UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2003

Commission file number 1-10962

Callaway Golf Company

(Exact name of registrant as specified in its charter)

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

2180 Rutherford Road, Carlsbad, CA 92008

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

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

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

The number of shares outstanding of the Registrant’s Common Stock, $.01 par value, as of October 31, 2003 was 75,558,927.

Important Notice to Investors: Statements made in this report that relate to future plans, events, liquidity, financial results or performance including statements relating to sufficiency of liquidity and estimated charges to earnings, 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations — Certain Factors Affecting Callaway Golf Company" contained in this report, as well as the Company's other reports on Forms 10-K, 10-Q and 8-K subsequently filed with the Securities and Exchange Commission from time to time. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to 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: *Apex — Apex Edge — Apex Tour — Ben Hogan — Big Bertha — Big Bertha C4 — Biggest Big Bertha — C design — C4 design — CB1 — CTU 30 — Callaway — Callaway Golf — Callaway Hickory Stick — Carnoustie — Chevron Device — Dawn Patrol — Daytripper — Demonstrably Superior and Pleasingly Different — Deuce — DFX — Divine Nine — Dual Force — Edge CFT — Ely Would — Enjoy the Game — ERC — ERC II — Ever Grip — Ginty — Great Big Bertha — Great Big Bertha II — Hawk Eye — Heavenwood — HX — Legacy — Legend — Little Bertha — Odyssey — Pure Distance — RCH — Riviera — Rossie — Rule 35 — S2H2 — Steelhead — Steelhead Plus — Strata — Stronomic — Top-Flite — Top-Flite Infinity — Top-Flite Tour — Top-Flite XL — Tour Ace — Tour Professional — Tour Straight — Tour Ultimate — TriForce — TriHot — Tru Bore — Tubular Lattice Network — Tungsten Injected — VFT — Warbird — White Hot — World's Friendliest — X-12 — X-14 — X-16 — XL 3000 — X-SPANN*

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Item 1. *Financial Statements*

CALLAWAY GOLF COMPANY

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

	September 30, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 72,835	$ 108,452
Accounts receivable, net	136,329	63,867
Inventories, net	141,174	151,760
Deferred taxes	34,531	34,519
Prepaid investment in Top-Flite International	29,954	—
Other current assets	11,002	10,429
Total current assets	425,825	369,027
Property, plant and equipment, net	194,044	167,340
Intangible assets, net	150,538	103,115
Goodwill	19,281	18,202
Deferred taxes	5,218	5,216
Other assets	16,266	16,945
	$ 811,172	$ 679,845
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 79,168	$ 61,720
Accrued employee compensation and benefits	28,425	23,168
Accrued warranty expense	13,615	13,464
Income taxes payable	34,452	7,649
Other current liabilities	1,407	3,160
Total current liabilities	157,067	109,161
Long-term liabilities:		
Deferred compensation	8,204	7,375
Energy derivative valuation account	19,922	19,922
Long-term debt, net of current portion	4,828	—
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred Stock, $.01 par value, 3,000,000 shares authorized, none issued and outstanding at September 30, 2003 and December 31, 2002	—	—
Common Stock, $.01 par value, 240,000,000 shares authorized, 83,625,094 and 83,577,427 issued at September 30, 2003 and December 31, 2002, respectively	836	836
Paid-in capital	377,266	371,496
Unearned compensation	—	(15)
Retained earnings	504,546	439,454
Accumulated other comprehensive gain (loss)	778	(3,847)
Less: Grantor Stock Trust held at market value, 9,020,586 shares and 10,128,723 shares at September 30, 2003 and December 31, 2002, respectively	(128,724)	(134,206)
	754,702	673,718
Less: Common Stock held in treasury, at cost, 8,048,575 shares and 7,772,378 shares at September 30, 2003 and December 31, 2002, respectively	(133,551)	(130,331)
Total shareholders' equity	621,151	543,387
	$ 811,172	$ 679,845

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

CALLAWAY GOLF COMPANY

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2003		2002		2003		2002	
Net sales	$153,634	100%	$161,257	100%	$667,430	100%	$670,439	100%
Cost of goods sold	83,414	54%	81,371	50%	332,878	50%	324,012	48%
Gross profit	70,220	46%	79,886	50%	334,552	50%	346,427	52%
Operating expenses:								
Selling	47,462	31%	47,681	30%	149,527	22%	159,958	24%
General and administrative	14,684	10%	12,467	8%	43,154	6%	40,875	6%
Research and development	7,734	5%	8,202	5%	20,648	3%	24,529	4%
Total operating expenses	69,880	45%	68,350	42%	213,329	32%	225,362	34%
Income from operations	340	0%	11,536	7%	121,223	18%	121,065	18%
Other income (expense), net	1,056		(1,002)		1,345		20	
Income before income taxes	1,396	1%	10,534	7%	122,568	18%	121,085	18%
Provision for (benefit from) income taxes	(938)		3,347		43,613		46,062	
Net income	$ 2,334	2%	$ 7,187	4%	$ 78,955	12%	$ 75,023	11%
Earnings per common share:								
Basic	$ 0.04		$ 0.11		$ 1.20		$ 1.12	
Diluted	$ 0.03		$ 0.11		$ 1.19		$ 1.11	
Weighted-average shares outstanding:								
Basic	66,261		65,822		65,936		66,691	
Diluted	66,808		66,356		66,295		67,623	
Dividends paid per share	$ 0.07		$ 0.07		$ 0.21		$ 0.21	

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

CALLAWAY GOLF COMPANY

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

	Nine Months Ended September 30,	
	2003	**2002**
Cash flows from operating activities:		
Net income	$ 78,955	$ 75,023
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	30,447	27,622
Loss on disposal of assets	1,580	1,202
Loss on purchase of leased equipment	—	2,318
Tax benefit from exercise of stock options	(1,623)	5,054
Non-cash compensation	15	268
Net non-cash foreign currency hedging losses (gains)	2,628	(4,051)
Net losses (gains) from sale of marketable securities	98	(35)
Deferred taxes	422	8,204
Non-cash advertising expense	219	—
Changes in assets and liabilities, net of effects of acquisition:		
Accounts receivable, net	(40,009)	(49,504)
Inventories, net	39,548	43,702
Other assets	(1,290)	13,785
Accounts payable and accrued expenses	1,272	13,101
Accrued employee compensation and benefits	264	938
Accrued warranty expense	151	(20,031)
Income taxes payable	26,598	11,200
Deferred compensation	828	(1,548)
Net cash provided by operating activities	140,103	127,248
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(165,147)	—
Capital expenditures	(4,826)	(70,701)
Net investments in marketable securities	—	(7,540)
Proceeds from sale of marketable securities	24	6,997
Cash paid for investments	—	(2,000)
Proceeds from sale of capital assets	114	862
Net cash used in investing activities	(169,835)	(72,382)
Cash flows from financing activities:		
Payments on note payable	(2,590)	(1,764)
Issuance of Common Stock	12,875	16,731
Acquisition of Treasury Stock	(3,220)	(44,020)
Dividends paid, net	(13,863)	(14,000)
Net cash used in financing activities	(6,798)	(43,053)
Effect of exchange rate changes on cash and cash equivalents	913	1,253
Net (decrease) increase in cash and cash equivalents	(35,617)	13,066
Cash and cash equivalents at beginning of period	108,452	84,263
Cash and cash equivalents at end of period	$ 72,835	$ 97,329
Non-cash financing and investing activities:		
Liabilities assumed in connection with acquisition	$ 20,588	$ —
Unrealized loss on marketable securities	$ —	$ (92)

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

CALLAWAY GOLF COMPANY

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

	Common Stock							Treasury Stock		
	Shares	Amount	Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Gain (Loss)	GST	Shares	Amount	Total
Balance, December 31, 2002	83,577	$836	$371,496	$(15)	$439,454	$(3,847)	$(134,206)	(7,772)	$(130,331)	$543,387
Exercise of stock options	48	—	(1,130)	—	—	—	9,762	—	—	8,632
Tax benefit from exercise of stock options	—	—	(1,623)	—	—	—	—	—	—	(1,623)
Acquisition of Treasury Stock	—	—	—	—	—	—	—	(277)	(3,220)	(3,220)
Compensatory stock and stock options	—	—	—	15	—	—	—	—	—	15
Employee stock purchase plan	—	—	(851)	—	—	—	5,094	—	—	4,243
Cash dividends	—	—	—	—	(13,863)	—	—	—	—	(13,863)
Adjustment of Grantor Stock Trust shares to market value	—	—	9,374	—	—	—	(9,374)	—	—	—
Equity adjustment from foreign currency translation	—	—	—	—	—	3,820	—	—	—	3,820
Unrealized gain on cash flow hedges, net of tax	—	—	—	—	—	713	—	—	—	713
Change in unrealized loss on marketable securities	—	—	—	—	—	92	—	—	—	92
Net income	—	—	—	—	78,955	—	—	—	—	78,955
Balance, September 30, 2003	83,625	$836	$377,266	$ —	$504,546	$ 778	$(128,724)	(8,049)	$(133,551)	$621,151

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

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited interim financial statements have been prepared by Callaway Golf Company (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 filed with the Securities and Exchange Commission. These consolidated condensed financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring accruals) necessary for the fair presentation of the financial position, results of operations and cash flows for the periods and dates presented. Interim operating results are not necessarily indicative of operating results for the full year.

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

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

2. Top-Flite Asset Purchase

On September 15, 2003, the Company completed the acquisition of substantially all of the assets of TFGC Estate Inc. (f/k/a The Top-Flite Golf Company, f/k/a Spalding Sports Worldwide, Inc., the "Seller") and thereafter completed the valuation and settlement of certain additional assets related to Seller's international operations (the "Acquisition"). The Acquisition was consummated pursuant to the terms of the Asset Purchase Agreement between the Seller and the Company, dated as of June 30, 2003, as amended (the "Asset Purchase Agreement"). The purchase price was initially determined through an arms-length negotiation between the parties and was subject to certain contingencies, including the approval of the Acquisition by the U.S. Bankruptcy Court. In connection with the approval process, the court approved the Company as the "stalking horse" bidder, permitting other qualified bidders to submit higher and better bids for the subject assets than the Company's bid. The court-ordered auction was conducted on September 3, 2003. The Company made the prevailing bid which was approved by the bankruptcy court on September 4, 2003.

Pursuant to the court-approved bid, the Company agreed to acquire the Seller's assets for approximately $174,363,000 (approximately $169,294,000 cash and the assumption of approximately $5,069,000 of debt) and the assumption of certain liabilities. The cash portion of the purchase price was subject to adjustments for the amount of inventory and accounts receivable delivered at closing. The Seller delivered inventories, accounts receivable, fixed assets (primarily plant and manufacturing equipment), and all of Seller's golf patents, trademarks and intellectual property. Based on the actual amount of inventories and accounts receivable delivered, and certain other adjustments, the cash portion of the purchase price was adjusted downward by approximately $10,149,000. Accordingly, the adjusted cash portion of the purchase price was approximately $159,145,000. The purchase price is subject to further adjustment based upon the confirmation of the value of inventories and accounts receivable acquired in connection with the Acquisition.

The Company acquired the Top-Flite assets because they provided a unique opportunity to increase significantly the size and profitability of the Company's golf ball business and the Company was able to purchase the acquired assets at less than their estimated fair value. The Company paid the cash purchase price for the Acquisition out of cash on hand. The Company intends to continue the U.S. and foreign operations of the acquired golf assets, including the use of acquired assets in the manufacture of golf balls and golf clubs and the commercialization of existing Top-Flite, Strata and Ben Hogan brands, patents and trademarks.

The Company's consolidated statement of operations include The Top-Flite Golf Company results of operations in the United States for the two week post-acquisition period ended September 30, 2003.

The Acquisition was accounted for as a purchase in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations." Under SFAS No. 141, the estimated aggregate cost of the acquired assets is $185,735,000, which includes cash paid ($159,145,000), transaction costs (approximately $6,002,000), and assumed liabilities (approximately $20,588,000). The estimated fair value of the assets exceeded the estimated aggregate acquisition costs. As a result, the Company was required to reduce the carrying value of the acquired long-term assets on a pro rata basis. A full determination of the allocation of the aggregate acquisition costs will be made within twelve months of the effective acquisition date, upon receipt of a final independent valuation analysis of tangible and intangible assets. It is anticipated that the final allocation will not differ materially from the preliminary allocation. The preliminary allocation is as follows (in thousands):

Assets Acquired:	
Accounts receivable, net	$ 28,718
Inventory, net	25,624
Other assets	682
Property and equipment, net	52,292
Intangible assets, net	48,465
Liabilities Assumed:	
Current liabilities	(15,760)
Long term liabilities	(4,828)
Net assets acquired	135,193
Prepaid Investment in Top-Flite International(*)	29,954
Total net assets acquired	$165,147

(*) Because the settlement of the international assets was not effective until October 1, 2003, the Company recorded the aggregate cost of the international assets as a prepaid asset as of September 30, 2003. During the fourth quarter, the prepaid asset will be eliminated and the estimated aggregate cost of the international assets will be allocated among the acquired international assets.

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Pro Forma Results of Operations

The following sets forth the Company's pro forma results of operations for the three and nine months ended September 30, 2003 and 2002, as if the acquisition of the Top-Flite golf operations in the United States had taken place at the beginning of the periods presented (in thousands, except per share data)[*].

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net sales	$175,575	$197,622	$784,730	$812,124
Net income (loss)	$ (5,214)	$ 3,020	$ 65,536	$ 75,915
Earnings (loss) per common share:				
Basic	$ (0.08)	$ 0.05	$ .99	$ 1.14
Diluted	$ (0.08)	$ 0.05	$ .99	$ 1.12

(*) Because the settlement of the international assets was not effective until October 1, 2003, the pro forma results of operations do not include the results of the international operations of the Top-Flite golf business, which operations consist primarily of the sale and distribution of golf balls. Furthermore, until September 15, 2003, the Top-Flite golf business in the United States was operated as a part of, and was integrated with, the other businesses of Spalding Sports Worldwide. The pro forma results of operations presented above therefore are based upon an estimated allocation of personnel and costs with regard to the manner in which the Top-Flite golf business was structured and operated as part of Spalding Sports Worldwide. The allocated personnel and costs are not necessarily indicative of the personnel and costs that would have been included had the Top-Flite business been operated as part of Callaway Golf Company since the beginning of the periods presented. As a result, the pro forma results of operations are not necessarily indicative of the results of operations for the periods presented had the acquisition been completed at the beginning of the periods presented.

