 217 | $ 684 |
| Common Stock issued for acquisition of intangible assets | $ 516 | $ -- | $ -- |
| Non-cash financing | $ -- | $ -- | $ 48,732 |
| Cash paid for interest and fees | $ 977 | $ 805 | $ 3,637 |
| Cash paid for income taxes | $ 25,738 | $ 29,245 | $ 30,670 |

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands)

| | Shares | Common Stock Amount | Paid-in Capital |
|---|---|---|---|
| Balance, December 31, 1998 | 75,095 | $ 751 | $ 258,015 |
| Exercise of stock options | 851 | 8 | 5,362 |
| Tax benefit from exercise of stock options | -- | -- | 2,377 |
| Cancellation of Restricted Common Stock | (22) | -- | (684) |
| Compensatory stock and stock options | -- | -- | (795) |
| Employee stock purchase plan | 378 | 4 | 3,635 |
| Cash dividends | -- | -- | -- |
| Dividends on shares held by GST | -- | -- | -- |
| Adjustment of GST shares to market value | -- | -- | 39,419 |
| Equity adjustment from foreign currency translation | -- | -- | -- |
| Net income | -- | -- | -- |
| Balance, December 31, 1999 | 76,302 | 763 | 307,329 |
| Exercise of stock options | 2,252 | 23 | 23,932 |
| Tax benefit from exercise of stock options | -- | -- | 6,806 |
| Cancellation of Restricted Common Stock | (7) | -- | (217) |
| Acquisition of Treasury Stock | -- | -- | -- |
| Compensatory stock and stock options | -- | -- | 804 |
| Employee stock purchase plan | 412 | 4 | 4,274 |
| Cash dividends | -- | -- | -- |
| Dividends on shares held by GST | -- | -- | -- |
| Adjustment of GST shares to market value | -- | -- | 4,969 |
| Equity adjustment from foreign currency translation | -- | -- | -- |
| Unrealized loss on cash flow hedges, net of tax | -- | -- | -- |
| Other | -- | -- | (132) |
| Net income | -- | -- | -- |
| Balance, December 31, 2000 | 78,959 | 790 | 347,765 |
| Exercise of stock options | 3,484 | 34 | 42,621 |
| Tax benefit from exercise of stock options | -- | -- | 14,520 |
| Cancellation of Restricted Common Stock | (32) | -- | (992) |
| Acquisition of Treasury Stock | -- | -- | -- |
| Compensatory stock and stock options | -- | -- | 331 |
| Employee stock purchase plan | 283 | 3 | 2,244 |
| Shares issued for intangible assets | -- | -- | (129) |
| Cash dividends | -- | -- | -- |
| Dividends on shares held by GST | -- | -- | -- |
| Addition to GST | -- | -- | (9,717) |
| Adjustment of GST shares to market value | -- | -- | 22,898 |
| Equity adjustment from foreign currency translation | -- | -- | -- |
| Unrealized gain on cash flow hedges, net of tax | -- | -- | -- |
| Net income | -- | -- | -- |
| Balance, December 31, 2001 | 82,694 | $ 827 | $419,541 |

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

| Unearned Compensation | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | GST | Treasury Stock | | Total Shareholders' Equity | Comprehensive Income |
|---|---|---|---|---|---|---|---|
| | | | | Shares | Amount | | |
| $ (5,653) | $ 252,528 | $ 1,780 | $ (54,325) | -- | $ -- | $ 453,096 | |
| -- | -- | -- | -- | -- | -- | 5,370 | |
| -- | -- | -- | -- | -- | -- | 2,377 | |
| 684 | -- | -- | -- | -- | -- | -- | |
| 2,185 | -- | -- | -- | -- | -- | 1,390 | |
| -- | -- | -- | -- | -- | -- | 3,639 | |
| -- | (21,244) | -- | -- | -- | -- | (21,244) | |
| -- | 1,484 | -- | -- | -- | -- | 1,484 | |
| -- | -- | -- | (39,419) | -- | -- | -- | |
| -- | -- | (1,500) | -- | -- | -- | (1,500) | $ (1,500) |
| -- | 55,322 | -- | -- | -- | -- | 55,322 | 55,322 |
| (2,784) | 288,090 | 280 | (93,744) | -- | -- | 499,934 | $ 53,822 |
| -- | -- | -- | -- | -- | -- | 23,955 | |
| -- | -- | -- | -- | -- | -- | 6,806 | |
| 217 | -- | -- | -- | -- | -- | -- | |
| -- | -- | -- | -- | (4,815) | (80,469) | (80,469) | |
| 1,353 | -- | -- | -- | -- | -- | 2,157 | |
| -- | -- | -- | -- | -- | -- | 4,278 | |
| -- | (21,022) | -- | -- | -- | -- | (21,022) | |
| -- | 1,484 | -- | -- | -- | -- | 1,484 | |
| -- | -- | -- | (4,969) | -- | -- | -- | |
| -- | -- | (5,422) | -- | -- | -- | (5,422) | $ (5,422) |
| -- | -- | (954) | -- | -- | -- | (954) | (954) |
| -- | 130 | -- | -- | -- | -- | (2) | |
| -- | 80,999 | -- | -- | -- | -- | 80,999 | 80,999 |
| (1,214) | 349,681 | (6,096) | (98,713) | (4,815) | (80,469) | 511,744 | $ 74,623 |
| -- | -- | -- | 2,375 | -- | -- | 45,030 | |
| -- | -- | -- | -- | -- | -- | 14,520 | |
| 992 | -- | -- | -- | -- | -- | -- | |
| -- | -- | -- | -- | (6,001) | (104,049) | (104,049) | |
| 11 | -- | -- | -- | -- | -- | 342 | |
| -- | -- | -- | 3,374 | -- | -- | 5,621 | |
| -- | -- | -- | -- | 40 | 645 | 516 | |
| -- | (21,717) | -- | -- | -- | -- | (21,717) | |
| -- | 2,270 | -- | -- | -- | -- | 2,270 | |
| -- | -- | -- | (90,282) | 5,837 | 99,999 | -- | |
| -- | -- | -- | (22,898) | -- | -- | -- | |
| -- | -- | (3,297) | -- | -- | -- | (3,297) | $ (3,297) |
| -- | -- | 4,994 | -- | -- | -- | 4,994 | 4,994 |
| -- | 58,375 | -- | -- | -- | -- | 58,375 | 58,375 |
| $ (211) | $ 388,609 | $ (4,399) | $(206,144) | (4,939) | $ (83,874) | $ 514,349 | $ 60,072 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1
The Company

Callaway Golf Company ("Callaway Golf" or the "Company") was incorporated in California in 1982 and was reincorporated in Delaware in 1999. The Company designs, develops, manufactures and markets high-quality, innovative golf clubs, golf balls and golf accessories. Callaway Golf's primary products for the periods presented include Great Big Bertha Hawk Eye and Big Bertha Hawk Eye VFT Titanium Metal Woods, ERC and ERC II Forged Titanium Drivers, Big Bertha Steelhead Plus and Big Bertha Steelhead Metal Woods, Great Big Bertha Hawk Eye and Great Big Bertha Hawk Eye VFT Tungsten Injected Titanium Irons, Steelhead X-14 and Big Bertha X-12 Irons, Odyssey putters and wedges, Rule 35 and CB1 golf balls, golf bags and other golf accessories.

## NOTE 2
Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION The consolidated financial statements for the periods presented include the accounts of the Company and its subsidiaries, Callaway Golf Sales Company, Golf Funding Corporation ("Golf Funding"), Callaway Golf Ball Company, Odyssey Golf, Inc. ("Odyssey"), CGV, Inc., Callaway Golf Media Ventures ("CGMV"), Callaway Golf Europe Ltd., Callaway Golf Europe, S.A., Callaway Golf K.K. (formerly named ERC International Company), Callaway Golf (Germany) GmbH, Callaway Golf Canada Ltd., Callaway Golf Korea, Ltd., Callaway Golf South Pacific PTY Ltd. and Callaway Golf Company Grantor Stock Trust. All significant intercompany transactions and balances have been eliminated. Callaway Golf Ball Company and Odyssey were merged with the Company as of December 29, 2000 and December 22, 1999, respectively. The Company sold its interest in CGMV in March 1999 in an effort to discontinue certain initiatives not directly associated with the Company's core business (Note 12). Callaway Golf Europe, S.A. was merged with Callaway Golf Europe Ltd. in 1999 (Note 13).

USE OF ESTIMATES 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. Examples of such estimates include provisions for warranty, uncollectible accounts receivable, inventory obsolescence, restructuring costs and market value estimates of derivative instruments. Actual amounts could differ from those estimates.

REVENUE RECOGNITION Sales are recognized net of an allowance for sales returns when both title and risk of loss transfer to the customer. The Company adopted Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101") in the fourth quarter of 2000 with an effective date of January 1, 2000. SAB No. 101 summarizes the Securities and Exchange Commission ("SEC") Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. As a result of the adoption of SAB No. 101, the Company recognized a cumulative effect adjustment of $957,000 in the Consolidated Statement of Operations for the year ended December 31, 2000 to reflect the change in the Company's revenue recognition policy from shipping point to the time both legal and practical risk of loss transfers to the customer.

Amounts billed to customers for shipping and handling are included in net sales and costs incurred related to shipping and handling are included in cost of sales.

WARRANTY POLICY The Company's warranty policy provides two-year limited coverage for golf clubs following the date of purchase. The Company's policy is to accrue the estimated cost of warranty coverage at the time the sale is recorded. In estimating its future warranty obligations the Company considers various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty. During 2001, 2000 and 1999, the Company recorded a warranty provision of $9,527,000, $17,675,000 and $18,023,000, respectively.