3. Recent Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 clarifies the accounting for certain financial instruments with characteristics of both liabilities and equity and requires that those instruments be classified as liabilities in statements of financial position. Previously, many of those financial instruments were classified as equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 has not had, and is not expected to have, a material impact on the Company's financial position or results of operations.

In January 2003, the FASB issued Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities." In general, a variable interest entity is a corporation, partnership, trust, or any other legal entity used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN No. 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after December 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The adoption of FIN No. 46 has not had, and is not expected to have, a material impact on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure — an Amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require in both annual and interim financial statements prominent disclosures about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company is required to follow the prescribed disclosure format and has provided the additional disclosures required by SFAS No. 148 for the quarterly period ended September 30, 2003 (see Note 5).

In November 2002, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of FASB Statements No. 5, 57 and 107, and rescission of FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others." FIN No. 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, while the provisions of the disclosure requirements are effective for financial statements for interim or annual periods ending after December 15, 2002. The adoption of FIN No. 45 has not had a material impact on the Company's results of operations or financial position.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." SFAS No. 145 also rescinds SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers." SFAS No. 145 amends SFAS No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 were adopted on January 1, 2003. The provisions related to SFAS No. 13 are effective for transactions occurring after May 15, 2002. All other provisions of SFAS No. 145 are effective for financial statements issued after May 15, 2002. The adoption of SFAS No. 145 has not had a material impact on the Company's results of operations or financial position.

4. Change in Accounting Estimate

In preparing its financial statements, the Company is required to make certain estimates, including those related to provisions for warranty, uncollectible accounts receivable, inventory obsolescence, valuation allowance for deferred tax assets and the market value of derivative instruments. The Company periodically reviews its estimates to ensure that the estimates appropriately reflect changes in its business or as new information becomes available.

The Company has a stated two-year warranty policy for its golf clubs, although the Company's historical practice has been to honor warranty claims well after the two-year stated warranty period. Prior to the third quarter of 2002, the Company's method of estimating both its implicit and explicit warranty obligation was to utilize data and information based on the cumulative failure rate by product after taking into consideration specific risks the Company believes existed at the time the financial statements were prepared. These additional risks included product specific risks, such as the introduction of products with new technology or materials that would be more susceptible to failure or breakage, and other business risks, such as increased warranty liability as a result of acquisitions. In many cases, additions to the warranty reserve for new product introductions have been based on management's judgment of possible future claims derived from the limited product failure data that was available at the time.

Beginning in the second quarter of 2001, the Company began to compile data that illustrated the timing of warranty claims in relation to product life cycles. In the third quarter of 2002, the Company determined it had gathered sufficient data and concluded it should enhance its warranty accrual estimation methodology to utilize the additional data. The analysis of the data, in management's judgment, provided management with more insight into timing of claims and demonstrated that some product failures are more likely to occur early in a product's life cycle while other product failures occur in a more linear fashion over the product's life cycle. As a result of its analysis of the additional information, the Company believes it has gained better insight and improved judgment to more accurately project the ultimate failure rates of its products. As a result of this refinement in its methodology, the Company concluded that it should change its methodology of estimating warranty accruals and reduce its warranty reserve by approximately $17,000,000. The $17,000,000 reduction is recorded in cost of goods sold and favorably impacted gross profit as a percentage of net sales by 10 percentage points and 3 percentage points for the three and nine months ended September 30, 2002, respectively. The change in methodology has been accounted for as a change in accounting principle inseparable from a change in estimate.

5. Accounting for Stock-Based Compensation

The Company accounts for its stock-based employee compensation plans using the intrinsic value recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. For the three and nine months ended September 30, 2002, the Company recorded employee compensation expense of $46,000 and $138,000 in net income as a result of the restricted stock awards granted in 1998. The restricted stock awards vested in January 2003 and the Company recorded $15,000 of employee compensation expense in net income for the nine months ended September 30, 2003. No expense was recorded during the three months ended September 30, 2003. All other employee stock-based awards were granted with an exercise price equal to the market value of the underlying common stock on the date of grant and no compensation cost is reflected in net income for those awards. Compensation expense for non-employee stock-based compensation awards is measured using the fair-value method.

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, “Accounting for Stock-Based Compensation” to stock-based employee compensation (in thousands, except per share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net income:				
Net income, as reported	$ 2,334	$ 7,187	$78,955	$75,023
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	—	29	10	86
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(2,351)	(2,914)	(6,968)	(8,475)
Pro forma net income (loss)	$ (17)	$ 4,302	$71,997	$66,634
Earnings per common share:				
Basic — as reported	$ 0.04	$ 0.11	$ 1.20	$ 1.12
Basic — pro forma	$ (0.00)	$ 0.06	$ 1.09	$ 0.99
Diluted — as reported	$ 0.03	$ 0.11	$ 1.19	$ 1.11
Diluted — pro forma	$ (0.00)	$ 0.06	$ 1.09	$ 0.98

Under the fair-value method, compensation expense is measured at the grant date based on the fair value of the award using an option-pricing model. Compensation expense is recognized on a straight-line basis over the vesting period. The fair value of employee stock options was estimated using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Dividend yield	1.8%	1.7%	1.8%	1.7%
Expected volatility	47.3%	52.2%	48.3%	52.2%
Risk free interest rates	1.36%-2.18%	1.94%-2.37%	1.22%-3.93%	1.94%-2.37%
Expected lives	3-4 years	3-4 years	3-4 years	3-4 years

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.

6. Marketable Securities and Other Investments

The Company determines the appropriate classification of its investments at the time of acquisition and reevaluates such determination at each balance sheet date. Trading securities are carried at quoted fair value, with unrealized gains and losses included in earnings. Available-for-sale securities are carried at quoted fair value, with unrealized gains and losses reported in shareholders’ equity as a component of accumulated other comprehensive income. Investments in limited partnerships that do not have readily determinable fair values are stated at cost and are reported in other assets. Realized gains and losses are determined using the specific identification method and are included in other income (expense), net.

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(Unaudited)

The Company held no marketable securities at September 30, 2003. Marketable securities at December 31, 2002 were $26,000 and consisted primarily of investments in public corporations, which were classified as available-for-sale securities within other assets. Proceeds from the sale of available-for-sale securities for the nine months ended September 30, 2003 and 2002 were $24,000 and $6,997,000, respectively. The Company records gains and losses on available-for-sale securities sold and unrealized and realized gains on trading securities in other income (expense), net. For the nine months ended September 30, 2003 and 2002, the Company recorded net losses of $98,000 and net gains of $35,000, respectively. No gains or losses were recorded during the three months ended September 30, 2003 and 2002, respectively.

7. Inventories

Inventories are summarized below (in thousands):

	September 30, 2003	December 31, 2002
Raw materials	$ 63,056	$ 63,953
Work-in-process	8,871	2,550
Finished goods	88,088	102,018
	160,015	168,521
Reserve for excess and obsolescence	(18,841)	(16,761)
	$141,174	$151,760

8. Goodwill and Intangible Assets

Effective January 1, 2002, the Company adopted SFAS No. 142, “Goodwill and Other Intangible Assets.” As a result of adopting SFAS No. 142, the Company’s goodwill and certain intangible assets are no longer amortized, but are subject to an annual impairment test. The following sets forth the intangible assets by major asset class (in thousands):

	September 30, 2003			December 31, 2002		
	Gross	Accumulated Amortization	Net Book Value	Gross	Accumulated Amortization	Net Book Value
Non-amortizing:						
Trade name(1)	$ 62,013	$ —	$ 62,013	$ 62,013	$ —	$ 62,013
Trademark and trade dress(1)	26,577	—	26,577	26,577	—	26,577
Amortizing patents and other	20,164	6,681	13,483	20,224	5,699	14,525
Preliminary value of Top-Flite intangibles acquired(2)	48,465	—	48,465	—	—	—
Total intangible assets	$157,219	$6,681	$150,538	$108,814	$5,699	$103,115

(1) Acquired through acquisition transactions.

(2) The Company is in the process of finalizing the third-party valuation of the acquired Top-Flite intangible assets. Accordingly, the balances represent preliminary estimates and are subject to refinement.

Intangible assets with definite lives are amortized using the straight-line method over periods ranging from 3 to 16 years. During the three months ended September 30, 2003 and 2002, aggregate amortization expense was approximately $352,000 and $411,000, respectively. During the nine months ended September 30, 2003 and 2002, aggregate amortization expense was approximately $1,055,000 and $1,332,000, respectively. No amortization expense has been recognized on the Top-Flite intangible assets during the two-week post-acquisition period ended September 30, 2003 as the Company is in the process of obtaining a third-party valuation to determine the fair values and remaining useful lives of the intangible assets. Amortization expense, excluding any estimates for the Top-Flite intangible assets, in each of the next five fiscal years and beyond for the Company's intangible assets is expected to be incurred as follows (in thousands):

Remainder of 2003	$ 353
2004	1,492
2005	1,477
2006	1,427
2007	1,340
2008	1,332
Thereafter	6,062
	$13,483

Changes in goodwill during the nine months ended September 30, 2003 were due to foreign currency fluctuations.

9. Financing Arrangements

Effective June 16, 2003, the Company terminated its prior revolving credit facility with GE Capital Corporation and other lenders and entered into a revolving credit facility with Bank of America, N.A. for a $50.0 million line of credit that was scheduled to be available until September 16, 2005, subject to earlier termination in accordance with its terms. At September 30, 2003, there were no borrowings outstanding under the $50.0 million line of credit and the Company was in compliance with the covenants and other terms thereof.

Effective November 10, 2003, the Company terminated its $50.0 million line of credit with Bank of America, N.A. and obtained a new $100.0 million revolving line of credit from Bank of America, N.A. and certain other lenders. The new $100.0 million credit facility is scheduled to be available until November 2004, subject to earlier termination in accordance with its terms and subject to extension upon agreement of all parties. Upon the expiration of the new revolving credit facility, provided the Company is not in default of the terms of the new revolving credit facility and subject to certain conditions, the Company has the option to convert the amounts outstanding under the new revolving credit facility into a one-year term loan.

Subject to the terms of the new credit facility, the Company can borrow up to a maximum of $100.0 million. The Company is required to pay certain fees, including a quarterly unused commitment fee equal to 12.5 to 20.0 basis points of the unused commitment amount, with the exact amount determined based upon the Company's Consolidated Leverage Ratio. For purposes of the new credit facility, "Consolidated Leverage Ratio" means, as of any date of determination, the ratio of "Consolidated Funded Indebtedness" as of such date to "Consolidated EBITDA" for the four most recent fiscal quarters (as such terms are defined in the new credit facility agreement). Outstanding borrowings under the new credit facility accrue interest at the Company's election at (i) the higher of (a) the Federal Funds Rate plus 50.0 basis points or (b) Bank of America's prime rate, and in either case less a margin of 50.0 to 100.0 basis points depending upon the Company's Consolidated Leverage Ratio or (ii) the Eurodollar Rate (as such term is defined in the new credit facility agreement), plus a margin of 75.0 to 125.0 basis points depending upon the Company's Consolidated Leverage Ratio. The Company has agreed that repayment of amounts under the new credit facility will be guaranteed by certain of the Company's domestic subsidiaries and will be secured by the Company's pledge of 65% of the stock it holds in certain of its foreign subsidiaries and by certain intercompany debt securities and proceeds thereof. The Company has not yet borrowed any amounts under the new revolving credit facility.

The new credit facility agreement requires the Company to maintain certain minimum financial covenants. Specifically, (i) the Company's Consolidated Leverage Ratio may not exceed 1.25 to 1.00 and (ii) Consolidated EBITDA (which would exclude certain non-cash charges related to the restructuring of the Company's golf ball operations) for any four consecutive quarters may not be less than $50.0 million. The new credit facility agreement also includes certain other restrictions, including restrictions limiting additional indebtedness, dividends, stock repurchases, transactions with affiliates, capital expenditures, asset sales, acquisitions, mergers, liens and encumbrances and other matters customarily restricted in loan documents. The new credit facility also contains other customary provisions, including affirmative covenants, representations and warranties and events of default.

In connection with the Top-Flite acquisition, the Company assumed long-term debt related to a warehouse located in Chicopee, Massachusetts. As of September 30, 2003, the outstanding principal portion of this debt was $5,017,000. Interest on the outstanding balance accrues at an annual rate of 300 basis points over the one-year U.S. Treasury Note. Interest is currently accruing at 4.31% and is adjusted annually. The principal and interest is payable in monthly installments and is payable in full in 2018. The debt is secured by the warehouse.

Also in connection with the Top-Flite acquisition, the Company assumed capital lease obligations in the aggregate amount of $407,000 at September 30, 2003, related primarily to computer and telecommunication systems. The lease agreements expire in 2006.

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 amount payable in 2003 is $3,300,000. The present value of the note payable at issuance totaled $6,702,000 using an imputed interest rate of approximately 7%. The Company recorded interest expense of $28,000 and $125,000 for the three and nine months ended September 30, 2003, respectively. For the three and nine months ended September 30, 2002, the Company recorded interest expense of $76,000 and $260,000, respectively.

10. Product Warranty

The Company has a stated two-year warranty policy for its golf clubs, although the Company's historical practice has been to honor warranty claims well after the two-year stated warranty period. The Company's policy is to accrue the estimated cost of 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. The following table provides a reconciliation of the activity related to the Company's reserve for warranty expense (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Beginning balance(*)	$14,580	$ 33,791	$13,464	$ 34,864
Provision(*)	2,440	(14,612)	10,141	(8,828)
Claims paid/costs incurred	(3,405)	(4,346)	(9,990)	(11,203)
Ending balance	$13,615	$ 14,833	$13,615	$ 14,833

(*) During the third quarter of 2002, the Company refined its methodology for estimating its future warranty liability. As a result of this change in methodology, the Company reduced its warranty reserve by approximately $17,000,000. The change in methodology was accounted for as a change in accounting principle inseparable from a change in estimate (see Note 4).