FAIR VALUE OF FINANCIAL INSTRUMENTS The Company's financial instruments consist of cash and cash equivalents, marketable securities, trade receivables and payables, forward foreign currency exchange contracts (Note 6), its revolving line of credit and note payable (Note 4) and its accounts receivable securitization facility (Note 5). The carrying amounts of these instruments approximate fair value because of their short-term maturities and variable interest rates. During 2001, the Company also entered into an energy contract accounted for as a derivative instrument that has been recorded based on estimated fair values (see Notes 6 and 11).

ADVERTISING COSTS The Company advertises primarily through television and print media. The Company's policy is to expense advertising costs, including production costs, as incurred. Advertising expenses for 2001, 2000 and 1999 were $44,707,000, $35,100,000 and $26,202,000, respectively.

RESEARCH AND DEVELOPMENT COSTS Research and development costs are expensed as incurred.

FOREIGN CURRENCY TRANSLATION AND TRANSACTIONS The Company's foreign subsidiaries utilize their local currency as their functional currency. The accounts of these foreign subsidiaries have been translated into United States dollars at appropriate rates of exchange using the current rate method. Cumulative translation gains or losses are recorded as accumulated other comprehensive income in shareholders' equity. Gains or losses resulting from transactions that are made in a currency different from the functional currency are recognized in earnings as they occur or, for hedging contracts, when the underlying hedged transaction affects earnings. The Company recorded transaction gains of

$2,533,000 in 2001 and transaction losses of $147,000 and $793,000 in 2000 and 1999, respectively, included in interest and other income, net.

DERIVATIVES AND HEDGING In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("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 establishes accounting and reporting standards for derivative instruments and hedging activities and requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives are recorded each period in income or other comprehensive income, depending on whether the derivatives are designated as hedges and, if so, the types and effectiveness of hedges. SFAS No. 133 is effective for all periods beginning after June 15, 2000. The Company elected to adopt SFAS No. 133 early on January 1, 1999.

Adoption of these statements did not significantly affect the way in which the Company accounts for derivatives to hedge payments due on intercompany transactions. Accordingly, no cumulative effect adjustments were made. In the fourth quarter of 2000, the Company began hedging a portion of its anticipated intercompany sales of inventory denominated in foreign currencies using forward foreign currency exchange rate contracts. The purpose of these derivative instruments is to minimize the variability of cash flows associated with the anticipated transactions being hedged. As changes in foreign currency rates impact the United States dollar value of anticipated transactions, the fair value of the forward contracts also changes, providing a synthetic offset to foreign currency rate fluctuations. During the second quarter of 2001, the Company entered into a derivative commodity instrument as part of a comprehensive strategy to ensure the uninterrupted supply of electricity while capping electricity costs in the volatile California energy market. Additional information about the Company's use of derivative instruments is presented in Notes 6 and 11.

EARNINGS PER COMMON SHARE Basic earnings per common share is calculated by dividing net income for the period by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income for the period by the weighted-average number of common shares outstanding during the period, increased by dilutive potential common shares ("dilutive securities") that were outstanding during the period. Dilutive securities include shares owned by the Callaway Golf Company Grantor Stock Trust, options issued pursuant to the Company's stock option plans, potential shares related to the Employee Stock Purchase Plan and rights to purchase preferred shares under the Callaway Golf Company Shareholder Rights Plan (Note 8). Dilutive securities related to the Callaway Golf Company Grantor Stock Trust and the Company's stock option plans are included in the calculation of diluted earnings per common share using the treasury stock method. Dilutive securities related to the Employee Stock Purchase Plan are calculated by dividing the average withholdings during the period by 85% of the lower of the offering period price or the market value at the end of the period. The dilutive effect of rights to purchase preferred shares under the Callaway Golf Shareholder Rights Plan have not been included as dilutive securities because the conditions necessary to cause these rights to be exercisable were not met. A reconciliation of the numerators and denominators of the basic and diluted earnings per common share calculations for the years ended December 31, 2001, 2000 and 1999 is presented in Note 7.

CASH AND CASH EQUIVALENTS Cash equivalents are highly liquid investments purchased with maturities of three months or less.

MARKETABLE SECURITIES The Company classifies its marketable securities as available-for-sale. These securities consist of equity securities and are recorded at fair value based on quoted market prices, with unrealized gains and losses reported in shareholders' equity as a component of accumulated other comprehensive income. Proceeds from the sale of securities for the years ended December 31, 2001, 2000 and 1999, were $253,565,000, $10,057,000 and $254,000, respectively. Gains and losses on securities sold are determined based on the specific identification method and are included in "interest and other income, net." For the years ended December 31, 2001, 2000 and 1999, the Company recorded $1,597,000, $57,000 and $36,000 of realized gains on securities sold in interest and other income, net.

INVENTORIES Inventories are valued at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method. Inventories include material, labor and manufacturing overhead costs.

PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives as follows:

| | |
|---|---|
| Buildings and improvements | 10-30 years |
| Machinery and equipment | 5-15 years |
| Furniture, computers and equipment | 3-5 years |
| Production molds | 2 years |

Normal repairs and maintenance costs are expensed as incurred. Expenditures that materially increase values, change capacities or extend useful lives are capitalized. Replacements are capitalized and the property, plant, and equipment accounts are relieved of the items being replaced. The related costs and accumulated depreciation of disposed assets are eliminated and any resulting gain or loss on disposition is included in income. Construction in process consists primarily of store display equipment not yet assembled and installed, in-process internally developed software and unfinished molds that have not yet been placed in service.

Effective January 1, 1999, the Company adopted Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." In accordance with SOP 98-1, the Company capitalizes certain costs incurred in connection with developing or obtaining internal use software. Costs incurred in the preliminary project stage are expensed. All direct external costs incurred to develop internal-use software during the development stage are capitalized and amortized using the straight-line method over the remaining estimated useful lives. Costs such as maintenance and training are expensed as incurred.

In September 2000, the Company completed an extensive upgrade of its enterprise-wide business software system to a more current release. The upgrade included improved functionalities and provides the Company the opportunity to build upon its investment in the software. As a result of this upgrade, the Company expects that this business system will have a greater useful life to the Company than originally estimated. Therefore, in fiscal 2000, the Company extended the estimated useful life of its business system by three years. For the years ended December 31, 2001 and 2000, the effect of this change in accounting estimate reduced depreciation expense by $3,892,000 and $1,319,000, respectively, and increased net income by $2,314,000 and $791,000, respectively. The resulting increase in net income increased the Company's earnings per diluted share by $0.03 and $0.01 for the years ended December 31, 2001 and 2000, respectively.

LONG-LIVED ASSETS The Company assesses potential impairments of its long-lived assets whenever events or changes in circumstances indicate that the asset's carrying value may not be recoverable. An impairment loss would be recognized when the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset (asset group) is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (asset group).

INTANGIBLE ASSETS Intangible assets consist primarily of trade name, trademark, trade dress, patents and goodwill resulting from the 1997 purchase of substantially all of the assets and certain liabilities of Odyssey Sports, Inc. and goodwill associated with the purchase of certain foreign distributors (Note 13). During 2001, 2000 and 1999, intangible assets were amortized using the straight-line method over periods ranging from three to 40 years and amortization of intangible assets was $7,569,000, $7,195,000 and $7,476,000, respectively.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." 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 are no longer amortized effective January 1, 2002. Goodwill and other intangible assets with indefinite lives acquired on or after July 1, 2001 follow the non-amortization approach under SFAS No. 142. Under the non-amortization approach, goodwill and other intangible assets with indefinite lives are tested for impairment, rather than 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 adopted the amortization provisions of SFAS No. 142 effective January 1, 2002. At December 31, 2001, the carrying value of unamortized goodwill, intangible assets with indefinite lives, and other intangible assets was $16,846,000, $88,590,000 and $15,877,000, respectively. Intangible assets with indefinite lives consist of trade name, trademark and trade dress and goodwill. In 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 follow the non-amortization approach effective January 1, 2002. Patents and other intangible assets are amortized using the straight-line method over periods ranging from three to sixteen years (Note 3).

STOCK-BASED COMPENSATION The Company measures compensation expense for its stock-based employee compensation awards using the intrinsic value method. Pro forma disclosures of net income and earnings per share, as if the fair value-based method had been applied in measuring stock-based employee compensation expense, are presented in Note 8. Compensation expense for non-employee stock-based compensation awards is measured using the fair-value method.

INCOME TAXES Current income tax expense is the amount of income taxes expected to be payable for the current year. A deferred income tax asset or liability is established for the expected future consequences resulting from temporary differences in the financial reporting and tax bases of assets and liabilities. Deferred income tax expense (benefit) is the net change during the year in the deferred income tax asset or liability.

Deferred taxes have not been provided on the cumulative undistributed earnings of foreign subsidiaries since such amounts are expected to be reinvested indefinitely. The Company provides a valuation allowance for its deferred tax assets when, in the opinion of management, it is more likely than not that such assets will not be realized.

INTEREST AND OTHER INCOME, NET Interest and other income, net includes royalty income, gains and losses on foreign currency transactions, interest income, gains on the sale of marketable securities and losses generated from the sale of the Company's excess energy supply. Gains and losses are presented as a net amount for foreign currency and excess energy sales transactions. Also included in other income during 1999 were net proceeds from an insurance policy related to the deferred compensation plan of $3,622,000 (Note 9). The components of interest and other income, net are as follows:

| (IN THOUSANDS) | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|
| Royalty income | $ 3,231 | $ 2,669 | $ 1,058 |
| Net foreign currency gains (losses) | 2,533 | (147) | (793) |
| Interest income | 1,462 | 6,157 | 5,462 |
| Gain on sale of securities | 1,597 | 57 | 36 |
| Net losses on excess energy sales | (2,052) | -- | -- |
| Net proceeds from insurance policy | -- | -- | 3,622 |
| Other | 378 | 55 | (203) |
| | $ 7,149 | $ 8,791 | $ 9,182 |

COMPREHENSIVE INCOME SFAS No. 130, "Reporting Comprehensive Income," requires that all components of comprehensive income be reported in the financial statements in the period in which they are recognized. The components of comprehensive income for the Company include net income, unrealized gains or losses on cash flow hedges and foreign currency translation adjustments. Since the Company has met the indefinite reversal criteria, it does not accrue income taxes on foreign currency translation adjustments. During 2001, the Company recorded $4,994,000, net of tax expense of $3,055,000, related to net unrealized gains on cash flow hedges. No amounts were reclassified to earnings during 2001 as a result of discontinuance of any cash flow hedges.

SEGMENT INFORMATION The Company utilizes the management approach to report segment information. The Company's operating segments are organized on the basis of products and include golf clubs and golf balls. The Company also discloses information about geographic areas. This information is presented in Note 14.

DIVERSIFICATION OF CREDIT RISK The Company's financial instruments that are subject to concentrations of credit risk consist primarily of cash equivalents, marketable securities and trade receivables.

The Company may invest its excess cash in money market accounts and U.S. Government securities and has established guidelines relative to diversification and maturities in an effort to maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates.

The Company operates in the golf equipment industry and 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. The Company maintains reserves for potential credit losses, which it considers adequate to cover any such losses.

During 2001, 2000 and 1999, approximately 46%, 46% and 42%, respectively, of the Company's net sales were made to foreign customers. An adverse change in either economic conditions abroad or in the Company's relationship with significant foreign retailers could negatively impact the volume of the Company's international sales and the Company's results of operations, cash flows and financial position.

The Company enters into forward exchange rate contracts and put or call options for the purpose of hedging foreign exchange rate exposures on existing or anticipated transactions. In the event of a failure to honor one of these contracts by one of the banks with which the Company has contracted, management believes any loss would be limited to the exchange rate differential from the time the contract was made until the time it was compensated.

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. During the fourth quarter of 2001, the energy supplier filed for bankruptcy protection and the Company notified the energy supplier that, among other things, the energy supplier was in default of the energy supply contract and that based upon such default, and for other reasons, the Company was terminating the energy supply contract. As a result, the Company began procuring energy from an alternative source at current market rates.

RECENT ACCOUNTING PRONOUNCEMENTS In June 2001, the FASB issued 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. In addition, SFAS No. 142 requires that acquired intangible assets be separately identified and amortized over their individual useful lives. The Company was required to adopt these statements beginning January 1, 2002. In accordance with SFAS No. 142, goodwill and other intangible assets with indefinite lives that were being amortized over periods ranging from five to 40 years follow the non-amortization approach effective January 1, 2002. Other intangible assets with indefinite lives include trademark, trade name and trade dress. At December 31, 2001, the carrying value of unamortized goodwill and other intangible assets with indefinite lives was $16,846,000 and $88,590,000, respectively. For the year ended December 31, 2001, amortization expense of $3,588,000 and $2,487,000 was recorded for goodwill and other intangible assets with indefinite lives, respectively.

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 became effective for the Company beginning January 1, 2002. Adoption of SFAS No. 144 as of January 1, 2002 did not have a material impact on the Company's results of operations and financial position.

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

NOTE 3
SELECTED FINANCIAL STATEMENT INFORMATION

| (IN THOUSANDS) | DECEMBER 31, 2001 | 2000 |
|---|---|---|
| Accounts receivable, net: | | |
| Trade accounts receivable | $ 53,810 | $ 65,063 |
| Allowance for doubtful accounts | (5,157) | (6,227) |
| | $ 48,653 | $ 58,836 |
| Inventories, net: | | |
| Raw materials | $ 67,336 | $ 56,936 |
| Work-in-process | 2,179 | 1,293 |
| Finished goods | 105,381 | 83,453 |
| | 174,896 | 141,682 |
| Reserve for excess and obsolescence | (7,136) | (7,720) |
| | $ 167,760 | $ 133,962 |
| Property, plant and equipment, net: | | |
| Land | $ 10,533 | $ 12,358 |
| Buildings and improvements | 84,687 | 90,301 |
| Machinery and equipment | 67,329 | 60,399 |
| Furniture, computers and equipment | 65,300 | 65,140 |
| Production molds | 31,371 | 25,610 |
| Construction-in-process | 7,025 | 5,766 |
| | 266,245 | 259,574 |
| Accumulated depreciation | (132,995) | (124,862) |
| | $ 133,250 | $ 134,712 |
| Intangible assets, net: | | |
| Trade name | $ 69,629 | $ 69,629 |
| Trademark and trade dress | 29,841 | 29,841 |
| Goodwill | 29,313 | 24,761 |
| Patents and other | 22,067 | 10,970 |
| | 150,850 | 135,201 |
| Accumulated amortization | (29,537) | (21,441) |
| | $ 121,313 | $ 113,760 |
| Accounts payable and accrued expenses: | | |
| Accounts payable | $ 7,892 | $ 5,552 |
| Accrued expenses | 30,369 | 38,621 |
| | $ 38,261 | $ 44,173 |
| Accrued employee compensation and benefits: | | |
| Accrued payroll and taxes | $ 19,313 | $ 16,178 |
| Accrued vacation and sick pay | 5,068 | 5,111 |
| Accrued commissions | 920 | 1,285 |

| | | |
|---|---|---|
| | $ 25,301 | $ 22,574 |

NOTE 4
DEBT

The Company has a revolving credit facility of up to $120,000,000 (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 December 31, 2001, up to $120,000,000 of the credit facility remained available for borrowings, subject to meeting certain availability requirements under a borrowing base formula and other limitations. Fees incurred in connection with the credit facility for the years ended December 31, 2001, 2000 and 1999 were $556,000 for each year and were recorded as interest expense.

In December 1998, Callaway Golf Ball Company, then a wholly-owned subsidiary of the Company, entered into a master lease agreement for the acquisition and lease of up to $56,000,000 of machinery and equipment. By December 31, 1999, the Company had finalized its lease program and leased $50,000,000 of equipment pursuant to the master lease agreement. This lease program included an interim finance agreement (the "Finance Agreement"). The Finance Agreement provided pre-lease financing advances for the acquisition and installation costs of the aforementioned machinery and equipment. The Finance Agreement bore interest at LIBOR plus a margin and was secured by the underlying machinery and equipment and a corporate guarantee from the Company. During the third and fourth quarters of 1999, the Company converted the balance of this note payable into an operating lease (Notes 11 and 17). As of December 31, 1999, no amount was outstanding under this facility. On December 29, 2000, pursuant to an assumption agreement, the Company assumed all of the rights, title, interest and obligations of Callaway Golf Ball Company under the master lease agreement.

In April 2001, the Company entered into a note payable in the amount of $7,500,000 as part of a licensing agreement for patent rights. The unsecured, interest-free note payable matures on December 31, 2003 and is payable in quarterly installments. The total amounts payable in 2002 and 2003 are $2,700,000 and $3,300,000, respectively. During 2001, the Company recorded imputed interest expense of $332,000. The present value of the note payable at issuance totaled $6,702,000 using an imputed interest rate of approximately 7%.

NOTE 5
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 $80,000,000, 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 December 31, 2001, no amount was outstanding under the Accounts Receivable Facility. Fees incurred in connection with the facility for the years ended December 31, 2001, 2000 and 1999 were $305,000, $303,000 and $923,000, respectively, and were recorded as interest expense.

NOTE 6
DERIVATIVES AND HEDGING

The Company uses derivative financial instruments to manage its exposures to foreign exchange rates. The Company also utilized a derivative commodity instrument to manage its exposure to electricity rates in the volatile California energy market during the period of June 2001 through November 2001. 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.

FOREIGN CURRENCY EXCHANGE CONTRACTS The Company enters into foreign exchange contracts to hedge against exposure to changes in foreign currency exchange rates. Such contracts are designated at inception to the related foreign currency exposures being hedged, which include anticipated intercompany sales of inventory denominated in foreign currencies, payments due on intercompany transactions from certain wholly-owned foreign subsidiaries, and anticipated sales by the Company's wholly-owned European subsidiary for certain euro-denominated transactions. Hedged transactions are denominated primarily in European currencies, Japanese Yen, Korean Won, Canadian Dollars and Australian Dollars. To achieve hedge accounting, contracts must reduce the foreign currency exchange rate risk otherwise inherent in the amount and duration of the hedged exposures and comply with established company risk management policies. Pursuant to its foreign exchange hedging policy, the Company may hedge anticipated transactions and certain firm commitments and the related receivables and payables 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 of minimizing variability in the Company's operating results arising from foreign exchange rate movements. The Company does not enter into foreign exchange contracts for speculative purposes. Hedging contracts generally mature within twelve months.

At December 31, 2001, 2000 and 1999, the Company had approximately $156,961,000, $118,236,000 and $7,117,000, respectively, of foreign exchange contracts outstanding. Of the total contracts outstanding at December 31, 2001, 2000 and 1999, approximately $122,550,000, $107,779,000 and $0, respectively, were designated as cash flow hedges. The Company estimates the fair values of derivatives based on quoted market prices or pricing models using current market rates, and records all derivatives on the balance sheet at fair value. At December 31, 2001, 2000 and 1999, the net fair value of foreign currency-related derivatives designated as cash flow hedges or fair value hedges were recorded as net current assets of $8,762,000, net current liabilities of $1,551,000 and net current assets of $74,000, respectively.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is initially recorded in accumulated other comprehensive income as a separate component of shareholders' equity and subsequently reclassified into earnings in the period during which the hedged transaction is recognized in earnings. The Company began utilizing cash flow hedges in the fourth quarter of 2000. During 2001, the Company reclassified $2,927,000 of gains into earnings related to the release of the effective portion of gains on contracts designated as cash flow hedges. As of December 31, 2001, the Company expects to reclassify $6,424,000 of deferred net gains into earnings within the next twelve months. During 2001 and 2000, no gains or losses were reclassified into earnings as a result of the discontinuance of any cash flow hedges.