11. Earnings Per Share

A reconciliation of the weighted average shares used in the basic and diluted earnings per common share computations for the three and nine months ended September 30, 2003 and 2002 is presented below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Weighted-average shares outstanding:				
Weighted-average shares outstanding — Basic	66,261	65,822	65,936	66,691
Dilutive securities	547	534	359	932
Weighted-average shares outstanding — Diluted	66,808	66,356	66,295	67,623

For the three months ended September 30, 2003 and 2002, options outstanding totaling 9,846,000 and 11,443,000 shares, respectively, were excluded from the calculations, as their effect would have been antidilutive. For the nine months ended September 30, 2003 and 2002, options outstanding totaling 11,160,000 and 8,344,000 shares, respectively, were excluded from the calculations, as their effect would have been antidilutive.

12. Commitments and Contingencies

Legal Matters

The Company, incident to its business activities, is often the plaintiff in legal proceedings, both in the United States 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. Historically, these matters individually and in the aggregate have not had a material adverse effect upon the financial position or results of operations of the Company. It is possible, however, that in the future one or more defenses or claims asserted by defendants in one or more of those actions may succeed, resulting in the loss of all or part of the rights under one or more patents, loss of a trademark, a monetary award against the Company or some other material loss to the Company. One or more of these results could adversely affect the Company's overall ability to protect its product designs and ultimately limit its future success in the marketplace.

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

On April 6, 2001, a complaint was filed against Callaway Golf Company and Callaway Golf Sales 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 select 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. The parties are engaged in discovery.

On November 4, 2002, Callaway Golf Sales Company was served with a complaint filed in the District Court of Sedgwick County, Kansas, Case No. 0203607, seeking to assert an alleged class action on behalf of Kansas consumers who purchased select Callaway Golf products covered by the New Product Introduction Policy. Callaway Golf Company is also named in the Kansas case. The plaintiff in the Kansas case seeks damages and restitution for the alleged class under Kansas law.

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, U.S. Patent No. 6,213,898 (the "Aerodynamics Patent"). On October 15, 2001, MaxFli filed an answer to the complaint denying any infringement, and also filed a counterclaim against the Company asserting that former MaxFli employees hired by 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 compensatory damages; an additional award of punitive damages equal to two times the compensatory damages; attorneys' fees; a declaratory judgment; and injunctive relief. Both parties have amended their claims. The Company added a claim for false advertising and MaxFli added a claim for inequitable conduct before the Patent and Trademark Office. The parties are engaged in expert discovery. MaxFli submitted a report from its damages expert asserting that MaxFli is entitled to at least $18,500,000 in compensatory damages from the Company. MaxFli has informed the Company that it may seek leave to amend its damages expert report to substantially increase the compensatory damages that MaxFli will seek at trial. The Company has submitted its own expert report seeking damages for false advertising. The Company anticipates that each party will challenge the methodology and conclusions in the expert damages reports of the other. On November 12, 2003, pursuant to an agreement between the Company and MaxFli, the Court dismissed the Company's claim for infringement of the Aerodynamics Patent and all portions of MaxFli's counterclaim related to the Aerodynamics Patent, thereby resolving that part of the case. The trial on the Company's false advertising claim and MaxFli's remaining counterclaims is scheduled to commence in the summer of 2004. An unfavorable resolution of MaxFli's counterclaims could have a significant adverse effect upon the Company's results of operations, cash flows and financial position.

On December 2, 2002, Callaway Golf Company was served with a complaint filed in the Circuit Court of the 19th Judicial District in and for Martin County, Florida, Case No. 935CA, by the Perfect Putter Co. and certain principals of the Perfect Putter Co. Plaintiffs have sued Callaway Golf Company, Callaway Golf Sales

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(Unaudited)

Company and a Callaway Golf Sales Company sales representative. Plaintiffs allege that the Company misappropriated certain alleged trade secrets of the Perfect Putter Co. and incorporated those purported trade secrets in the Company's Odyssey White Hot 2-Ball Putter. Plaintiffs also allege that the Company made false statements and acted inappropriately during discussions with plaintiffs. Plaintiffs are seeking compensatory damages, exemplary damages, attorney's fees and costs, pre- and post-judgment interest and injunctive relief. On December 20, 2002, Callaway Golf removed the case to the United States District Court for the Southern District of Florida, Case No. 02-14342. On April 29, 2003, the District Court denied plaintiffs' motion to remand the case to state court, holding that the sales representative had been "fraudulently joined" solely for the purpose of defeating diversity jurisdiction. Thereafter, on August 14, 2003, the plaintiffs filed a second amended complaint adding a new claim for civil theft under Florida law based on the facts set forth in the original complaint. If successful on that claim, the plaintiffs will be entitled to treble damages. The Company has denied the allegations of the second amended complaint. The parties are currently engaged in discovery. The trial of the action has been set to commence in the fall of 2004.

On July 3, 2003, Saso Golf, Inc. filed a lawsuit against the Company, Callaway Golf Sales Company, and an unrelated defendant in the United States District Court for the Northern District of Illinois, Case No. 03-CV-4646. Saso Golf alleges that sales of Callaway Golf's metal woods, including but not limited to the original Callaway Golf Biggest Big Bertha, infringe U.S. Patent No. 5,645,495 and seeks compensatory damages, treble damages, attorney's fees, prejudgment interest, costs and injunctive relief. The Company has denied the allegations in the Complaint. The Court has not set a trial date, and the parties are conducting discovery.

The Company and its subsidiaries, incident to their business activities, are parties to a number of legal proceedings, lawsuits and other claims, including the matters specifically noted above. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, management is unable to estimate the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance, or the financial impact with respect to these matters as of September 30, 2003. Except as discussed above with regard to the MaxFli litigation, management believes at this time that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon the Company's consolidated annual results of operations or cash flows, or financial position.

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 (the "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 would have been 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 (see Note 14).

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 (because of financial difficulties or otherwise) are unable or fail to provide suitable 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. As of September 30, 2003, the purchase commitment related to golf ball materials through December 2003 was approximately $2,313,000. As of September 30, 2003, the Company did not have any outstanding commitments to purchase golf club materials.

Golf Professional Endorsement Contracts

The Company establishes relationships with professional golfers in order to evaluate and promote Callaway Golf, Odyssey, Top-Flite, Ben Hogan and Strata branded products. The Company has entered into endorsement arrangements with members of the various professional tours, including the Champions Tour, the PGA Tour, the LPGA Tour, the PGA European Tour, the Japan Golf Tour and the Nationwide Tour. Many of these contracts provide incentives for successful performances using the Company’s products. For example, under these contracts, the Company could be obligated to pay a cash bonus to a professional who wins a particular tournament while playing the Company’s golf clubs or golf balls. It is not possible to predict with any certainty the amount of such performance awards the Company will be required to pay in any given year. Such expenses, however, are an ordinary part of the Company’s business and the Company does not believe that the payment of these performance awards will have a material adverse effect upon the Company.

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Other Contingent Contractual Obligations

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company's customers and licensees in connection with the use, sale and/or license of Company products, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct of the Company and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has made contractual commitments to several employees providing for severance payments upon the occurrence of certain prescribed events. The Company also has several consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain workers compensation insurance policies. The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company's financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that material payments will be required under the commitments and guarantees described above. The fair value of indemnities, commitments and guarantees that the Company issued during the nine months ended September 30, 2003 was not material to the Company's financial position, results of operations or cash flows.

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 employment 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.

13. 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 primarily of Callaway Golf, Top-Flite and Ben Hogan woods, irons and wedges, Callaway Golf, Top-Flite, Ben Hogan and Odyssey putters and golf-related accessories. The Golf Balls segment consists primarily of Callaway Golf, Top-Flite, Ben Hogan and Strata golf balls that are designed, manufactured and sold by the Company. There are no significant intersegment transactions.

The table below contains information utilized by management to evaluate its operating segments for the interim periods presented (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net sales				
Golf clubs	$139,513	$149,912	$624,034	$612,841
Golf balls	14,121	11,345	43,396	57,598
	$153,634	$161,257	$667,430	$670,439
Income (loss) before provision for income taxes				
Golf clubs	$ 17,436	$ 31,455	$170,192	$168,756
Golf balls	(6,982)	(11,133)	(17,081)	(17,314)
Reconciling items[1]	(9,058)	(9,788)	(30,543)	(30,357)
	$ 1,396	$ 10,534	$122,568	$121,085
Additions to long-lived assets[2]				
Golf clubs	$ 14,603	$ 5,026	$ 18,519	$ 19,416
Golf balls	87,024	48,702	87,064	50,011
	$101,627	$ 53,728	$105,583	$ 69,427

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

(2) Additions for the three and nine months ended September 30, 2003 include long-lived assets acquired as part of the purchase of the Top-Flite golf operations in the United States.

14. Derivatives and Hedging

The Company uses derivative financial instruments to manage its exposures to foreign currency 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 balance sheet, 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 British Pounds, Euros, 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 risk management policies. Pursuant to its foreign exchange hedging policy, the Company may hedge anticipated transactions 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 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 mature within twelve months from their inception.

At September 30, 2003 and 2002, the notional amounts of the Company's foreign exchange contracts were approximately $87,714,000 and $63,040,000, respectively. 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 September 30, 2003, the fair value of foreign currency-related derivatives were recorded as current assets of $840,000 and current liabilities of $2,660,000.

At September 30, 2003 and 2002, the notional amounts of the Company's foreign exchange contracts designated as cash flow hedges were approximately $42,886,000 and $4,638,000, 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 ("OCI") as a separate component of shareholders' equity and subsequently reclassified into earnings in the period during which the hedged transaction is recognized in earnings. During the three and nine months ended September 30, 2003 and 2002, the Company recorded the following activity in OCI (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Beginning OCI balance related to cash flow hedges	$ (561)	$345	$(1,362)	$ 6,424
Add: Net gain/(loss) initially recorded in OCI	(1,076)	591	(2,420)	(2,382)
Deduct: Net gain/(loss) reclassified from OCI into earnings	(475)	551	(2,620)	3,657
Ending OCI balance related to cash flow hedges	$(1,162)	$385	$(1,162)	$ 385

During the three and nine months ended September 30, 2003, no gains were reclassified into earnings as a result of the discontinuance of cash flow hedges. During the nine months ended September 30, 2002, $171,000 of gains were reclassified into earnings as a result of the discontinuance of cash flow hedges. No gains were reclassified into earnings as the result of the discontinuance of cash flow hedges during the three months ended September 30, 2002.

As of September 30, 2003, $1,162,000 of deferred net losses related to derivative instruments designated as cash flow hedges were included in OCI. These derivative instruments hedge transactions that are expected to occur within the next twelve months. As the hedged transactions are completed, the related deferred net gain or loss is reclassified from OCI into earnings. The Company does not expect that such reclassifications will have a material effect on the Company's earnings, as any gain or loss on the derivative instruments generally would be offset by the opposite effect on the related underlying transactions.

The ineffective portion of the gain or loss for derivative instruments that are designated and qualify as cash flow hedges is immediately reported as a component of other income (expense), net. 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 other income (expense), net. During the three months ended September 30, 2003 and 2002, the Company recorded net gains of $35,000 and net losses of $322,000, respectively, as a result of changes in the spot-forward differential. During the nine months ended September 30, 2003 and 2002, the Company recorded net losses of $50,000 and net gains of $395,000, respectively, as a result of changes in the spot-forward differential. 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 hedged 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 quarterly.

At September 30, 2003 and 2002, the notional amounts of the Company’s foreign exchange contracts used to hedge outstanding balance sheet exposures were approximately $44,828,000 and $58,402,000, respectively. The gains and losses on foreign currency contracts used to hedge balance sheet exposures are recognized as a component of other income (expense), 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 the three months ended September 30, 2003 and 2002, the Company recorded net losses of $716,000 and net gains of $724,000, respectively, due to net realized and unrealized gains and losses on contracts used to hedge balance sheet exposures. During the nine months ended September 30, 2003 and 2002, the Company recorded net losses of $5,021,000 and $7,108,000, respectively, due to net realized and unrealized gains and losses on contracts used to hedge balance sheet exposures.

Energy Derivative

In 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. As the contract is terminated and neither party to the contract is performing pursuant to the terms of the contract, the terminated contract has ceased to represent a derivative instrument in accordance with SFAS No. 133. The Company, therefore, 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 reported as non-operating income.

As of the date of termination of the energy supply contract, the derivative valuation account reflected $19,922,000 of unrealized losses resulting from changes in the estimated fair value of the contract. The fair value of the contract was estimated at the time of termination 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 at the time of termination. The estimate was highly subjective because quoted market rates directly relevant to the Company’s local energy market and for periods extending beyond a 10- to 12-month horizon were not quoted on a traded market. In making the estimate, the Company instead had to rely upon near-term market quotations and other market information to determine an estimate of the fair value of the contract. In management’s opinion, there are no available contract valuation methods that provide a reliable single measure of the fair value of the energy derivative because of the lack of quoted market rates directly relevant to the terms of the contract and because changes in subjective input assumptions can materially affect the fair value estimates. See Note 12 for a discussion of contingencies related to the termination of the Company’s derivative energy supply contract.

15. Comprehensive Income

Comprehensive income is defined as all changes in a company's net assets except changes resulting from transactions with shareholders. It differs from net income in that certain items currently recorded to equity would be a part of comprehensive income. The following table sets forth the computation of comprehensive income for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net income	$2,334	$7,187	$78,955	$75,023
Other comprehensive income:				
Foreign currency translation	1,335	(114)	3,820	3,789
Net unrealized gain on cash flow hedges, net of tax	(407)	103	713	(3,776)
Change in unrealized loss on marketable securities	—	(92)	92	(92)
Comprehensive income	$3,262	$7,084	$83,580	$74,944

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

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

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its results of operations, financial condition and liquidity are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets 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. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an on-going basis, the Company reviews its estimates to ensure that the estimates appropriately reflect changes in its business or as new information becomes available.