The ineffective gain or loss for derivative instruments that are designated and qualify as cash flow hedges is reported in interest and other income, net immediately. For foreign currency contracts designated as cash flow hedges, hedge effectiveness is measured 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 interest and other 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 the hedges to be highly effective. The effectiveness of each derivative is assessed monthly. During the years ended December 31, 2001 and 2000, a net gain of $1,988,000 and a net loss of $174,000, respectively, was recorded in interest and other income, net representing the ineffective portion of the Company's derivative instruments.

At December 31, 2001, 2000, and 1999, the Company had approximately $34,411,000, $10,457,000 and $7,117,000 of foreign contracts used to hedge balance sheet exposures outstanding. The gains and losses on foreign currency contracts used to hedge balance sheet exposures are recognized in interest and other income, net in the same period as the remeasurement gain and loss of the related foreign currency denominated assets and liabilities and thus offset these gains and losses. During 2001, 2000 and 1999, the Company recorded net realized and unrealized gains on contracts used to hedge balance sheet exposures of $4,473,000, $5,299,000 and $358,000, respectively.

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 electricity while capping costs in the volatile California electricity market. The contract was originally effective through May 2006. This derivative did not qualify for hedge accounting treatment under SFAS No. 133. Therefore, the Company recognized in earnings the changes in the estimated fair value of the contract based on current market rates as unrealized energy derivative losses. During the fourth quarter of 2001, the Company notified the energy supplier that, among other things, the energy supplier was in default of the energy supply contract and that based upon such default, and for other reasons, the Company was terminating the energy supply contract. As a result, the Company adjusted the estimated fair value of this contract through the date of termination, at which time the terminated contract ceased to represent a derivative instrument in accordance with SFAS No. 133. As the contract is terminated and neither party to the contract is performing pursuant to the terms of the contract, the Company no longer records future valuation adjustments for changes in electricity rates. The Company continues to reflect the derivative valuation account on its balance sheet, subject to periodic review, in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Any non-cash unrealized gains to be recognized upon extinguishment of the derivative valuation account would be excluded from income from operations.

As of the date of termination, the derivative valuation account reflected $19,922,000 of unrealized losses resulting from changes in estimated fair value of the contract. The fair value of the contract was estimated based on market prices of electricity for the remaining period covered by the contract. The net differential between the contract price and estimated market prices for future periods was applied to the volume stipulated in the contract and discounted on a present value basis to arrive at the estimated fair value of the contract. The estimate of the fair value of the Company's energy derivative is highly subjective and quoted market rates directly relevant to the Company's local energy market and for periods extending beyond a 10 to 12-month horizon are not quoted on a traded market. The Company has relied upon near-term market quotations and other market information to determine fair value estimates. In management's opinion, contract valuation models do not necessarily provide a reliable single measure of the fair value of the energy derivative because there are no quoted market rates directly relevant to the terms of the contract and changes in subjective input assumptions can materially affect the fair value estimates. See Note 11 for a discussion of contingencies related to the termination of the Company's derivative energy contract.

## NOTE 7
## EARNINGS PER COMMON SHARE

The schedule below summarizes the elements included in the calculation of basic and diluted earnings per common share for the years ended December 31, 2001, 2000 and 1999.

| (IN THOUSANDS, EXCEPT PER SHARE DATA) | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|
| Net income | $ 58,375 | $ 80,999 | $ 55,322 |

| | | | |
|---|---|---|---|
| Weighted-average shares outstanding: | | | |
| Weighted-average shares outstanding - Basic | 69,809 | 69,946 | 70,397 |
| Dilutive securities | 1,505 | 1,466 | 817 |
| Weighted-average shares outstanding - Diluted | 71,314 | 71,412 | 71,214 |
| Earnings per common share: | | | |
| Basic | | | |
| Income before cumulative effect of accounting change | $ 0.84 | $ 1.17 | $ 0.79 |
| Cumulative effect of accounting change | -- | (0.01) | -- |
| | $ 0.84 | $ 1.16 | $ 0.79 |
| Diluted | | | |
| Income before cumulative effect of accounting change | $ 0.82 | $ 1.14 | $ 0.78 |
| Cumulative effect of accounting change | -- | (0.01) | -- |
| | $ 0.82 | $ 1.13 | $ 0.78 |

For the years ended December 31, 2001, 2000 and 1999, options outstanding totaling 8,943,000, 8,931,000 and 10,979,000, respectively, were excluded from the calculations of earnings per common share, as their effect would have been antidilutive.

NOTE 8
STOCK, STOCK OPTIONS AND RIGHTS
COMMON STOCK AND PREFERRED STOCK The Company has an authorized capital of 243,000,000 shares, $.01 par value, of which 240,000,000 shares are designated Common Stock, and 3,000,000 shares are designated Preferred Stock. Of the Preferred Stock, 240,000 shares are designated Series A Junior Participating Preferred Stock in connection with the Company's shareholders' rights plan (see Shareholders' Rights Plan below). The remaining shares of Preferred Stock are undesignated as to series, rights, preferences, privileges or restrictions.

The holders of Common Stock are entitled to one vote for each share of Common Stock on all matters submitted to a vote of the Company's shareholders. Although to date no shares of Series A Junior Participating Preferred Stock have been issued, if such shares were issued, each share of Series A Junior Participating Preferred Stock would entitle the holder thereof to 1,000 votes on all matters submitted to a vote of the shareholders of the Company. The holders of Series A Junior Participating Preferred Stock and the holders of Common Stock shall generally vote together as one class on all matters submitted to a vote of the Company's shareholders. Shareholders entitled to vote for the election of directors are entitled to vote cumulatively for one or more nominees.

TREASURY STOCK 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 $100,000,000. 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 5,837,000 of the Company's Common Stock at an average cost of $17.13 per share for a total of $100,000,000.

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 $100,000,000. During the second half of 2001, the Company repurchased 4,979,000 shares of its Common Stock at an average cost of $16.98 per share for a total of $84,518,000.

The Company's repurchases of shares of Common Stock are recorded at average cost in Common Stock held in treasury and result in a reduction of shareholders' equity. For the years ended December 31, 2001 and 2000, the Company repurchased 6,001,000 shares of Common Stock at an average cost of $17.34 and 4,815,000 shares of Common Stock at an average cost of $16.71, respectively.

In July 2001, the Company issued 5,837,000 shares of Common Stock held in treasury to the Callaway Golf Grantor Stock Trust in exchange for a promissory note in the amount of 90,282,000. The sale of these shares had no net impact on shareholders' equity.

GRANTOR STOCK TRUST In July 1995, the Company established the Callaway Golf Company Grantor Stock Trust (the "GST") for the purpose of funding the Company's obligations with respect to one or more of the Company's non-qualified or qualified employee benefit plans. The GST shares are used primarily for the settlement of employee stock option exercises and employee stock plan purchases. The existence of the GST will have no impact upon the amount of benefits or compensation that will be paid under the Company's employee benefit plans. The GST acquires, holds and distributes shares of the Company's Common Stock in accordance with the terms of the trust. Shares held by the GST are voted in accordance with voting directions from eligible employees of the Company as specified in the GST.

In conjunction with the formation of the GST, the Company issued 4,000,000 shares of newly issued Common Stock to the GST in exchange for a promissory note in the amount of $60,575,000 ($15.14 per share). In December 1995, the Company issued an additional 1,300,000 shares of newly issued Common Stock to the GST in exchange for a promissory note in the amount of $26,263,000 ($20.20 per share). In July 2001, the Company issued 5,837,000 shares of Common Stock held in treasury to the GST in exchange for a promissory note in the amount of $90,282,000 ($15.47 per share). The issuance of these shares to the GST had no net impact on shareholders' equity.

For financial reporting purposes, the GST is consolidated with the Company. The value of shares owned by the GST are accounted for as a reduction to shareholders' equity until used in connection with the settlement of employee stock purchases. Each period, the shares owned by the GST are valued at the closing market price, with corresponding changes in the GST balance reflected in paid-in capital. The issuance of shares by the GST is accounted for by reducing the GST and paid-in capital accounts proportionately as the shares are released. The GST does not impact the determination or amount of compensation expense for the benefit plans being settled. For the year ended December 31, 2001, 150,000 shares and 223,000 shares were released from the GST in connection with the settlement of employee stock option exercises and employee stock plan purchases, respectively, and no shares were released during the years ended December 31, 2000 and 1999.

OPTIONS The Company had the following fixed stock option plans, under which shares were available for grant at December 31, 2001: the 1995 Employee Stock Incentive Plan (the "1995 Plan"), the 1996 Stock Option Plan (the "1996 Plan"), the 1998 Stock Incentive Plan (the "1998 Plan"), the Promotion, Marketing and Endorsement Stock Incentive Plan (the "Promotion Plan") and the 2001 Non-Employee Directors Stock Option Plan (the "2001 Directors Plan").

The 1996 Plan and the 1998 Plan permit the granting of options or other stock awards to the Company's officers, employees and consultants. Under the 1996 Plan and the 1998 Plan, options may not be granted at option prices that are less than fair market value at the date of grant. The 1995 Plan permits the granting of options or other stock awards to only non-executive officer employees and consultants of the Company at option prices that may be less than market value at the date of grant. The 1995 Plan was amended in 2001 and the 1996 Plan was amended in 2000 to increase the maximum number of shares of Common Stock to be issued upon exercise of an option to 10,800,000 and 9,000,000 shares, respectively.

During 1996 and 1995, the Company granted options to purchase shares to two key officers, under separate plans, in conjunction with terms of their initial employment (the "Key Officer Plans"). No shares are available for grant under the Key Officer Plans as of December 31, 2001.