Management believes the following critical accounting policies affect its more significant estimates and assumptions used in the preparation of its consolidated financial statements:

Revenue Recognition

Sales are recognized when both title and risk of loss transfer to the customer. Sales are recorded net of an allowance for sales returns and sales programs. Sales returns are estimated based upon historical returns, current economic trends, changes in customer demands and sell-through of products. The Company also records estimated reductions to revenue for sales programs such as incentive offerings. Sales program accruals are estimated based upon the attributes of the sales program, management's forecast of future product demand, and historical customer participation in similar programs. If the actual costs of sales returns and sales programs significantly exceed the recorded estimated allowance, the Company's sales would be significantly adversely affected.

Allowance for Doubtful Accounts

The Company maintains an allowance for estimated losses resulting from the failure of its customers to make required payments. An estimate of uncollectable amounts is made by management based upon historical bad debts, current customer receivable balances, age of customer receivable balances, the customer's financial condition and current economic trends. If the actual uncollected amounts significantly exceed the estimated allowance, then the Company's operating results would be significantly adversely affected.

Inventories

Inventories are valued at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method. The inventory balance, which includes material, labor and manufacturing overhead costs, is recorded net of an estimated allowance for obsolete or unmarketable inventory. The estimated allowance for obsolete or unmarketable inventory is based upon management's understanding of market conditions and forecasts of future product demand. If the actual amount of obsolete or unmarketable inventory significantly exceeds the estimated allowance, the Company's cost of sales, gross profit and net income would be significantly adversely affected.

Long-Lived Assets

In the normal course of business, the Company acquires tangible and intangible assets. The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets (including property, plant and equipment, goodwill and other intangible assets) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. An impairment is assessed when the undiscounted future cash flows estimated to be derived from an asset are less than its carrying amount. Impairments are recognized in operating earnings. The Company uses its best judgment based on the most current facts and circumstances surrounding its business when applying these impairment rules to determine the timing of the impairment test, the undiscounted cash flows used to assess impairments, and the fair value of a potentially impaired asset. Changes in assumptions used could have a significant impact on the Company's assessment of recoverability.

Numerous factors, including changes in the Company's business, industry segment, and global economy, could significantly impact management's decision to retain, dispose of, or idle certain of its long-lived assets. For example, in connection with the Top-Flite acquisition, the Company has initiated steps to consolidate its golf ball and golf club manufacturing and research and development operations. In connection with this consolidation of operations, the Company may decide to dispose of or idle certain of its long-lived assets, which could result in a write-down of a significant portion of the assets used in the Company's golf ball operations. On October 23, 2003, the Company announced that in connection with such consolidation, it estimated that it could incur charges to earnings of up to $60.0 million, mostly non-cash, with the charges to be taken as incurred over the next twelve months. These charges would relate to the write-down of assets, severance payments and other consolidation charges.

In connection with the Top-Flite acquisition, the Company evaluated and determined during the third quarter of 2003 that the undiscounted future cash flows estimated to be derived from its golf ball assets, including the acquired Top-Flite golf ball assets, exceeded the carrying value of such assets. If the Company were to change the manner in which it conducts its golf ball business or otherwise lower its estimates of the undiscounted cash flows it expects to derive from its golf ball assets, the Company could be required to assess impairment. Impairment is assessed by comparing the fair value of the golf ball assets against the carrying value of such assets. Such assessment could result in a write-down of a significant portion of such assets.

Warranty

The Company has a stated two-year warranty policy for its golf clubs, although the Company's historical practice has been to honor warranty claims well after the two-year stated warranty period. The Company's policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty. If the number of actual warranty claims or the cost of satisfying warranty claims significantly exceeds the estimated warranty reserve, the Company's cost of sales, gross profit and net income would be significantly adversely affected.

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. The Company provides a valuation allowance for its deferred tax assets when, in the opinion of management, it is more likely than not that such assets will not be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should the Company determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Change in Accounting Estimate

As discussed above, the Company has a stated two-year warranty policy for its golf clubs, although the Company's historical practice has been to honor warranty claims well after the two-year stated warranty period. Prior to the third quarter of 2002, the Company's method of estimating both its implicit and explicit warranty obligation was to utilize data and information based on the cumulative failure rate by product after taking into consideration specific risks the Company believes existed at the time the financial statements were prepared. These additional risks included product specific risks, such as the introduction of products with new technology or materials that would be more susceptible to failure or breakage, and other business risks, such as increased warranty liability as a result of acquisitions. In many cases, additions to the warranty reserve for new product introductions have been based on management's judgment of possible future claims derived from the limited product failure data that was available at the time.

Beginning in the second quarter of 2001, the Company began to compile data that illustrated the timing of warranty claims in relation to product life cycles. In the third quarter of 2002, the Company determined it had gathered sufficient data and concluded it should enhance its warranty accrual estimation methodology to utilize the additional data. The analysis of the data, in management's judgment, provided management with more insight into timing of claims and demonstrated that some product failures are more likely to occur early in a product's life cycle while other product failures occur in a more linear fashion over the product's life cycle. As a result of its analysis of the additional information, the Company believes it has gained better insight and improved judgment to more accurately project the ultimate failure rates of its products. As a result of this refinement in its methodology, the Company concluded that it should change its methodology of estimating warranty accruals and reduce its warranty reserve by approximately $17.0 million. The $17.0 million reduction is recorded in cost of goods sold and favorably impacted gross profit as a percentage of net sales by 10 percentage points and 3 percentage points for the three and nine months ended September 30, 2002, respectively. The change in methodology has been accounted for as a change in accounting principle inseparable from a change in estimate.

The following summarizes what net income and earnings per share would have been had the warranty reserve adjustment, adjusted for taxes, been excluded from reported results (in millions, except for per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Reported net income	$ 2.3	$ 7.2	$79.0	$ 75.0
Non-cash warranty reserve adjustment, net of tax	—	(10.5)	—	(10.4)
Pro forma net income (loss)	$ 2.3	$ (3.3)	$79.0	$ 64.6
Basic earnings per share:				
Reported net income	$0.04	$ 0.11	$1.20	$ 1.12
Non-cash warranty reserve adjustment, net of tax	—	(0.16)	—	(0.16)
Pro forma net income (loss)	$0.04	$(0.05)	$1.20	$ 0.96
Diluted earnings per share:				
Reported net income	$0.03	$ 0.11	$1.19	$ 1.11
Non-cash warranty reserve adjustment, net of tax	—	(0.16)	—	(0.16)
Pro forma net income (loss)	$0.03	$(0.05)	$1.19	$ 0.95

The pro forma net income and earnings per share information set forth above has not been prepared in accordance with accounting principles generally accepted in the United States. This information is being provided as additional information for interested readers and is not intended to be a substitute for the Company's reported results which were prepared in accordance with accounting principles generally accepted in the United States and which are discussed elsewhere in this report. The Company's management believes that this pro forma information is useful in comparing the Company's results with the prior periods presented. The warranty reserve adjustment is a non-cash accounting adjustment. The magnitude of the warranty reserve adjustment was unusual for the Company and management did not believe that it was reasonably likely that a similar adjustment of that magnitude would be made within two fiscal years of such adjustment.

Results of Operations

Three-Month Periods Ended September 30, 2003 and 2002

Net sales decreased 5% to $153.6 million for the three months ended September 30, 2003 as compared to $161.3 million for the comparable period in the prior year. The overall decrease in net sales is primarily due to a $12.1 million (22%) decrease in sales of woods combined with a $1.2 million (4%) decrease in sales of putters and a $0.9 million (6%) decrease in the sale of other products. These decreases were partially offset by a $3.7 million (7%) increase in sales of irons and a $2.8 million (25%) increase in sales of golf balls in the third quarter of 2003 as compared to the third quarter of 2002. The weakening of the U.S. dollar in relation to other foreign currencies during the third quarter of 2003 had a favorable impact on net sales. As compared to the third quarter of 2002, the strengthening of foreign currency exchange rates favorably impacted net sales for the third quarter of 2003 by approximately $2.7 million, as measured by applying 2002 exchange rates to 2003 net sales.

The Company believes that adverse economic conditions and continued economic uncertainty, particularly in the United States, Japan and other parts of Asia, negatively affected its overall net sales during the third quarter of 2003. For example, unemployment in the United States remains high, which has a negative impact on consumer spending on discretionary goods, including the Company's products. The Company also believes that its net sales for 2003 were negatively affected by a continued decrease in the number of golf rounds played. Golf Datatech has reported that the number of golf rounds played in the United States declined 4.4% during the third quarter of 2003, as compared to the same period in 2002.

Net sales information by product category is summarized as follows (in millions):

	For the Three Months Ended September 30,		Growth/(Decline)	
	2003	2002	Dollars	Percent
Net sales:				
Woods	$ 44.0	$ 56.1	$(12.1)	(22)%
Irons	54.7	51.0	3.7	7%
Putters	27.0	28.2	(1.2)	(4)%
Golf balls	14.1	11.3	2.8	25%
Accessories and other(*)	13.8	14.7	(0.9)	(6)%
	$153.6	$161.3	$ (7.7)	(5)%

(*) Beginning with the first quarter of 2003, the Company records royalty revenue in net sales. Previously, royalty revenue was recorded as a component of other income and prior periods have been reclassified to conform with the current period presentation.

The $12.1 million (22%) decrease in net sales of woods to $44.0 million represents a decrease in both unit and dollar sales. This decrease was primarily attributable to a decline in sales of Big Bertha Hawk Eye VFT Titanium Drivers and Fairway Woods, ERC II Forged Titanium Drivers and Fairway Woods and Big Bertha Steelhead III Drivers and Fairway Woods. The declines in sales of these products were expected as the Company's products generally sell better in their first year after introduction. Both the Big Bertha Hawk Eye VFT Titanium Drivers and Fairway Woods and ERC II Forged Titanium Drivers were introduced in 2001 and were being closed out in 2003. In addition, 2003 is the second year in the life cycle for ERC II Forged

Titanium Fairway Woods and Big Bertha Steelhead III Drivers and Fairway Woods. These decreases were partially offset by sales of Great Big Bertha II Drivers and Fairway Woods, which were launched during the fourth quarter of 2002. Sales of Great Big Bertha II Drivers and Fairway Woods exceeded the sales of all other lines of the Company's titanium products for the comparable period in 2002.

The $3.7 million (7%) increase in net sales of irons to $54.7 million represents an increase in both unit and dollar sales. The sales growth was due primarily to the January 2003 launch of the Steelhead X-16 Stainless Steel Irons, including the Steelhead X-16 Pro Series line and the new Great Big Bertha Titanium Irons launched in August 2003. This sales growth was partially offset by a decline in sales of Big Bertha Irons which were launched in January 2002, Hawkeye VFT irons which were launched in August 2001, and Steelhead X-14 irons which were launched in October 2000 and were being closed out in 2003.

The $1.2 million (4%) decrease in net sales of putters to $27.0 million is attributable to decreased sales of the Company's Odyssey putters. The Company does not believe that this decline is significant. As discussed below, net sales of putters increased 31% for the first nine months in 2003 as compared to 2002. The Company believes the third quarter decline merely reflects the timing of product reaching the market place.

The $2.8 million (25%) increase in net sales of golf balls to $14.1 million is primarily attributable to sales of Top-Flite golf balls in the United States for the last two weeks of the quarter subsequent to the acquisition. These additional sales were partially offset by a decrease in Callaway Golf ball sales during the third quarter of 2003. The Company believes that its golf ball sales during the quarter were adversely affected by the decline in rounds played this year, the absence of any new Callaway Golf product introductions in 2003, and the uncertainty surrounding the Callaway Golf and the Top-Flite businesses earlier in the year.

The $0.9 million (6%) decrease in sales of accessories and other products is primarily attributable to a decrease in Callaway Golf Forged Wedges. This decrease reflects the significant sales of the Callaway Golf Forged Wedges during the third quarter of 2002 in connection with the launch and initial sell-in of the Callaway Golf Forged Wedges, as well as the introduction of competitive products in this segment. This decline was partially offset by increases in golf bags, accessories and other products.

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

	For the Three Months Ended September 30,		Growth/(Decline)	
	2003	2002	Dollars	Percent
Net sales:				
United States	$ 77.7	$ 81.3	$(3.6)	(4)%
Europe	29.8	30.7	(0.9)	(3)%
Japan	23.0	23.7	(0.7)	(3)%
Rest of Asia	15.3	14.0	1.3	9%
Other foreign countries	7.8	11.6	(3.8)	(33)%
	$153.6	$161.3	$(7.7)	(5)%

Net sales in the United States decreased $3.6 million (4%) to $77.7 million during the third quarter of 2003 versus the third quarter of 2002. Overall, the Company's sales in regions outside of the United States decreased $4.1 million (5%) to $75.9 million during the third quarter of 2003 versus the same quarter of 2002. As shown in the table above, the Company's sales decreased in all regions outside of the United States except Rest of Asia. The Company's net sales in regions outside of the United States were favorably affected by the strengthening of foreign currencies in relation to the U.S. dollar. Had exchange rates for the third quarter of 2003 been the same as the third quarter 2002 exchange rates, overall sales in regions outside of the United States would have been approximately $2.7 million lower than reported.

For the third quarter of 2003, gross profit decreased $9.7 million to $70.2 million from $79.9 million in the third quarter of 2002. Gross profit as a percentage of net sales decreased to 46% of net sales in the third quarter of 2003 from 50% in the comparable period of 2002. The Company's gross profit in 2002 was favorably impacted by the $17.0 million reduction in the Company's warranty accrual during the third quarter of 2002 (see above "Change in Accounting Estimate"). Excluding the effects of such reduction, gross profit would have increased $7.3 million in 2003 from $62.9 million in the third quarter of 2002. Excluding the effects of such reduction, gross profit as a percentage of net sales would have increased 7 percentage points in 2003 from 39% of net sales in the third quarter of 2002. This improvement in the Company's gross profit percentage (excluding the warranty accrual reduction) was primarily attributable to the additional reserves established in 2002 on ERC II Drivers and Big Bertha C4 Drivers and a customs and duty assessment in Korea in the third quarter of 2002. This improvement was partially offset by declines in golf ball production volumes and overall lower average selling prices.

Selling expenses remained relatively constant at $47.5 million in the third quarter of 2003 as compared to $47.7 million in the comparable period of 2002. As a percentage of sales, the expenses increased slightly to 31% in the third quarter of 2003 from 30% in the third quarter of 2002. The dollar decrease in expenses was primarily due to a $2.9 million decrease related to employee costs and advertising expenses. These decreases were partially offset by a $2.7 million increase related to promotional expenses and the addition of Top-Flite expenses which were not included in the prior period.