Under the Promotion Plan, shares of Common Stock may be granted in the form of options or other stock awards to golf professionals and other endorsers at prices that may be less than the market value of the stock at the grant date. The 2001 Directors Plan permits the granting of options to purchase shares of Common Stock to Directors of the Company who are not employees, at prices based on the market value of the stock at the date of grant.

The following table presents shares authorized, available for future grant and outstanding under each of the Company's plans as of December 31, 2001:

(IN THOUSANDS)

| | Authorized | Available | Outstanding |
|---|---|---|---|
| 1991 Plan | 10,000 | -- | 958 |
| Promotion Plan | 3,560 | 771 | 870 |
| 1995 Plan | 10,800 | 2,683 | 6,050 |
| 1996 Plan | 9,000 | 1,926 | 5,549 |
| 1998 Plan | 500 | 300 | 166 |
| Key Officer Plans | 1,100 | -- | 720 |
| 2001 Directors Plan | 500 | 456 | 44 |
| Directors Plan | 840 | -- | 396 |
| Total | 36,300 | 6,136 | 14,753 |

Under the Company's stock option plans, outstanding options vest over periods ranging from zero to five years from the grant date and expire up to 12 years after the grant date.

The following summarizes stock option transactions for the years ended December 31, 2001, 2000 and 1999:

(IN THOUSANDS, EXCEPT PER SHARE DATA)

| | YEAR ENDED DECEMBER 31, 2001 | | 2000 | | 1999 | |
|---|---|---|---|---|---|---|
| | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price |
| Outstanding at beginning of year | 16,758 | $ 19.66 | 15,747 | $ 20.46 | 13,637 | $ 22.62 |
| Granted | 3,475 | $ 19.72 | 4,461 | $ 13.71 | 4,012 | $ 11.30 |
| Exercised | (3,634) | $ 12.39 | (2,252) | $ 10.64 | (851) | $ 6.40 |
| Canceled | (1,846) | $ 26.77 | (1,198) | $ 25.01 | (1,051) | $ 24.95 |
| Outstanding at end of year | 14,753 | $ 20.57 | 16,758 | $ 19.66 | 15,747 | $ 20.46 |
| Options exercisable at end of year | 11,484 | $ 21.20 | 12,394 | $ 19.99 | 11,066 | $ 18.64 |
| Price range of outstanding options | | $ 5.00 - $ 40.00 | | $ 2.50 - $ 40.00 | | $ 0.44 - $ 40.00 |

The exercise price of all options granted during 2001 was equal to the market value on the date of grant. The following table summarizes additional information about outstanding stock options at December 31, 2001:

| Range of Exercise Price | Number Outstanding (in thousands) | Weighted-Average Remaining Contractual Life-Years | Weighted-Average Exercise Price | Number Exercisable (in thousands) | Weighted-Average Exercise Price |
|---|---|---|---|---|---|
| $ 5- $ 10 | 86 | 1.81 | $ 5.95 | 78 | $ 5.57 |
| $ 10- $ 15 | 4,897 | 5.20 | $ 12.63 | 3,940 | $ 12.44 |
| $ 15- $ 25 | 4,595 | 6.72 | $ 18.63 | 2,723 | $ 18.63 |
| $ 25- $ 40 | 5,175 | 3.12 | $ 30.05 | 4,743 | $ 30.22 |
| $ 5- $ 40 | 14,753 | 4.93 | $ 20.57 | 11,484 | $ 21.20 |

During 2001 and 2000, the Company, at its discretion, extended the expiration terms or accelerated the vesting of 1,422,000 and 622,000 options, respectively, held by certain employees and officers. Also, during 1999, the Company, at its discretion, extended the expiration terms of 1,532,000 options held by certain employees and officers. At the time of the modifications, the exercise prices of the options were in excess of the then-current market price and accordingly these actions did not result in compensation expense for the Company. Also during 2001, the Company, at its discretion, indirectly re-priced 17,000 options and recognizes compensation expense related to these options in accordance with variable plan accounting.

SHAREHOLDERS' RIGHTS PLAN The Company has a plan to protect shareholders' rights in the event of a proposed takeover of the Company. Under the plan, each share of the Company's outstanding Common Stock carries one right to purchase one one-thousandth of a share of the Company's Series "A" Junior Participating Preferred Stock (the "Right"). The Right entitles the holder, under certain circumstances, to purchase Common Stock of Callaway Golf Company or of the acquiring company at a substantially discounted price ten days after a person or group publicly announces it has acquired or has tendered an offer for 15% or more of the Company's outstanding Common Stock. The Rights are redeemable by the Company at $.01 per Right and expire in 2005.

RESTRICTED COMMON STOCK During 1998, the Company granted 130,000 shares of Restricted Common Stock with a fair value of $31 per share to 26 officers of the Company. Of these shares, 80,250 shares have been canceled due to the service requirement not being met. During 1998, the Company, at its discretion, accelerated the vesting of 20,000 shares and recorded related compensation expense of $618,000. The remaining 29,750 shares, which are restricted as to sale or transfer until vesting, will vest on January 1, 2003. The net compensation expense of $922,000 related to the remaining shares is being recognized ratably over the vesting period, based on the difference between the exercise price and market value of the stock on the measurement date.

EMPLOYEE STOCK PURCHASE PLAN The Company had an Employee Stock Purchase Plan ("ESPP") whereby eligible employees purchased shares of Common Stock at 85% of the lower of the fair market value on the first day of a two year offering period or the last day of each six month exercise period. Eligible employees authorized the Company to withhold compensation during an offering period, subject to certain limitations. In May 1999, the Company's shareholders approved a new ESPP (the "1999 ESPP") with substantially the same terms as the ESPP. This plan was effective February 1, 2000 upon the termination of the ESPP.

During 2001, 2000 and 1999, approximately 506,000, 412,000 and 378,000 shares, respectively, of the Company's Common Stock were purchased under the 1999 ESPP or the ESPP. As of December 31, 2001, 1,277,000 shares were reserved for future issuance under the 1999 ESPP.

COMPENSATION EXPENSE During 2001, 2000 and 1999, the Company recorded $342,000, $2,157,000 and $1,390,000, respectively, in compensation expense for Restricted Common Stock and certain options to purchase shares of Common Stock granted to employees, officers, professional endorsers and consultants of the Company. The valuation of options granted to non-employees is estimated using the Black-Scholes option-pricing model.

Unearned compensation has been charged for the value of options granted to both employees and non-employees on the measurement date based on the valuation methods described above. These amounts are amortized over the vesting period. The unamortized portion of unearned compensation is shown as a reduction of shareholders' equity in the accompanying consolidated balance sheet.

PRO FORMA DISCLOSURES If the Company had elected to recognize compensation expense based upon the fair value at the grant date for employee awards under these plans, the Company's net income and earnings per share would be changed to the pro forma amounts indicated below:

| (IN THOUSANDS, EXCEPT PER SHARE DATA) | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|
| Net income: | | | |
| As reported | $ 58,375 | $ 80,999 | $ 55,322 |
| Pro forma | $ 43,948 | $ 58,761 | $ 34,422 |
| Earnings per Common Share: | | | |
| As reported | | | |
| Basic | $ 0.84 | $ 1.16 | $ 0.79 |
| Diluted | $ 0.82 | $ 1.13 | $ 0.78 |
| Pro forma | | | |
| Basic | $ 0.63 | $ 0.84 | $ 0.49 |
| Diluted | $ 0.62 | $ 0.83 | $ 0.48 |

The pro forma amounts reflected above may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense as the options vest and additional options may be granted in future years. The fair value of employee stock options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

| | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Dividend yield | 1.6% | 1.1% | 1.4% |
| Expected volatility | 53.9% | 53.0% | 45.6% |
| Risk free interest rates | 3.81% - 4.22% | 5.18% - 5.56% | 5.36% - 6.24% |
| Expected lives | 3 - 4 years | 3 - 4 years | 3 - 4 years |

The weighted-average grant-date fair value of options granted during 2001, 2000 and 1999 was $6.98, $6.91 and $3.57 per share, respectively. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of grants under the Company's employee stock-based compensation plans.

NOTE 9

Employee Benefit Plans

The Company has a voluntary deferred compensation plan under Section 401(k) of the Internal Revenue Code (the "401(k) Plan") for all employees who satisfy the age and service requirements under the 401(k) Plan. Each participant may elect to contribute up to 15% of annual compensation, up to the maximum permitted under Federal law, and the Company is obligated to contribute annually an amount equal to 100% of the participant's contribution up to 6% of that participant's annual compensation. Employees contributed

$6,353,000, $6,119,000 and $5,486,000 to the 401(k) Plan in 2001, 2000 and 1999, respectively. In accordance with the provisions of the 401(k) Plan, the Company matched employee contributions in the amount of $4,474,000, $4,706,000 and $4,510,000 during 2001, 2000 and 1999, respectively. Additionally, the Company can make discretionary contributions based on the profitability of the Company. For the years ended December 31, 2001, 2000 and 1999, the Company recorded compensation expense for discretionary contributions of $3,786,000, $3,799,000 and $3,605,000, respectively.

The Company also has an unfunded, non-qualified deferred compensation plan. The plan allows officers, certain other employees and directors of the Company to defer all or part of their compensation, to be paid to the participants or their designated beneficiaries upon retirement, death or separation from the Company. To support the deferred compensation plan, the Company has elected to purchase Company-owned life insurance. The cash surrender value of the Company-owned insurance related to deferred compensation is included in other assets and was $10,556,000 and $8,310,000 at December 31, 2001 and 2000, respectively. The liability for the deferred compensation is included in long-term liabilities and was $8,297,000 and $9,884,000 at December 31, 2001 and 2000, respectively. For the years ended December 31, 2001, 2000 and 1999, the total participant deferrals, which are reflected in long-term liabilities, were $836,000, $843,000 and $997,000, respectively. Included in other income during 1999 were net proceeds from an insurance policy related to the deferred compensation plan of $3,622,000.