General and administrative expenses increased $2.2 million (18%) in the third quarter of 2003 to $14.7 million from $12.5 million in the third quarter of 2002. As a percentage of sales, the expenses increased to 10% in the third quarter of 2003 from 8% in the third quarter of 2002. The dollar increase resulted primarily from increases in employee costs.

Research and development expenses decreased $0.5 million (6%) in the third quarter of 2003 to $7.7 million from $8.2 million in the comparable period of 2002. As a percentage of sales, the expenses remained constant at 5%.

Other income increased to $1.1 million in the third quarter of 2003 as compared to other expenses of $1.0 million in the third quarter of 2002. The $2.1 million of additional other income is primarily attributable to increases in gains on foreign currency transactions of $1.6 million, increases in gains on investments to fund the deferred compensation plan of $0.6 million, and litigation settlement of $0.6 million. These increases were partially offset by a $1.1 million increase in net losses on foreign currency contracts.

During the third quarter of 2003, the Company recorded a $0.9 million benefit from income taxes, as compared to a $3.3 million provision for income taxes in the comparable period of 2002. The difference is primarily attributable to a one-time export tax benefit in the current period.

Nine-Month Periods Ended September 30, 2003 and 2002

Net sales decreased less than 1% to $667.4 million for the nine months ended September 30, 2003 as compared to $670.4 million for the comparable period in the prior year. The overall decrease in net sales is primarily due to a $44.2 million (17%) decrease in sales of woods and a $14.3 million (25%) decrease in sales of golf balls. These decreases were partially offset by a $28.0 million (31%) increase in sales of putters, a $21.1 million (10%) increase in sales of irons and a $6.4 million (12%) increase in sales of the Company's other products during the first nine months of 2003 as compared to the first nine months of 2002. The weakening of the U.S. dollar in relation to other foreign currencies during the first nine months of 2003 had a significant favorable impact on net sales. As compared to the first nine months of 2002, the strengthening of foreign currency exchange rates favorably impacted net sales for the first nine months of 2003 by approximately $22.1 million, as measured by applying 2002 exchange rates to 2003 net sales.

The Company believes that adverse economic conditions and continued economic uncertainty, particularly in the United States, Japan and other parts of Asia negatively affected its overall net sales during the first nine months of 2003. For example, unemployment in the United States remains high, which has a negative impact on consumer spending on discretionary goods, including the Company's products. The Company also believes that its net sales for 2003 were negatively affected by a continued decrease in the number of golf rounds played. Golf Datatech has reported that the number of golf rounds played in the United States declined 3.9% during the first nine months of 2003, as compared to the same period in 2002.

Net sales information by product category is summarized as follows (in millions):

	For the Nine Months Ended September 30,		Growth/(Decline)	
	2003	2002	Dollars	Percent
Net sales:				
Woods	$213.9	$258.1	$(44.2)	(17%)
Irons	233.9	212.8	21.1	10%
Putters	118.1	90.1	28.0	31%
Golf balls	43.3	57.6	(14.3)	(25%)
Accessories and other(*)	58.2	51.8	6.4	12%
	$667.4	$670.4	$ (3.0)	(0%)

(*) Beginning with the first quarter of 2003, the Company records royalty revenue in net sales. Previously, royalty revenue was recorded as a component of other income and prior periods have been reclassified to conform with the current period presentation.

The $44.2 million (17%) decrease in net sales of woods to $213.9 million represents a decrease in both unit and dollar sales. This decrease was primarily attributable to a decline in sales of Big Bertha Hawk Eye VFT Titanium Drivers and Fairway Woods, Big Bertha Steelhead III Drivers and Fairway Woods, ERC II Forged Titanium Drivers and Fairway Woods and Big Bertha C4 Drivers. The declines in sales of these products were expected as the Company's products generally sell better in their first year after introduction. Both Big Bertha Hawk Eye VFT Titanium Drivers and Fairway Woods and ERC II Forged Titanium Drivers were introduced in 2001 and Big Bertha C4 Drivers were introduced in 2002. All of these products were being closed out in 2003. In addition, 2003 is the second year in the life cycle for ERC II Forged Titanium Fairway Woods and Big Bertha Steelhead III Drivers and Fairway Woods. These decreases were partially offset by sales of Great Big Bertha II Drivers and Fairway Woods, which were launched during the fourth quarter of 2002. Sales of Great Big Bertha II Drivers and Fairway Woods exceeded the combined prior year sales of all titanium woods products which included Big Bertha Hawk Eye VFT Titanium Drivers and Fairway Woods and ERC II Forged Titanium Drivers and Fairway Woods.

The $21.1 million (10%) increase in net sales of irons to $233.9 million represents an increase in both unit and dollar sales. The sales growth was due primarily to the January 2003 launch of the Steelhead X-16 Stainless Steel Irons, including the Steelhead X-16 Pro Series line. This sales growth was partially offset by a decline in sales of Big Bertha Irons which were launched in January 2002, Hawkeye VFT irons which were launched in August 2001, and Steelhead X-14 Irons which were launched in October 2000.

The $28.0 million (31%) increase in net sales of putters to $118.1 million is attributable to increased sales of the Company's Odyssey putters primarily resulting from the continued success of the Odyssey White Hot 2-Ball Putter, which was introduced in January 2002.

The $14.3 million (25%) decrease in net sales of golf balls to $43.3 million represents a decrease in both unit and dollar sales. The Company believes that its Callaway Golf ball sales during the first nine months of 2003 were adversely affected by the decline in rounds played this year, the absence of any new product introductions in 2003, and the uncertainty surrounding the Company's golf ball business earlier in the year. This decline was partially offset by sales of Top-Flite golf balls in the United States for the last two weeks of the current period.

The $6.4 million (12%) increase in sales of accessories and other products is primarily attributable to increased sales of Callaway Golf Forged Wedges, which were launched in August 2002, and golf bags.

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

	For the Nine Months Ended September 30,		Growth/(Decline)	
	2003	2002	Dollars	Percent
Net sales:				
United States	$370.2	$376.5	$(6.3)	(2%)
Europe	123.9	117.8	6.1	5%
Japan	77.6	80.5	(2.9)	(4%)
Rest of Asia	48.9	48.0	0.9	2%
Other foreign countries	46.8	47.6	(0.8)	(2%)
	$667.4	$670.4	$(3.0)	(0%)

Net sales in the United States decreased $6.3 million (2%) to $370.2 million during the first nine months of 2003 versus the first nine months of 2002. Overall, the Company's sales in regions outside of the United States increased $3.3 million (1%) to $297.2 million during the first nine months of 2003 versus the same period in 2002. As shown in the table above, the Company's sales increased in Europe and Rest of Asia while sales decreased in Japan and other foreign countries. The Company's net sales in regions outside of the United States were favorably affected by the strengthening of foreign currencies in relation to the U.S. dollar. Had exchange rates for the first nine months of 2003 been the same as the first nine months of 2002 exchange rates, overall sales in regions outside of the United States would have been approximately $22.1 million lower than reported.

For the nine months ended September 30, 2003, gross profit decreased $11.9 million to $334.6 million from $346.4 million in the comparable period of 2002. Gross profit as a percentage of net sales decreased to 50% of net sales in the first nine months of 2003 from 52% in the comparable period of 2002. The Company's gross profit in 2002 was favorably impacted by the $17.0 million reduction in the Company's warranty accrual during the third quarter of 2002 (see above "Change in Accounting Estimate"). Excluding the effects of such reduction, gross profit would have increased $5.1 million in 2003 from $329.4 million for the nine months ended September 30, 2002. Excluding the effects of such reduction, gross profit as a percentage of net sales would have increased 1 percentage point to 50% in 2003 from 49% in 2002. This improvement in the Company's gross profit percentage (excluding the warranty accrual reduction) was primarily attributable to a more favorable sales mix combined with the additional reserves established in 2002 on ERC II Drivers and Big Bertha C4 Drivers. These increases were partially offset by declines in golf ball production volumes and overall lower average selling prices.

Selling expenses decreased $10.4 million (7%) in the first nine months of 2003 to $149.5 million from $160.0 million in the comparable period of 2002, and were 22% and 24% of net sales, respectively. This decrease was primarily due to decreases in advertising expenses, employee costs and other promotional expenses of $6.5 million, $5.2 million and $3.0 million, respectively. These decreases were partially offset by increases in depreciation and amortization expenses of $2.3 million and tour expenses of $1.2 million.

General and administrative expenses increased $2.3 million (6%) in the first nine months of 2003 to $43.2 million, from $40.9 million in the comparable period of 2002. As a percentage of sales, the expenses remained constant at 6%. The dollar increase resulted primarily from increases in employee related costs.

Research and development expenses decreased $3.9 million (16%) in the first nine months of 2003 to $20.6 million from $24.5 million in the comparable period of 2002, and were 3% and 4% of net sales, respectively. The dollar decrease resulted primarily from a $1.1 million decrease in consulting fees, a $1.1 million decrease in employee costs and a $0.9 million decrease in depreciation.

Other income totaled $1.3 million in the first nine months of 2003 as compared to other income of less than $0.1 million in the first nine months of 2002. The $1.3 million increase in other income is primarily attributable to increases of $1.8 million in gains on investments to fund the deferred compensation plan and $0.6 million generated from litigation settlements. These increases were partially offset by a $0.9 million increase in net losses on foreign currency transactions.

During the nine months ended September 30, 2003, the Company recorded a provision for income taxes of $43.6 million (35.6% of pre-tax income), as compared to $46.1 million (38.0% of pre-tax income) in the comparable period of 2002. The difference is primarily attributable to one-time benefits related to export tax incentives in the current period.

Financial Condition

Cash and cash equivalents decreased $35.6 million (33%) to $72.8 million at September 30, 2003, from $108.5 million at December 31, 2002. The decrease primarily resulted from cash used in investing activities of $169.8 million and cash used in financing activities of $6.8 million, respectively, partially offset by cash provided by operating activities of $140.1 million. Cash flows used in investing activities reflect business acquisition costs of $165.1 million, which includes the domestic ($135.2 million) and international ($29.9 million) portions of the Top-Flite acquisition, and capital expenditures of $4.8 million. Cash flows used in financing activities are primarily attributable to the $13.9 million payment of dividends, the $3.2 million acquisition of treasury stock and the $2.6 million payment on notes payable, partially offset by $8.6 million of proceeds received from the exercise of employee stock options and $4.2 million of proceeds from purchases under the employee stock purchase plan. Cash flows provided by operating activities reflect net income adjusted for depreciation and amortization of $109.4 million combined with a $39.5 million decrease in inventory and a $26.6 million increase in income taxes payable partially, offset by a $40.0 million increase in accounts receivable.

During the first nine months of 2003, the Company’s cash decreased $35.6 million compared to a $13.1 million increase in cash during the first nine months of 2002. The Company’s decrease in cash in the current year was primarily attributable to the Top-Flite Acquisition, partially offset by a decrease in share repurchase activity and a decline in capital expenditures.

At September 30, 2003, the Company’s net accounts receivable increased $72.5 million from December 31, 2002. The increase is partially due to the acquisition of Top-Flite’s accounts receivable which were $27.0 million at September 30, 2003. Excluding the Top-Flite balances, accounts receivable would have increased $45.5 million, which is consistent with seasonal trends (see below “Certain Factors Affecting Callaway Golf Company — Seasonality and Adverse Weather Conditions”). The Company’s accounts receivable also increased $33.0 million over the Company’s accounts receivable at September 30, 2002. Excluding the Top-Flite balances, accounts receivable would have increased $6.0 million. This increase is primarily attributable to late second quarter 2003 sales and timing of payments on those sales.

At September 30, 2003, the Company’s net inventory increased $10.6 million from December 31, 2002. The increase is primarily due to the acquisition of Top-Flite inventory which was $27.0 million at September 30, 2003. Excluding the Top-Flite inventory, the net inventory balance at September 30, 2003 would have declined $37.5 million from December 31, 2002, which is consistent with seasonal trends (see below “Certain Factors Affecting Callaway Golf Company — Seasonality and Adverse Weather Conditions”). The Company’s inventory increased $12.7 million as compared to September 30, 2002. This increase is also attributable to the $27.0 million of Top-Flite inventory at September 30, 2003. Excluding the Top-Flite inventory, the September 30, 2003 net inventory balance would have declined $14.3 million from September 30, 2002.

At September 30, 2003, the Company’s net property, plant and equipment increased $26.7 million from December 31, 2002. This increase is primarily due to the acquisition of Top-Flite property, plant and equipment which was $51.8 million at September 30, 2003, partially offset by depreciation of $29.3 million during the first nine months of 2003.

Liquidity

Sources of Liquidity

The Company's principal sources of liquidity, both on a short-term and long-term basis, for the periods presented has generally been cash flows provided by operations. The Company currently expects this to continue over the long-term. In the short term, however, given the significant amount of cash used in the Top-Flite acquisition, the Company intends to supplement its cash provided by operations with its credit facility. At September 30, 2003, the Company had a line of credit with Bank of America to borrow up to $50.0 million. At September 30, 2003, there were no borrowings outstanding under that facility and the Company was in compliance with the covenants prescribed by that facility.

Effective November 10, 2003, the Company terminated its $50.0 million line of credit with Bank of America, N.A. and obtained a new $100.0 million revolving line of credit from Bank of America, N.A. and certain other lenders. The new $100.0 million credit facility is scheduled to be available until November 2004, subject to earlier termination in accordance with its terms and subject to extension upon agreement of all parties. Upon the expiration of the new revolving credit facility, provided the Company is not in default of the terms of the new revolving credit facility and subject to certain conditions, the Company has the option to convert the amounts outstanding under the new revolving credit facility into a one-year term loan.