NOTE 10
INCOME TAXES

The Company's income before income tax provision was subject to taxes in the following jurisdictions for the following periods:

| (IN THOUSANDS) | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|
| United States | $ 75,872 | $ 101,890 | $ 75,799 |
| Foreign | 22,320 | 27,432 | 9,698 |
| | $ 98,192 | $ 129,322 | $ 85,497 |

The provision for income taxes is as follows:

| (IN THOUSANDS) | YEAR ENDED DECEMBER 31, 2001 | 2000 | 1999 |
|---|---|---|---|
| Current tax provision: | | | |
| Federal | $ 23,056 | $ 26,616 | $ 14,779 |
| State | 3,350 | 5,130 | 2,774 |
| Foreign | 8,273 | 10,623 | 3,044 |
| Deferred tax expense (benefit): | | | |
| Federal | 3,595 | 7,463 | 8,956 |
| State | 1,526 | (1,596) | 1,162 |
| Foreign | 17 | (870) | (540) |
| Income tax provision | $ 39,817 | $ 47,366 | $ 30,175 |

During 2001, 2000 and 1999, the Company recognized certain tax benefits related to stock option exercises in the amount of $14,520,000, $6,806,000 and $2,377,000, respectively. Such benefits were recorded as a reduction of income taxes payable and an increase in paid-in capital.

Deferred tax assets and liabilities are classified as current or noncurrent according to the classification of the related asset or liability. Significant components of the Company's deferred tax assets and liabilities as of December 31, 2001 and 2000 are as follows:

| (IN THOUSANDS) | DECEMBER 31, 2001 | 2000 |
|---|---|---|
| Deferred tax assets: | | |
| Reserves and allowances | $ 20,032 | $ 22,365 |
| Depreciation and amortization | 2,962 | 12,225 |
| Compensation and benefits | 5,506 | 7,208 |
| Effect of inventory overhead adjustment | 3,571 | 1,934 |
| Compensatory stock options and rights | 2,344 | 3,473 |
| Foreign net operating loss carryforwards | -- | 107 |
| Revenue recognition | 8,433 | 1,320 |
| Long-lived asset impairment | 1,738 | 1,738 |
| Capital loss carryforward | 283 | 834 |
| Tax credit carryforwards | 2,192 | 3,200 |
| Other | 5,612 | 1,793 |
| Total deferred tax assets | 52,673 | 56,197 |
| Valuation allowance for deferred tax assets | (2,764) | (1,354) |

| | | |
|---|---|---|
| Deferred tax assets, net of valuation allowance | 49,909 | 54,843 |
| Deferred tax liabilities: | | |
| State taxes, net of federal income tax benefit | (2,361) | (2,157) |
| Net deferred tax assets | $ 47,548 | $ 52,686 |

At December 31, 2001, the Company had $2,192,000 of credit carryforwards primarily relating to state investment tax credits which expire at various dates between December 31, 2007 and 2009.

A valuation allowance has been established due to the uncertainty of realizing certain tax attribute carryforwards, and a portion of other deferred tax assets. Based on management's assessment, it is more likely than not that all the net deferred tax assets will be realized through future earnings.

A reconciliation of income taxes computed by applying the statutory U.S. income tax rate to the Company's income before income taxes to the income tax provision is as follows:

| (IN THOUSANDS) | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 2001 | 2000 | 1999 |
| Amounts computed at statutory U.S. tax rate | $ 34,367 | $ 45,263 | $ 29,924 |
| State income taxes, net of U.S. tax benefit | 4,047 | 4,112 | 3,046 |
| State tax credits, net of U.S. tax benefit | (878) | (325) | (2,075) |
| Nondeductible foreign losses | -- | 65 | (476) |
| Expenses with no tax benefit | 693 | 931 | 814 |
| Nondeductible capital losses | -- | -- | 130 |
| Foreign sales corporation tax benefits | (1,406) | (1,487) | (1,471) |
| Nontaxable insurance proceeds | -- | -- | (1,408) |
| Change in deferred tax valuation allowance | 1,410 | (2,836) | 2,431 |
| Other | 1,584 | 1,643 | (740) |
| Income tax provision | $ 39,817 | $ 47,366 | $ 30,175 |

U.S. tax return examinations have been completed for the years through 1994. Management believes adequate provisions for income tax have been recorded for all years.

NOTE 11
COMMITMENTS AND CONTINGENCIES
SUPPLY OF ELECTRICITY AND ENERGY CONTRACTS In the second quarter of 2001, the Company entered into an agreement with Pilot Power Group, Inc. ("Pilot Power") as the Company's energy service provider and in connection therewith entered into a long-term, fixed-priced, fixed-capacity, energy supply contract ("Enron Contract") with Enron Energy Services, Inc. ("EESI"), a subsidiary of Enron Corporation, as part of a comprehensive strategy to ensure the uninterrupted supply of energy while capping electricity costs in the volatile California energy market. The Enron Contract provided, subject to the other terms and conditions of the contract, for the Company to purchase nine megawatts of energy per hour from June 1, 2001 through May 31, 2006 (394,416 megawatts over the term of the contract). The total purchase price for such energy over the full contract term was approximately $43,484,000.

At the time the Company entered into the Enron Contract, nine megawatts per hour was in excess of the amount the Company expected to be able to use in its operations. The Company agreed to purchase this amount, however, in order to obtain a more favorable price than the Company could have obtained if the Company had purchased a lesser quantity. The Company expected to be able to sell any excess supply through Pilot Power.

On November 29, 2001, the Company notified EESI that, among other things, EESI was in default of the Enron Contract and that based upon such default, and for other reasons, the Company was terminating the Enron Contract effective immediately. At the time of termination, the contract price for the remaining energy to be purchased under the Enron Contract through May 2006 was approximately $39,126,000.

On November 30, 2001, EESI notified the Company that it disagreed that it was in default of the Enron Contract and that it was prepared to deliver energy pursuant to the Enron Contract. On December 2, 2001, EESI, along with Enron Corporation and numerous other related entities, filed for bankruptcy. Since November 30, 2001, the parties have not been operating under the Enron Contract and Pilot Power has been providing energy to the Company from alternate suppliers.

As a result of the Company's notice of termination to EESI, and certain other automatic termination provisions under the Enron Contract, the Company believes that the Enron Contract has been effectively and appropriately terminated. There can be no assurance that EESI or another party will not assert a future claim against the Company or that a bankruptcy court or arbitrator will not ultimately nullify the Company's termination of the Enron Contract. No provision has been made for contingencies or obligations, if any, under the Enron Contract beyond November 30, 2001.

LEGAL MATTERS 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. 100-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 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 the 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. Among other remedies, 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 December 31, 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 consolidated financial position, results of operations or cash flows.

VENDOR ARRANGEMENTS The Company is dependent on a limited number of suppliers for its clubheads and shafts, some of which are single-sourced. In addition, some of the Company's products require specifically developed manufacturing techniques and processes which make it difficult to identify and utilize alternative suppliers quickly. 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 has entered into long-term purchase agreements for various key raw materials. The purchase commitments covered by these agreements aggregate approximately $4,000,000 per year for 2002 and 2003.

LEASE COMMITMENTS The Company leases certain warehouse, distribution and office facilities, as well as office and manufacturing equipment under operating leases. Lease terms range from one to ten years expiring at various dates through December 2008, with options to renew at varying terms. Commitments for minimum lease payments under non-cancelable operating leases as of December 31, 2001 are as follows:

| (IN THOUSANDS) | |
|---|---|
| 2002 | $ 7,598 |
| 2003 | 2,792 |
| 2004 | 2,039 |
| 2005 | 1,929 |
| 2006 | 1,974 |
| Thereafter | 1,922 |
| | $18,254 |

Future minimum lease payments have not been reduced by future minimum sublease rentals of $1,882,000 under an operating lease. At December 31, 2001, the Company is contingently liable for $3,167,000 through February 2003 under an operating lease that was assigned to a third party (Note 12). Rent expense for the years ended December 31, 2001, 2000, and 1999 was $3,759,000, $3,197,000 and $2,315,000, respectively. Rent expense for 1999 does not include a credit of $6,076,000 related to the reversal of a restructuring reserve for excess lease costs (Note 12).

EMPLOYMENT CONTRACTS The Company has entered into employment contracts with each of the Company's officers. These contracts generally provide for severance benefits, including salary continuation, if the officer is terminated by the Company for convenience or by the officer for substantial cause. In addition, in order to assure that the officers would continue to provide independent leadership consistent with the Company's best interests in the event of an actual or threatened change in control of the Company, the contracts also generally provide for certain protections in the event of such a change in control. These protections include the extension of employment contracts and the payment of certain severance benefits, including salary continuation, upon the termination of employment following a change in control. The Company is also generally obligated to reimburse such officers for the amount of any excise taxes associated with such benefits.

NOTE 12
RESTRUCTURING
In 1998, the Company recorded a restructuring charge of $54,235,000 resulting from a number of cost reduction actions and operational improvements. These actions included: the consolidation of the operations of the Company's wholly-owned subsidiary, Odyssey, into the operations of the Company while maintaining the distinct and separate Odyssey brand; the discontinuation, transfer or suspension of certain initiatives not directly associated with the Company's core business, such as the Company's involvement with interactive golf sites, golf book publishing, new player development and a golf venue in Las Vegas; and the re-sizing of the Company's core business to reflect current and expected business conditions. These initiatives were completed during 1999, with the exception of cash outlays related to the assignment of a lease obligation for a facility in New York City that continued through July 2000. During 1999, the Company incurred charges of $1,295,000 on the disposition of building improvements eliminated during the consolidation of manufacturing operations, as well as other charges of $671,000. These charges did not meet the criteria for accrual in 1998. The Company also incurred charges of $749,000 during 1999 related to asset dispositions and other restructuring activities for which reserves were not established in 1998. Additionally, in 1999, the Company reversed $8,609,000 of the reserve as actual amounts differed from estimates established in 1998. The reversal was primarily attributable to the $6,076,000 reversed as a result of the assignment of a lease obligation at terms significantly more favorable than estimated at the establishment of the reserve combined with the $1,470,000 reversal related to the disposition of two buildings at higher sales prices than estimated. No charges were incurred during 2000 and during the third quarter of 2000, the restructuring reserve balance was fully depleted.

NOTE 13
ACQUISITIONS AND REORGANIZATIONS
During the first quarter of 2001, the Company acquired distribution rights and substantially all of the assets from its distributors in Spain and Australia for $4,400,000 and $1,400,000, respectively. These acquisitions were accounted for using the purchase method. On December 29, 2000, the Company consolidated a wholly-owned subsidiary, Callaway Golf Ball Company, with the Company. During 1999, the Company acquired distribution rights and substantially all of the assets from its distributor in Ireland for $810,000. Also in 1999, the Company merged its subsidiary, Callaway Golf Europe, S.A., with another of its subsidiaries, Callaway Golf Europe, Ltd. and now operates in France through a satellite office. These acquisitions are not considered significant business combinations. Accordingly, pro forma financial information is not presented.

NOTE 14
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 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. There are no significant intersegment transactions. The tables below contain information utilized by management to evaluate its operating segments.

| (IN THOUSANDS) | 2001 | 2000 | 1999 |
|---|---|---|---|
| Net sales | | | |
| Golf Clubs | $ 761,310 | $ 803,663 | $ 719,038 |
| Golf Balls | 54,853 | 33,964 | -- |
| | $ 816,163 | $ 837,627 | $ 719,038 |
| Income (loss) before tax | | | |
| Golf Clubs | $ 184,770 | $ 213,786 | $ 175,794 |
| Golf Balls | (17,868) | (45,918) | (36,097) |
| Reconciling items(1) | (68,710) | (38,546) | (54,200) |
| | $ 98,192 | $ 129,322 | $ 85,497 |
| Identifiable assets(2) | | | |
| Golf Clubs | $ 343,741 | $ 317,036 | $ 303,905 |
| Golf Balls | 60,166 | 52,255 | 42,293 |
| | $ 403,907 | $ 369,291 | $ 346,198 |

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

(2) Identifiable assets are comprised of net inventory, property, plant and equipment and intangible assets. Total identifiable assets differ from total assets as a result of unidentified corporate assets not segregated between the two segments.

The Company markets its products domestically and internationally, with its principal international markets being Japan and Europe. The tables below contain information about the geographical areas in which the Company operates. Revenues are attributed to the location to which the product was shipped. Long-lived assets are based on location of domicile.

(IN THOUSANDS)

| | Sales | Long-Lived Assets |
|---|---|---|
| 2001 | | |
| United States | $ 444,091 | $ 234,281 |
| Japan | 130,706 | 3,415 |
| Europe | 118,417 | 13,261 |
| Rest of Asia | 63,928 | 729 |
| Other foreign countries | 59,021 | 2,877 |
| | $ 816,163 | $ 254,563 |
| 2000 | | |
| United States | $ 451,264 | $ 228,920 |
| Japan | 122,003 | 3,229 |
| Europe | 125,511 | 11,229 |
| Rest of Asia | 82,371 | 994 |
| Other foreign countries | 56,478 | 3,164 |
| | $ 837,627 | $ 247,536 |
| 1999 | | |
| United States | $ 418,397 | $ 241,241 |
| Japan | 55,927 | 2,634 |
| Europe | 115,673 | 14,027 |
| Rest of Asia | 73,121 | 974 |
| Other foreign countries | 55,920 | 3,481 |
| | $ 719,038 | $ 262,357 |

The Company, through a distribution agreement, had appointed Sumitomo as the sole distributor of Callaway Golf clubs in Japan. The distribution agreement, which began in February 1993 and ended on December 31, 1999, required Sumitomo to purchase specified minimum quantities. In 1999, sales to Sumitomo accounted for 7% of the Company's net sales. In the fourth quarter of 1999, the Company successfully completed negotiations with Sumitomo to provide a transition of its business. As a result of this transition agreement, the Company purchased all undamaged, unopened inventory products in the possession of the distributor and paid a transition fee to the distributor. The Company recorded a net charge of $8,600,000 in the fourth quarter of 1999 for transition expenses, excess and obsolete inventory purchased, and foreign currency transaction losses. The transition expenses, excess and obsolete inventory charge, and foreign currency transaction losses were included in income from operations, gross profits, and other income, respectively. The Company also purchased saleable products and accordingly increased its inventory balance by $3,600,000. Odyssey brand products are sold through the Company's wholly-owned Japanese subsidiary, Callaway Golf K.K., and beginning January 1, 2000, Callaway Golf brand products were sold through this subsidiary.

## NOTE 15
## LICENSING ARRANGEMENTS

In 2001, the Company and Nordstrom, Inc. mutually terminated their prior licensing arrangement, which included men's and women's golf apparel, men's footwear and sun and skin care products. Also in 2001, the Company entered into an exclusive licensing arrangement with Ashworth, Inc. for the creation of a complete line of men's and women's apparel for distribution in the United States, Canada, Europe, Australia, New Zealand and South Africa. In addition, the Company also entered into a long-term licensing agreement with Sanei International Co., Ltd. to create and sell Callaway Golf apparel in Japan. The Company's golf apparel products will be available at retail beginning in 2002. The first full year for which the Company will receive royalty revenue under these licensing arrangements is 2003.

## NOTE 16
## TRANSACTIONS WITH RELATED PARTIES

A director of the Company is also a senior managing director of an investment bank which performed services for the Company. Investment banking fees incurred with this investment bank totaled $557,000 in 2001 and no fees were paid in 2000 and 1999. Another director of the Company is also an advisory partner of a law firm which performs legal services for the Company. Legal fees incurred with this law firm totaled $351,000, $469,000 and $1,063,000 in 2001, 2000, and 1999, respectively.

The Callaway Golf Company Foundation (the "Foundation") oversees and administers charitable giving for the Company and makes grants to carefully selected organizations. Directors and executive officers of the Company also serve as directors of the Foundation and the Company's employees provide accounting and administrative services for the Foundation. In 2001, the Company recognized a charitable contribution expense of $1,000,000 as a result of its unconditional promise to contribute such amount to the Foundation. As of December 31, 2001, the Company had paid $584,000 of the contribution. The remaining $416,000 was to be paid in 2002. In 2000 and 1999, the Company donated $288,000 and $232,000, respectively, to the Foundation.

During 1998, the Company entered into an agreement with Callaway Editions, Inc. to form CGMV, a limited liability company that was owned 80% by the Company and 20% by Callaway Editions, Inc. ("Callaway Editions"). Callaway Editions is a publishing and media company which was owned 9% by Ely Callaway, Chairman, President and Chief Executive Officer of the Company, and 81% by his son, Nicholas Callaway. During 1999, in connection with the termination of its relationship with CGMV, the Company forgave the existing loan balance from CGMV of approximately $2,142,000, sold its interest to Callaway Editions for a nominal amount and paid $1,000,000 as consideration for release from its obligation to loan CGMV up to $20,000,000. These transactions did not result in a charge in 1999, as they were adequately accrued in the 1998 restructuring reserve (Note 12).

In December 1998, the Company purchased the remaining 20% interest in Callaway Golf Trading GmbH, the Company's former German distributor, for $6,766,000. The purchase price was in the form of a note payable bearing interest at 7%, due in June 1999 to the seller, who was then an officer of a wholly-owned subsidiary of the Company. The note payable was included in accounts payable and accrued expenses at December 31, 1998 and was paid in February 1999.

NOTE 17
SUBSEQUENT EVENT

In December 1998, the Company entered into a master lease agreement for the acquisition and lease of machinery and equipment utilized in the Company's golf ball operations. By December 31, 1999, the Company had finalized its lease program and leased $50,000,000 of equipment under the operating lease. On February 11, 2002, pursuant to the master lease agreement, the Company notified the lessor of its election to purchase the leased equipment in August 2002 for approximately $44,834,000 plus the payment of approximately $5,200,000 of lease termination fees

# REPORTS OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholders of Callaway Golf Company:

We have audited the accompanying consolidated balance sheet of Callaway Golf Company (a Delaware corporation) and Subsidiaries as of December 31, 2001, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Callaway Golf Company and Subsidiaries as of December 31, 2001, and the results of their operations and their cash flows for the year ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

/s/ Arthur Andersen LLP
San Diego, California
January 15, 2002 (except with respect to
the matter discussed in Note 17, as to
which the date is February 11, 2002)

To the Board of Directors and Shareholders of Callaway Golf Company:

In our opinion, the accompanying consolidated balance sheet as of December 31, 2000 and the related consolidated statements of operations, of cash flows and of shareholders' equity for each of the two years in the period ended December 31, 2000 present fairly, in all material respects, the financial position, results of operations and cash flows of Callaway Golf Company and its subsidiaries at December 31, 2000 and for each of the two years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
San Diego, California
March 19, 2001

## CHANGE IN INDEPENDENT PUBLIC ACCOUNTANTS

In early 2001, the Company's Audit Committee requested that the Company evaluate proposals from other firms in addition to its then current outside auditor, PricewaterhouseCoopers ("PwC"). Management solicited proposals from likely candidates, and during the second quarter of 2001 the Audit Committee reviewed a number of candidates that had been pre-screened by management. At the conclusion of this review process, the Audit Committee recommended to the Board of Directors, and the Board of Directors approved, the appointment, effective as of June 18, 2001, of Arthur Andersen LLP ("Arthur Andersen") as the Company's new outside auditor for fiscal year 2001 (PwC's engagement officially ended on June 15, 2001). The Audit Committee recommended the change because, among other things, it believed that a change in outside auditor could help assure an independent and rigorous review of the Company's practices. (PwC had been the Company's outside auditor for over ten years). In addition, the Committee felt that Arthur Andersen offered a very high level of audit services at a competitive cost to the Company.