Subject to the terms of the new credit facility, the Company can borrow up to a maximum of $100.0 million. The Company is required to pay certain fees, including a quarterly unused commitment fee equal to 12.5 to 20.0 basis points of the unused commitment amount, with the exact amount determined based upon the Company's Consolidated Leverage Ratio. For purposes of the new credit facility, "Consolidated Leverage Ratio" means, as of any date of determination, the ratio of "Consolidated Funded Indebtedness" as of such date to "Consolidated EBITDA" for the four most recent fiscal quarters (as such terms are defined in the new credit facility agreement). Outstanding borrowings under the new credit facility accrue interest at the Company's election at (i) the higher of (a) the Federal Funds Rate plus 50.0 basis points or (b) Bank of America's prime rate, and in either case less a margin of 50.0 to 100.0 basis points depending upon the Company's Consolidated Leverage Ratio or (ii) the Eurodollar Rate (as such term is defined in the new credit facility agreement), plus a margin of 75.0 to 125.0 basis points depending upon the Company's Consolidated Leverage Ratio. The Company has agreed that repayment of amounts under the new credit facility will be guaranteed by certain of the Company's domestic subsidiaries and will be secured by the Company's pledge of 65% of the stock it holds in certain of its foreign subsidiaries and by certain intercompany debt securities and proceeds thereof. The Company has not yet borrowed any amounts under the new revolving credit facility.

The new credit facility agreement requires the Company to maintain certain minimum financial covenants. Specifically, (i) the Company's Consolidated Leverage Ratio may not exceed 1.25 to 1.00 and (ii) Consolidated EBITDA (which would exclude certain non-cash charges related to the restructuring of the Company's golf ball operations) for any four consecutive quarters may not be less than $50.0 million. The new credit facility agreement also includes certain other restrictions, including restrictions limiting additional indebtedness, dividends, stock repurchases, transactions with affiliates, capital expenditures, asset sales, acquisitions, mergers, liens and encumbrances and other matters customarily restricted in loan documents. The new credit facility also contains other customary provisions, including affirmative covenants, representations and warranties and events of default.

Golf Ball Operations

Through September 30, 2003, the Company's golf ball operations related to the Callaway Golf brand have not generated cash flows sufficient to fund these operations. In September 2003, the Company acquired substantially all of the assets associated with Top-Flite's golf business. The Company believes that the future combined Callaway and Top-Flite golf ball operations will generate sufficient cash flows to fund these operations.

Share Repurchases

In August 2001, the Company announced that its Board of Directors authorized it to repurchase 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. The Company began the repurchase program in August 2001 and during the third quarter of 2002 completed the program, which resulted in the repurchase of 5.8 million shares of the Company's Common Stock at an average cost of $17.11 per share for a total of $100.0 million. In May 2002, 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 $50.0 million. Under this authorization, the Company has spent $34.2 million to repurchase 2.2 million shares of its Common Stock at an average cost of $15.25 per share through September 30, 2003. During the nine months ended September 30, 2003, the Company spent a total of $3.2 million to repurchase 0.3 million shares under the May 2002 authorization at an average cost of $11.65 per share. As of September 30, 2003, the Company had $15.8 million of remaining authority under the May 2002 stock repurchase authorization.

Other Significant Cash Obligations

The following table provides, as of September 30, 2003 certain significant cash obligations that will affect the Company's future liquidity (in millions):

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Operating leases(1)	$16.3	$4.7	$6.4	$3.5	$ 1.7
Capital leases(2)	0.4	0.2	0.2	—	—
Unconditional purchase obligations(3)	2.3	2.3	—	—	—
Deferred compensation(4)	8.2	0.7	1.4	0.4	5.7
Notes payable(5)	0.8	0.8	—	—	—
Long-term debt(6)	5.0	0.4	0.8	0.8	3.0
Total(7)	$33.0	$9.1	$8.8	$4.7	$10.4

(1) The Company leases certain warehouse, distribution and office facilities, vehicles as well as office equipment under operating leases. The amounts presented in this line item represent commitments for minimum lease payments under non-cancelable operating leases and include operating leases assumed as part of the Top-Flite acquisition.

(2) The Company acquired certain capital lease obligations as a result of the Top-Flite acquisition primarily related to computer and telecommunications systems. The amounts presented in this line item represent commitments for minimum lease payments under non-cancelable capital leases.

(3) The amounts presented in this line item reflect a purchase agreement for golf ball materials through 2003. As of September 30, 2003, there were no outstanding commitments to purchase golf club materials. In addition, in the normal course of operations, the Company enters into unconditional purchase obligations with various vendors and suppliers of goods and services through purchase orders or other documentation or are undocumented except for an invoice. Such obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in the total unconditional purchase obligations presented in this line item.

(4) The amounts presented in this line item represent the liability for the Company's 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 after 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 $9.8 million at September 30, 2003.

(5) In April 2001, the Company entered into a note payable in the amount of $7.5 million 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.

(6) In connection with the Top-Flite acquisition, the Company assumed long-term debt related to a warehouse located in Chicopee, Massachusetts. As of September 30, 2003, the outstanding principal portion of this debt was $5.0 million. Interest on the outstanding balance accrues at an annual rate of 300 basis points over the one-year U.S. Treasury Note, currently 4.31%, adjusted annually. The principal and interest is payable in monthly installments and is payable in full in 2018. The debt is secured by the warehouse.

(7) During the third quarter of 2001, the Company entered into a derivative commodity instrument to manage electricity costs in the volatile California energy market. The contract was originally effective through May 2006. 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. The Company continues to reflect the $19.9 million derivative valuation account on its balance sheet, subject to periodic review, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The $19.9 million represents unrealized losses resulting from changes in the estimated fair value of the contract and does not represent contractual cash obligations. The Company believes the energy supply contract has been terminated and, therefore, the Company does not have any further cash obligations under the contract. Accordingly, the energy derivative valuation account is not included in the table. There can be no assurance, however, that a 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 contract. No provision has been made for contingencies or obligations, if any, under the contract beyond November 2001. See below "Supply of Electricity and Energy Contracts."

In addition to the obligations listed above, the Company has entered into contracts with professional golfers to evaluate and promote Callaway Golf, Odyssey, Top-Flite, Ben Hogan and Strata branded products. Many of these contracts provide incentives for successful performances using the Company's products. For example, under these contracts, the Company could be obligated to pay a cash bonus to a professional who wins a particular tournament while playing the Company's golf clubs or golf balls. It is not possible to predict with any certainty the amount of such performance awards the Company will be required to pay in any given year. Such expenses, however, are an ordinary part of the Company's business and the Company does not believe that the payment of these performance awards will have a material adverse effect upon the Company. See below "Certain Factors Affecting Callaway Golf Company — Golf Professional Endorsements."

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company's customers and licensees in connection with the use, sale and/or license of Company products, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct of the Company and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has made contractual commitments to several employees providing for severance payments upon the occurrence of certain prescribed events. The Company also has several consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain workers compensation insurance policies. The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company's financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that material payments will be required under the commitments and guarantees described above. The fair value of indemnities, commitments and guarantees that the Company issued during the nine months ended September 30, 2003 were not material to the Company's financial position, results of operations or cash flows.

In addition to the contractual obligations listed above, the Company's liquidity could also be adversely affected by an unfavorable outcome with respect to claims and litigation that the Company is subject to from time to time. See below "Part II, Item 1. — Legal Proceedings."

Sufficiency of Liquidity

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 current credit facility, will be sufficient to finance current operating requirements planned capital expenditures, contractual obligations and commercial commitments, for the next twelve months. 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 below "Certain Factors Affecting Callaway Golf Company").

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 third 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 third 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 September 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 would have been 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 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 had recorded unrealized pre-tax losses of $19.9 million.

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, subject to periodic review, in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."

The Company believes the Enron Contract has been terminated, and as of November 7, 2003, 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.

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.

Top-Flite Golf Company Asset Acquisition

In September 2003, the Company acquired substantially all of the assets associated with The Top-Flite Golf Company's golf business, including its manufacturing facilities, the Top-Flite, Strata and Ben Hogan brands, and all U.S. and foreign golf-related patents and trademarks. The Company faces certain risks associated with such acquisition. The Company faces many challenges in trying to reverse the decline of the Top-Flite brand in the marketplace and in trying to consolidate the golf ball manufacturing operations to eliminate the losses in the Company's golf ball operations. Some of these challenges include the (i) retention of Top-Flite key employees, (ii) maintaining good vendor relationships, particularly if the Top-Flite vendors are not paid in full in the bankruptcy proceedings, (iii) the difficulties in integrating the Top-Flite brands with the Callaway Golf Company brands and (v) the employee and other issues inherent in any consolidation. Furthermore, the integration and consolidation of the acquired assets will require a considerable amount of time and attention of senior management and others, which could have an adverse effect upon the Company's club business.

In addition, in connection with the integration and consolidation of the acquired assets, the Company could incur significant charges to earnings. The Company previously announced that it estimated such charges could be up to $60.0 million and that the majority of these charges would be non-cash.

Finally, the Company has spent a considerable amount of cash to acquire the Top-Flite Golf Company assets and there is no assurance that the Company will realize a satisfactory return on its investment.

Terrorist Activity and Armed Conflict

Terrorist activities and armed conflicts in recent years (such as the attacks on the World Trade Center and the Pentagon, the incidents of Anthrax poisoning and the military actions in the Middle East, including the conflicts in Iraq), as well as the threat of future conflict, have had a significant adverse effect upon the Company's business. Any such additional events would likely have an adverse effect upon the world economy 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 would 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 and when consumers are feeling confident and prosperous. Adverse economic conditions in the United States or in the Company's international markets (which represent almost half of the Company's total sales), or a decrease in prosperity among consumers, or even a decrease in consumer confidence as a result of anticipated adverse 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 Company believes that the current economic conditions in many of the countries where the Company conducts business, although beginning to show signs of improvement, generally remain unfavorable to the golf industry. Many people in the United States have lost a substantial amount of wealth in the stock market, including some who have lost all or substantially all of their retirement savings. Furthermore, in the United States, there have been announcements by companies of significant reductions in force, and others are possible, and consumers are less likely to purchase new golf equipment when they are unemployed. The Company believes that these adverse conditions have adversely affected the Company's sales and will continue to do so until such conditions improve.

Foreign Currency Risk

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 fluctuations in foreign currency exchange rates relative to the U.S. dollar. Changes in exchange rates may positively or negatively affect the Company's financial results. Overall, the Company is generally negatively affected by a stronger U.S. dollar in relation to the foreign currencies in which the Company conducts business. Conversely, overall, the Company is generally positively affected by a weaker U.S. dollar relative to such foreign currencies. For the effect of foreign currencies on the Company's financial results for the current reporting periods, see above "Results of Operations."

The effects of foreign currency fluctuations can be significant. The Company therefore engages in certain hedging activities to mitigate the impact of foreign currency fluctuations over time on the Company's financial results. The Company's hedging activities reduce, but do not eliminate, the effects of such foreign currency fluctuations. Factors that could affect the effectiveness of the Company's hedging activities include accuracy of sales forecasts, volatility of currency markets and the availability of hedging instruments. Since the hedging activities are designed to reduce volatility, they not only reduce the negative impact of a stronger U.S. dollar but they also reduce the positive impact of a weaker U.S. dollar. For the effect of the Company's hedging activities during the current reporting periods, see below "Quantitative and Qualitative Disclosures about Market Risk."

The Company's future financial results could be significantly negatively affected if the value of the U.S. dollar increases relative to the foreign currencies in which the Company conducts business. The degree to which the Company's financial results are affected will depend in part upon the effectiveness or ineffectiveness of the Company's hedging activities.

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 the number of golfers in the United States in 2000, 2001 or 2002. Golf Datatech has reported that thus far during 2003 the number of golf rounds played in the United States declined 3.9%, as compared to the same period in 2002, and that rounds played have decreased each year since at least 1999. 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.

Golf Balls. In connection with the acquisition of the Top-Flite assets, the Company anticipates that it will significantly increase its golf ball market share. Prior to the acquisition, however, both Callaway Golf's and Top-Flite's market shares had been declining. The Company's ability to reverse such decline and obtain the market share previously enjoyed by The Top-Flite Golf Company will depend in part upon the Company's ability to integrate the Top-Flite brands and operations with the Callaway Golf brands and operations. There is no assurance that the Company will be able to successfully or profitably integrate these brands or operations or maintain the combined market share previously enjoyed by The Top-Flite Golf Company and Callaway Golf Company.

Golf Ball Costs

The cost of entering the golf ball business has been significant. The cost of competing in the golf ball business has also been significant and has required significant investment in advertising, tour and promotion. The development of the Callaway Golf Company golf ball business has had a significant negative impact on the Company's cash flows, financial position and results of operations. In addition, in September 2003, the Company spent approximately $159 million in cash to acquire substantially all of the assets of The Top-Flite Golf Company. As presently structured, the Company will need to produce and sell golf balls in large volumes to cover its costs and be profitable. There is no assurance that the Company will be able to achieve the sales volume 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 forecasted demand. 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. In 2001, some companies in California, including the Company, experienced periods of blackouts during which electricity was not available. 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. The Company is currently purchasing wholesale energy through the Company's energy service provider under short-term contracts. From time to time, legislation has been introduced that would restrict the Company's ability to purchase wholesale energy through its energy service provider. If passed, the Company may be required to purchase energy from the local public utility, which could cause the Company's cost of energy to increase. If the Company's costs of energy were to increase as a result of such legislation or otherwise, the Company's results of operations would be adversely affected.

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 (because of financial difficulties or otherwise) are unable or fail to provide suitable components. However, there could be a significant production delay or disruption caused by the inability of current suppliers to deliver or the transition to other suppliers, which in turn 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 significant interruption in such 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 and ship services. 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 (see also below "International Risks").

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 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, consignment sales, extended payment terms and "close-outs" (including close-outs of products that were recently commercially successful) 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, consignment sales, 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. Furthermore, worldwide sales of golf balls have been declining due to declines in the number of golf rounds played and other factors, resulting in a surplus of worldwide golf ball manufacturing capacity. As competition in this business increases, many of these competitors are substantially discounting the prices of their products and/or increasing advertising, tour or other promotional support. This increased competition has resulted in significant expenses in both tour and advertising support and product development. In order for its golf ball business to be successful, the Company will need to integrate the acquired Top-Flite assets with its golf ball manufacturing operations and must produce golf balls at prices and costs that are profitable. There can be no assurance that the Company's golf balls will obtain the market acceptance or profitability 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. 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, in 2002, the Company introduced the Big Bertha C4 Driver made of compression-cured carbon composite. Despite the product's excellent performance, this product did not meet the Company's sales expectations and is indicative of the risks associated with the subjective preferences of golfers. In general, there can be no assurance as to how long the Company's golf clubs and golf 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 and Product Cyclicality

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.