The report of Arthur Andersen in connection with its audit of the Company's consolidated financial statements for the year ended December 31, 2001 does not contain an adverse opinion or a disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope or accounting principles.

PwC's reports in connection with its audits of the Company's consolidated financial statements for the years ended December 31, 2000 and December 31, 1999, do not contain an adverse opinion or a disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles. In addition, during the Company's fiscal years ended December 31, 2000 and December 31, 1999 and through the subsequent interim period through the date PwC ceased to be the Company's auditor, there were no disagreements with PwC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements if not resolved to PwC's satisfaction would have caused PwC to make reference to the subject matter of the disagreement in connection with its reports.

## SUMMARIZED QUARTERLY FINANCIAL DATA (UNAUDITED)

| (IN THOUSANDS, EXCEPT PER SHARE DATA) | FISCAL YEAR 2001 QUARTERS | | | | |
|---|---|---|---|---|---|
| | 1st | 2nd(2) | 3rd(2) | 4th | Total |
| Net sales | $ 261,365 | $ 253,655 | $ 195,848 | $ 105,295 | $ 816,163 |
| Gross profit | $ 136,907 | $ 131,936 | $ 95,024 | $ 40,711 | $ 404,578 |
| Net income (loss) | $ 34,075 | $ 26,975 | $ 6,519 | $ (9,194) | $ 58,375 |
| Earnings (loss) per common share(1) | | | | | |
| Basic | $ 0.49 | $ 0.38 | $ 0.09 | $ (0.14) | $ 0.84 |
| Diluted | $ 0.47 | $ 0.36 | $ 0.09 | $ (0.14) | $ 0.82 |

| | FISCAL YEAR 2000 QUARTERS | | | | |
|---|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th | Total |
| Net sales | $ 197,406 | $ 289,922 | $ 208,081 | $ 142,218 | $ 837,627 |
| Gross profit | $ 88,265 | $ 144,507 | $ 102,031 | $ 62,705 | $ 397,508 |
| Income before cumulative effect of accounting change | $ 13,098 | $ 44,189 | $ 20,055 | $ 4,614 | $ 81,956 |
| Cumulative effect of accounting change | $ (957) | $ -- | $ -- | $ -- | $ (957) |
| Net income | $ 12,141 | $ 44,189 | $ 20,055 | $ 4,614 | $ 80,999 |
| Earnings per common share(1) | | | | | |
| Basic | | | | | |
| Income before cumulative effect of accounting change | $ 0.18 | $ 0.63 | $ 0.29 | $ 0.07 | $ 1.17 |
| Cumulative effect of accounting change | $ (0.01) | $ -- | $ -- | $ -- | $ (0.01) |
| | $ 0.17 | $ 0.63 | $ 0.29 | $ 0.07 | $ 1.16 |
| Diluted | | | | | |
| Income before cumulative effect of accounting change | $ 0.18 | $ 0.61 | $ 0.29 | $ 0.07 | $ 1.14 |
| Cumulative effect of accounting change | $ (0.01) | $ -- | $ -- | $ -- | $ (0.01) |
| | $ 0.17 | $ 0.61 | $ 0.29 | $ 0.07 | $ 1.13 |

(1) Earnings per share is computed individually for each of the quarters presented; therefore, the sum of the quarterly earnings per share may not necessarily equal the total for the year.
(2) The Company's net income and earnings per common share includes the recognition of unrealized energy contract losses due to changes in the estimated fair value of the energy contract based on market rates. During the second and third quarters of 2001, the Company recorded $6,400,000 and $7,800,000, respectively, of after-tax unrealized losses. During the fourth quarter of 2001, the Company terminated the energy contract. As a result, the Company will continue to reflect the derivative valuation account on its balance sheet with no future valuation adjustments for changes in market rates, subject to periodic review (Notes 6 and 11).

## MARKET FOR COMMON SHARES AND RELATED SHAREHOLDER MATTERS

The Company's Common Shares are traded on the New York Stock Exchange (NYSE). The Company's symbol for its Common Shares is "ELY." As of March 8, 2002, the approximate number of holders of record of the Company's Common Stock was 9,000.

STOCK PRICE INFORMATION

| | YEAR ENDED DECEMBER 31, 2001 | | | 2000 | | |
|---|---|---|---|---|---|---|
| Period: | High | Low | Dividend | High | Low | Dividend |
| First Quarter | $ 27.01 | $ 17.25 | $ 0.07 | $ 17.75 | $ 11.00 | $ 0.07 |
| Second Quarter | $ 26.34 | $ 14.60 | $ 0.07 | $ 20.56 | $ 14.81 | $ 0.07 |
| Third Quarter | $ 18.12 | $ 12.21 | $ 0.07 | $ 16.69 | $ 12.44 | $ 0.07 |
| Fourth Quarter | $ 19.83 | $ 12.87 | $ 0.07 | $ 19.56 | $ 14.50 | $ 0.07 |

EXHIBIT 21.1

| Subsidiary List | Incorporated |
|---|---|
| Callaway Golf Sales Company | California |
| Callaway Golf Shell Company | California |
| CGV, Inc. | California |
| All American Golf LLC | California |
| Callaway Golf South Pacific Pty Ltd | Australia |
| Callaway Golf Europe Ltd. | United Kingdom |
| Callaway (Barbados) Foreign Sales Corporation | Barbados |
| Callaway Golf Kabushiki Kaisha | Japan |
| Callaway Golf Korea Ltd. | Korea |
| Callaway Golf (Germany) GmbH | Germany |
| Callaway Golf Canada Ltd. | Canada |

Exhibit 23.1

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation by reference of our report dated January 15, 2002 (except with respect to the matter discussed in Note 17, as to which the date is February 11, 2002) on the Company's consolidated financial statements as of and for the year ended December 31, 2001 included in Exhibit 13.1 to this Form 10-K, and of our report dated January 15, 2002 on the financial statement schedule as of and for the year ended December 31, 2001 included in this Form 10-K, into the Company's previously filed S-3 Registration Statement No. 33-77024, and into the Company's previously filed S-8 Registration Statements Nos. 333-43756, No. 333-52020, No. 33-85692, No. 33-50564, No. 33-56756, No. 33-67160, No. 33-73680, No. 33-98750, No. 333-242, No. 333-5719, No. 333-5721, No. 333-24207, No. 333-27089, No. 333-39095, No. 333-61889, No. 333-95601, and No. 333-95603.

/s/ Arthur Andersen LLP
San Diego, California
March 20, 2002

EXHIBIT 23.2

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (No. 33-77024) and in the Registration Statements on Form S-8 (No. 333-43756, No. 333-52020, No. 33-85692, No. 33-50564, No. 33-56756, No. 33-67160, No. 33-73680, No. 33-98750, No. 333-242, No. 333-5719, No. 333-5721, No. 333-24207, No. 333-27089, No. 333-39095, No. 333-61889, No. 333-95601 and No. 333-95603) of Callaway Golf Company of our report dated March 19, 2001 relating to the consolidated financial statements, which appears in the 2001 Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10-K for the year ended December 31, 2001. We also consent to the incorporation by reference of our report dated March 19, 2001 relating to the financial statement schedule, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP
San Diego, California
March 20, 2002

EXHIBIT 24.1

FORM OF POWER OF ATTORNEY

Each of William C. Baker, Ronald S. Beard, Vernon E. Jordan, Jr., Yotaro Kobayashi and Richard L. Rosenfield executed the following power of attorney, except that his name was inserted where "[name of director]" appears.

LIMITED POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that I, [NAME OF DIRECTOR], a member of the Board of Directors of Callaway Golf Company, a Delaware corporation (the "Company"), with its principal executive offices in Carlsbad, California, do hereby constitute, designate and appoint each of Steven C. McCracken and Bradley J. Holiday, each of whom are executive officers of the Company, as my true and lawful attorneys-in-fact, each with power of substitution, with full power to act without the other and on behalf of and as attorney for me, for the purpose of executing and filing with the Securities and Exchange Commission the Company's Annual Report on Form 10-K for the year ended December 31, 2001, and any and all amendments thereto, and to do all such other acts and execute all such other instruments which said attorney may deem necessary or desirable in connection therewith.

I have executed this Limited Power of Attorney as of February 27, 2002.

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[NAME OF DIRECTOR]

EXHIBIT 99.1

Callaway Golf Company
2180 Rutherford Road
Carlsbad, CA 92008

March 21, 2002

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
Judiciary Plaza
450 5th Street, N.W.
Washington, D.C. 20549

Re: Confirmation of Receipt of Assurances from Arthur Andersen LLP

Dear Mr. Katz:

Arthur Andersen LLP has audited the consolidated financial statements of Callaway Golf Company as of December 31, 2001 and for the year then ended and has issued its report thereon dated January 15, 2002 (except with respect to the matter discussed in Note 17, as to which the date is February 11, 2002).

Please be advised that Arthur Andersen has represented to the Company that the audit was subject to its quality control system for the U.S. accounting and auditing practice to provide reasonable assurance that the engagement was conducted in compliance with professional standards and that there was appropriate continuity of Arthur Andersen personnel working on the audit, availability of national office consultation and availability of personnel at foreign affiliates of Arthur Andersen to conduct the relevant portions of the audit.

Please contact me if you have any questions regarding this matter.

Respectfully submitted,

/s/ Bradley J. Holiday

Bradley J. Holiday
Executive Vice President
and Chief Financial Officer