The Company's newly introduced golf club products generally have a product life cycle of approximately two years. These products generally sell significantly better in the first year after introduction as compared to the second year. In certain markets, such as Japan, the decline in sales during the second year is even more significant. The Company's titanium metal wood products generally sell at higher price points than its comparable steel metal wood products. The Company's wood products generally achieve better gross margins than its comparable iron products. The Company's sales and gross margins for a particular period may be negatively or positively affected by the mix of new products sold in such period.

Seasonality and Adverse Weather Conditions

In addition to the effects of product cycles described above, the Company's business is also subject to the effects of seasonal fluctuations. The Company's first quarter sales generally represent the Company's sell-in to the golf retail channel of its products for the new golf season. Orders for many of these sales are received during the fourth quarter of the prior year. The Company's second and third quarter sales generally represent re-order business. Sales during the second and third quarters therefore are significantly affected not only by the sell-through of the Company's products that were sold into the channel during the first quarter but also by the sell-through of the products of the Company's competitors. Retailers are sometimes reluctant to re-order the Company's products in significant quantity when they already have excess inventory of the Company's competitors' products. The Company's sales during the fourth quarter are generally significantly less than the other quarters because in general in the Company's principal markets less people are playing golf during that time of year due to cold weather. Furthermore, it previously was the Company's practice to announce its new product line at the beginning of each calendar year. The Company has departed from that practice and now generally announces its new product line in the fourth quarter to allow retailers to plan better. Such early announcements of new products could cause golfers, and therefore the Company's customers, to defer purchasing additional golf equipment until the Company's new products are available. Such deferments could have a material adverse effect upon sales of the Company's current products and/or result in close-out sales at reduced prices.

Because of these seasonal trends, the Company's business can be significantly adversely affected by unusual or severe weather conditions. Unfavorable 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.

Conformance with the Rules of Golf

New golf club and golf ball products generally seek to satisfy the standards established by the USGA and R&A because these standards are generally followed by golfers within their respective jurisdictions. The USGA rules are generally followed in the United States, Canada and Mexico, and the R&A rules are generally followed in most other countries throughout the world. The Rules of Golf as published by the R&A and the USGA are virtually the same except with respect to the regulation of "driving clubs."

All of the Company's current products (including the new ERC Fusion and Great Big Bertha II Drivers), with the exception of the Great Big Bertha II+ Drivers, are believed to be "conforming" under the Rules of Golf as published by the USGA. All of the Company's current products are believed to be conforming to the existing Rules of Golf as published by the R&A. However, effective January 1, 2003 the Company's Great Big Bertha II+ Titanium Drivers is not conforming in certain competitions involving highly skilled golfers and effective January 1, 2008 such drivers will not be conforming under the generally applicable Rules of Golf as published by the R&A. These new R&A restrictions could affect current and future sales of such drivers in R&A jurisdictions, including jurisdictions in which the Company previously sold such products and in which there previously were no R&A restrictions. The Company also believes that the general confusion created by the USGA as to what is a conforming or non-conforming driver has hurt sales of its drivers generally.

In addition, there is no assurance that the Company's future products 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 or the Company's brand. For example, both the USGA and the R&A are considering rules which would limit clubhead volume. If any such volume limitation rules were adopted and caused one or more of the Company's current products to be non-conforming, the Company's sales of such products could be adversely affected. Furthermore, such clubhead volume limitations would restrict the Company's ability to develop new golf club products.

Golf Professional Endorsements

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

Golf Clubs. 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. 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 from time to time implements programs that create cash incentives that financially reward such usage. Many other companies, however, also aggressively seek the patronage of these professionals and offer many inducements, including significant cash rewards and specially designed products. The inducements offered by other companies could result in a decrease in usage of the Company's clubs by professional golfers or increase the amount the Company must spend to maintain its tour presence. The Company believes that professional usage contributes to retail sales, and it is therefore 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/or usage, and the market leader has obtained a very high degree of tour penetration. While 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 currently plan to match the endorsement spending levels of the leading manufacturer, and will instead rely more heavily upon the performance of the Company's golf ball products and other factors to attract professionals to the product. There is some evidence to suggest that there is a correlation between use by professional golfers and retail sales. The Company therefore believes 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 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. As the Company develops new products, it attempts to avoid infringing the valid patents and other intellectual property rights of others. Before introducing new products, the Company's legal staff evaluates the patents and other intellectual property rights of others to determine if changes are required to avoid infringing any valid intellectual property rights that could be asserted against the Company's new product offerings. From time to time, 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.

The Company's Code of Conduct and Ethics Policy prohibits misappropriation of trade secrets and confidential information of third parties. The Code of Conduct and Ethics Policy is contained in the Company's Employee Handbook and available to all employees on the Company's internal website. Employees also sign an Employee Invention and Confidentiality Agreement prohibiting disclosure of trade secrets and confidential information from third parties. Periodic training is provided to employees on this topic as well. Despite taking these steps, as well as others, the Company cannot guarantee that these measures will be adequate in all instances to prevent misappropriation of trade secrets from third parties or the accusation by a third party that such misappropriation has taken place.

Brand Licensing

The Company licenses its trademarks to third party licensees who produce, market and sell their products bearing the Company's trademarks. The Company chooses its licensees carefully and imposes upon such licensees various restrictions on the products, and on the manner, on which such trademarks may be used. Despite these restrictions, or if a licensee fails to adhere to these restrictions, the Company's brand could be damaged by the use or misuse of the Company's trademarks in connection with its licensees' products.

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 defective 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. The Company believes that it has adequate reserves for warranty claims. If the Company were to experience an unusually high incidence of breakage or other warranty problems in excess of these reserves, the Company's financial results would be adversely affected. See above, "Critical Accounting Policies and Estimates — Warranty."

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 Risks

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

As a result of this international business, the Company is exposed to increased risks inherent in conducting business outside of the United States. In addition to foreign currency risks, these risks include (i) increased difficulty in protecting the Company's intellectual property rights and trade secrets, (ii) unexpected government action or changes in legal or regulatory requirements, (iii) social, economic or political instability, (iv) the effects of any anti-American sentiments on the Company's brands or sales of the Company's products, (v) increased difficulty in controlling and monitoring foreign operations from the United States and (vi) increased exposure to interruptions in air carrier or shipping services which interruptions could significantly adversely affect the Company's ability to obtain timely delivery of components from international suppliers or to timely deliver its products to international customers. Although the Company believes the benefits of conducting business internationally outweigh these risks, any significant adverse change in circumstances or conditions could have a significant adverse effect upon the Company's operations and therefore financial performance and condition.

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 uncollectable 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 by the Company's customers to pay a significant portion of outstanding account receivable balances would adversely impact the Company's performance and financial condition.

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, as a result of an internal system malfunction, infection from an external computer virus, or otherwise, 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 3. *Quantitative and Qualitative Disclosures about Market Risk*

The Company uses derivative financial instruments for hedging purposes to limit its exposure to changes in foreign currency 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 also utilized a derivative commodity instrument, the Enron Contract, to manage electricity costs in the volatile California energy market during the period of September 2001 through November 2001. Pursuant to its terms, the Enron Contract was terminated. The Company is also exposed to interest rate risk from its credit facility.

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 foreign currency related 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. Hedged transactions are denominated primarily in British Pounds, Euros, 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 risk management policies. Pursuant to its foreign exchange hedging policy, the Company may hedge anticipated transactions 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 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 mature within twelve months from their inception.

At September 30, 2003 and 2002, the notional amounts of the Company's foreign exchange contracts were approximately $87.7 million and $63.0 million, respectively. 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 September 30, 2003, the fair values of foreign currency-related derivatives were recorded as current assets of $0.8 million and current liabilities of $2.7 million.

At September 30, 2003 and 2002, the notional amounts of the Company's foreign exchange contracts designated as cash flow hedges were approximately $42.9 million and $4.6 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 ("OCI") as a separate component of shareholders' equity and subsequently reclassified into earnings in the period during which the hedged transaction is recognized in earnings. During the three and nine months ended September 30, 2003 and 2002, the Company recorded the following activity in OCI (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Beginning OCI balance related to cash flow hedges	$(0.6)	$0.3	$(1.4)	$ 6.4
Add: Net gain/(loss) initially recorded in OCI	(1.1)	0.6	(2.4)	(2.4)
Deduct: Net gain/(loss) reclassified from OCI into earnings	(0.5)	0.5	(2.6)	3.6
Ending OCI balance related to cash flow hedges	$(1.2)	$0.4	$(1.2)	$ 0.4

During the three and nine months ended September 30, 2003, no gains were reclassified into earnings as a result of the discontinuance of cash flow hedges. During the nine months ended September 30, 2002, $0.2 million of gains were reclassified into earnings as a result of the discontinuance of cash flow hedges. No gains were reclassified into earnings as a result of the discontinuance of cash flow hedges during the three months ended September 30, 2002.

As of September 30, 2003, $1.2 million of deferred net losses related to derivative instruments designated as cash flow hedges were included in OCI. These derivative instruments hedge transactions that are expected to occur within the next twelve months. As the hedged transactions are completed, the related deferred net gain or loss is reclassified from OCI into earnings. The Company does not expect that such reclassifications will have a material effect on the Company's earnings, as any gain or loss on the derivative instruments generally would be offset by the opposite effect on the related underlying transactions.

The ineffective portion of the gain or loss for derivative instruments that are designated and qualify as cash flow hedges is immediately reported as a component of other income (expense), net. 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 other income (expense), net. During the three months ended September 30, 2003 and 2002, the Company recorded net gains of less than $0.1 million and net losses of $0.3 million, respectively, as a result of changes in the spot-forward differential. During the nine months ended September 30, 2003 and 2002, the Company recorded net losses of $0.1 million and net gains of $0.4 million, respectively, as a result of changes in the spot-forward differential. 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 hedged 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 quarterly.

At September 30, 2003 and 2002, the notional amounts of the Company's foreign exchange contracts used to hedge outstanding balance sheet exposures were approximately $44.8 million and $58.4 million, respectively. The gains and losses on foreign currency contracts used to hedge balance sheet exposures are recognized as a component of other income (expense), 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 the three months ended September 30, 2003 and 2002, the Company recorded net losses of $0.7 million and net gains of $0.7 million, respectively, due to net realized and unrealized gains and losses on contracts used to hedge balance sheet exposures. During the nine months ended September 30, 2003 and 2002, the Company recorded net losses of $5.0 million and $7.1 million, respectively, due to net realized and unrealized gains and losses on contracts used to hedge balance sheet exposures.

Sensitivity analysis is the measurement of potential loss in future earnings of market sensitive instruments resulting from one or more selected hypothetical changes in interest rates or foreign currency values. The Company used a sensitivity analysis model to quantify the estimated potential effect of unfavorable movements of 10% in foreign currencies to which the Company was exposed at September 30, 2003 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 from the Company's foreign-currency derivative financial instruments, calculated using the sensitivity analysis model described above, is $9.6 million at September 30, 2003. The portion of the estimated loss associated with the foreign exchange contracts that offset the remeasurement gain and loss of the related foreign currency denominated assets and liabilities is $4.9 million at September 30, 2003 and would impact earnings. The remaining $4.7 million of the estimated loss at September 30, 2003 is derived from outstanding foreign exchange contracts designated as cash flow hedges and would initially impact OCI. 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 third 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. Because the contract is terminated and neither party to the contract is performing pursuant to the terms of the contract, the terminated contract ceased to represent a derivative instrument in accordance with SFAS No. 133. The Company, therefore, 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 above "Supply of Electricity and Energy Contracts."

Interest Rate Fluctuations

Additionally, the Company is exposed to interest rate risk from its new $100.0 million credit facility (see Note 9 to the Company's Consolidated Condensed Financial Statements). The new credit facility is indexed to, at the Company's election, (i) the higher of (a) the Federal Funds Rate plus 50.0 basis points or (b) Bank of America's prime rate, and in either case less a margin of 50.0 to 100.0 basis points depending upon the Company's Consolidated Leverage Ratio or (ii) the Eurodollar Rate (as such term is defined in the new credit facility agreement), plus a margin of 75.0 to 125.0 basis points depending upon the Company's Consolidated Leverage Ratio.

In connection with the Top-Flite acquisition, the Company assumed long-term debt, which is indexed to the U.S. Treasury Note, plus 300 basis points. The rate is adjusted annually and is currently 4.31%. The outstanding principal portion of the long-term debt at September 30, 2003 was $5.0 million.

Note 9 to the Company's Consolidated Condensed Financial Statements outlines the principal amounts, if any, and other terms required to evaluate the expected cash flows and sensitivity to interest rate changes.

Item 4. *Controls and Procedures*

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-14(c) of the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic filings with the Commission.

There were no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect these internal controls subsequent to the date of their most recent evaluation. Since there were no significant deficiencies or material weaknesses identified in the Company's internal controls, the Company did not take any corrective actions.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

The Company, incident to its business activities, is often the plaintiff in legal proceedings, both in the United States 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. Historically, these matters individually and in the aggregate have not had a material adverse effect upon the financial position or results of operations of the Company. It is possible, however, that in the future one or more defenses or claims asserted by defendants in one or more of those actions may succeed, resulting in the loss of all or part of the rights under one or more patents, loss of a trademark, a monetary award against the Company or some other material loss to the Company. One or more of these results could adversely affect the Company's overall ability to protect its product designs and ultimately limit its future success in the marketplace.

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

On April 6, 2001, a complaint was filed against Callaway Golf Company and Callaway Golf Sales 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 select 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. The parties are engaged in discovery.

On November 4, 2002, Callaway Golf Sales Company was served with a complaint filed in the District Court of Sedgwick County, Kansas, Case No. 0203607, seeking to assert an alleged class action on behalf of Kansas consumers who purchased select Callaway Golf products covered by the New Product Introduction Policy. Callaway Golf Company is also named in the Kansas case. The plaintiff in the Kansas case seeks damages and restitution for the alleged class under Kansas law.

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, U.S. Patent No. 6,213,898 (the "Aerodynamics Patent"). On October 15, 2001, MaxFli filed an answer to the complaint denying any infringement, and also filed a counterclaim against the Company asserting that former MaxFli employees hired by 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 compensatory damages; an additional award of punitive damages equal to two times the compensatory damages; attorneys' fees; a declaratory judgment; and injunctive relief. Both parties have amended their claims. The Company added a claim for false advertising and MaxFli added a claim for inequitable conduct before the Patent and Trademark Office. The parties are engaged in expert discovery. MaxFli submitted a report from its damages expert asserting that MaxFli is entitled to at least $18.5 million in compensatory damages from the Company. MaxFli has informed the Company that it may seek leave to amend its damages expert report to substantially increase the compensatory damages that MaxFli will seek at trial. The Company has submitted its own expert report seeking damages for false advertising. The Company anticipates that each party will challenge the methodology and conclusions in the expert damages reports of the other. On November 12, 2003, pursuant to an agreement between the Company and MaxFli, the Court dismissed the Company's claim for infringement of the Aerodynamics Patent and all portions of MaxFli's counterclaim related to the Aerodynamics Patent, thereby resolving that part of the case. The trial on the Company's false advertising claim and MaxFli's remaining counterclaims is scheduled to commence in the summer of 2004. An unfavorable resolution of MaxFli's counterclaim could have a significant adverse effect upon the Company's results of operations, cash flows and financial position.

On December 2, 2002, Callaway Golf Company was served with a complaint filed in the Circuit Court of the 19th Judicial District in and for Martin County, Florida, Case No. 935CA, by the Perfect Putter Co. and certain principals of the Perfect Putter Co. Plaintiffs have sued Callaway Golf Company, Callaway Golf Sales Company and a Callaway Golf Sales Company sales representative. Plaintiffs allege that the Company misappropriated certain alleged trade secrets of the Perfect Putter Co. and incorporated those purported trade secrets in the Company's Odyssey White Hot 2-Ball Putter. Plaintiffs also allege that the Company made false statements and acted inappropriately during discussions with plaintiffs. Plaintiffs are seeking compensatory damages, exemplary damages, attorney's fees and costs, pre- and post-judgment interest and injunctive relief. On December 20, 2002, Callaway Golf removed the case to the United States District Court for the Southern District of Florida, Case No. 02-14342. On April 29, 2003, the District Court denied plaintiffs' motion to remand the case to state court, holding that the sales representative had been "fraudulently joined" solely for the purpose of defeating diversity jurisdiction. Thereafter, on August 14, 2003, the plaintiffs filed a second amended complaint adding a new claim for civil theft under Florida law based on the facts set forth in the original complaint. If successful on that claim, the plaintiffs will be entitled to treble damages. The Company has denied the allegations of the second amended complaint. The parties are currently engaged in discovery. The trial of the action has been set to commence in the fall of 2004.

On July 3, 2003, Saso Golf, Inc. filed a lawsuit against the Company, Callaway Golf Sales Co., and an unrelated defendant in the United States District Court for the Northern District of Illinois, Case No. 03-CV-4646. Saso Golf alleges that sales of Callaway Golf's metal woods, including but not limited to the original Callaway Golf Biggest Big Bertha, infringe U.S. Patent No. 5,645,495 and seeks compensatory damages, treble damages, attorney's fees, prejudgment interest, costs and injunctive relief. The Company has denied the allegations in the Complaint. The Court has not set a trial date, and the parties are conducting discovery.

The Company and its subsidiaries, incident to their business activities, are parties to a number of legal proceedings, lawsuits and other claims, including the matters specifically noted above. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, management is unable to estimate the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance, or the financial impact with respect to these matters as of September 30, 2003. Except as discussed above with regard to the MaxFli litigation, management believes at this time that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon the Company's consolidated annual results of operations or cash flows, or financial position.

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

None

Item 3. ***Defaults Upon Senior Securities***

None

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

None

Item 5. ***Other Information***

None

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

a. *Exhibits*

3.1	Certificate of Incorporation, incorporated herein by this reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission ("Commission") on July 1, 1999 (file no. 1-10962).
3.2	Second Amended and Restated Bylaws, as amended and restated as of February 27, 2003, incorporated herein by this reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, as filed with the Commission on March 17, 2003 (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).
4.2	Rights Agreement by and between the Company and Mellon Investor Services LLC (f/k/a Chemical Mellon Shareholder Services) as Rights Agent, dated as of June 21, 1995, incorporated herein by this reference to Exhibit 4.0 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).
4.3	First Amendment to Rights Agreement, effective June 22, 2001, by and between Callaway Golf Company and Mellon Investor Services, LLC, incorporated herein by this reference to Exhibit 4.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001 as filed with the Commission on March 21, 2002 (file no. 1-10962).
4.4	Certificate of Determination of Rights, Preferences, Privileges and Restrictions of Series A Junior Participating Preferred Stock, incorporated herein by this reference to Exhibit 3.1.2 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).
10.59	Officer Employment Agreement between The Top-Flite Golf Company (f/k/a TFGC Acquisition Corp.) and Robert A. Penicka.(†)

10.60	Second Amendment to Second Amended Executive Officer Employment Agreement between Callaway Golf Company and Ronald A. Drapeau.(†)
10.61	Second Amendment to First Amended Executive Officer Employment Agreement between Callaway Golf Company and Steven C. McCracken.(†)
10.62	Second Amendment to First Amended Executive Officer Employment Agreement between Callaway Golf Company and Bradley J. Holiday.(†)
10.63	Second Amendment to Executive Officer Employment Agreement between Callaway Golf Company and Patrice Hutin.(†)
10.64	Amendment No. 1 to Asset Purchase Agreement between TFGC Estate Inc. (f/k/a The Top-Flite Golf Company) and Callaway Golf Company, dated as of August 11, 2003, incorporated herein by this reference to Exhibit 99.2 to the Company's current report on Form 8-K, as filed with the Commission on September 30, 2003 (file no. 1-10962).
10.65	Amendment No. 2 to Asset Purchase Agreement between TFGC Estate Inc. (f/k/a The Top-Flite Golf Company) and Callaway Golf Company, dated as of September 4, 2003, incorporated herein by this reference to Exhibit 99.3 to the Company's current report on Form 8-K, as filed with the Commission on September 30, 2003 (file no. 1-10962).
10.66	Amendment No. 3 to Asset Purchase Agreement between TFGC Estate Inc. (f/k/a The Top-Flite Golf Company) and Callaway Golf Company, dated as of September 15, 2003, incorporated herein by this reference to Exhibit 99.4 to the Company's current report on Form 8-K, as filed with the Commission on September 30, 2003 (file no. 1-10962).
10.67	Amendment No. 4 to Asset Purchase Agreement between TFGC Estate Inc. (f/k/a The Top-Flite Golf Company) and Callaway Golf Company, dated as of September 30, 2003, incorporated herein by this reference to Exhibit 99.5 to the Company's current report on Form 8-K, as filed with the Commission on September 30, 2003 (file no. 1-10962).
31.1	Certification of Ronald A. Drapeau pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(†)
31.2	Certification of Bradley J. Holiday pursuant to Rule13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(†)
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.(†)

(†) Included with this Report.

b. *Reports on Form 8-K*

Form 8-K, dated September 15, 2003, reporting the acquisition of substantially all of the assets of TFGC Estate Inc. (f/k/a The Top-Flite Company, f/k/a Spalding Sports Worldwide, Inc.).

Form 8-K, dated September 4, 2003, reporting the issuance of a press release of even date therewith, which press release was captioned, "Callaway Golf Approved as Buyer of Top-Flite."

Form 8-K, dated July 23, 2003, reporting the issuance of a press release of even date therewith, which press release was captioned, "Bankruptcy Court Approves Initial Bid by Callaway Golf to Buy Top-Flite Assets; Schedule Set for Other Bids and Sale."

Form 8-K, dated July 17, 2003, reporting the issuance of a press release of even date therewith, which press release was captioned, "Callaway Golf Announces Record Six Months' Net Income and EPS; Increases EPS Guidance for 2003."

Form 8-K, dated June 30, 2003, reporting the acquisition of the assets of The Top-Flite Golf Company, including the Top-Flite, Strata and Ben Hogan brands, captioned "Callaway Golf Announces Acquisition of Top-Flite."

SIGNATURES

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

CALLAWAY GOLF COMPANY

BY: /s/ BRADLEY J. HOLIDAY

Bradley J. Holiday
Senior Executive Vice President and
Chief Financial Officer

Date: November 12, 2003

EXHIBIT INDEX

Exhibit	Description
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EXHIBIT 10.59

OFFICER EMPLOYMENT AGREEMENT

This Officer Employment Agreement ("Agreement") is entered into as of September 15, 2003, by and between TFGC ACQUISITION CORP., a Delaware corporation formed as the wholly owned subsidiary of Callaway Golf Company for purposes of acquiring and operating Top-Flite golf assets ("TFGC"), and ROBERT A. PENICKA ("Employee"). It is expected that after the purchase of the Top-Flite golf assets is complete, TFGC Acquisition Corp. shall be renamed "The Top-Flite Golf Company." Hereinafter TFGC and The Top-Flite Golf Company are collectively referred to as the "Company."

1. TERM.

(a) The Company hereby employs Employee and Employee here by accepts employment pursuant to the terms and provisions of this Agreement for the period commencing September 15, 2003 and terminating December 31, 2004.

(b) On December 31, 2004, and on each December 31 thereafter (the "Extension Dates"), the expiration date of this Agreement shall be automatically extended one year, through December 31 of the following year, so long as (a) this Agreement is otherwise in full force and effect, (b) Employee is still employed by the Company pursuant to this Agreement, (c) Employee is not otherwise in breach of this Agreement, and (d) neither the Company nor Employee has given notice as provided in Section 1(c) of this Agreement.

(c) At any time prior to an Extension Date, either Employee or the Company may give written notice to the other ("Notice") that the next automatic extension of the expiration date of this Agreement pursuant to Section 1(b) shall be the final such automatic extension of the expiration date of this Agreement. Thus, if either Employee or the Company gives Notice on or before December 31, 2004, and all other conditions for automatic extension of the expiration date of this Agreement pursuant to Section 1(b) exist, then on December 31, 2004, the expiration date of this Agreement shall be extended pursuant to Section 1(b) from December 31, 2004 to December 31, 2005, with this Agreement expiring on that date (if not earlier terminated pursuant to its terms) without any further automatic extensions.

(d) Upon expiration of this Agreement, Employee's status shall be one of at will employment.

2. SERVICES.

(a) Employee shall serve as President and Chief Operating Officer of the Company. Employee's duties shall be the usual and customary duties of the office in which Employee serves. Employee shall report to the Chief Executive Officer of the Company, or to such other person as the Chief Executive Officer shall designate. The Board of Directors and/or the Chief Executive Officer of the Company may change Employee's title, position and/or duties at any time.

(b) Employee shall be required to comply with all policies and procedures of the Company, as such shall be adopted, modified or otherwise established by the Company from time to time.

(c) The Company and Employee agree that the services being provided by Employee for the Company under the terms of this Agreement are unique and intellectual in character and that Employee and Company are entering into this Agreement so that the Company will have the exclusive benefit of those services during the entire term of the Agreement and any extensions of the Agreement.

3. SERVICES TO BE EXCLUSIVE. During the term hereof, Employee agrees to devote his full productive time and best efforts to the performance of Employee's duties hereunder pursuant to the supervision and direction of the Company's Board of Directors and its Chief Executive Officer. Employee further agrees, as a condition to the performance by the Company of each and all of its obligations hereunder, that so long as Employee is employed by the Company, Employee will not directly or indirectly render services of any nature to, otherwise become employed by, or otherwise participate or engage in any other business without the Company's prior written consent. Employee further agrees to execute such secrecy, non-disclosure, patent, trademark, copyright and other proprietary rights agreements, if any, as the Company may from time to time reasonably require at the Company's sole expense but with no further compensation to Employee. Nothing herein contained shall be deemed to preclude Employee from having outside personal investments and involvement with appropriate community activities, and from devoting a reasonable amount of time to such matters, provided that this shall in no manner interfere with or derogate from Employee's work for the Company.

4. COMPENSATION.

(a) The Company agrees to pay Employee a base salary at the rate of $500,000.00 per year, prorated for the year 2003.

(b) The Company shall provide Employee an opportunity to earn an annual bonus based upon participation in the Company's officer bonus plan as it may or may not exist from time to time. Employee acknowledges that currently all bonuses are discretionary, that the current officer bonus plan does not include any nondiscretionary bonus plan, and that the Company does not currently contemplate establishing any nondiscretionary bonus plan applicable to Employee. Notwithstanding the foregoing, for the year 2003 only, Employee shall participate in the officer bonus plan for Callaway Golf Company, rather than any officer bonus plan available through the Company.

5. EXPENSES AND BENEFITS.

(a) Reasonable and Necessary Expenses. In addition to the compensation provided for in Section 4 hereof, the Company shall reimburse Employee for all reasonable, customary and necessary expenses incurred in the performance of Employee's duties hereunder. Employee shall first account for such expenses by submitting a signed statement itemizing such expenses prepared in accordance with the policy set by the Company for reimbursement of such expenses. The amount, nature, and extent of such expenses shall always be subject to the control, supervision and direction of the Company and its Chief Executive Officer.

(b) Vacation/Paid Time Off. Employee shall accrue vacation or paid time off commencing on the effective date of this Agreement, and Employee shall be credited with ten (10) days of vacation or paid time off toward the maximum annual accrual on the date employment commences. All other portions of the vacation or paid time off program, when adopted by the Company, shall govern Employee's vacation or paid time off. The vacation or paid time off may be taken any time during the year subject to prior approval by the Company, such approval not to be unreasonably withheld. The Company reserves the right to pay Employee for unused, accrued vacation or paid time off benefits in lieu of providing time off. It is the Company's intent that the new vacation or paid time off program, once adopted, shall provide Employee with four (4) weeks vacation and two (2) weeks sick leave, or an equivalent amount of paid time off.

(c) Benefits. During Employee's employment with the Company pursuant to this Agreement, the Company shall provide for Employee to:

(i) participate in the Company's health insurance and disability insurance plans as the same may be modified from time to time;

Robert A. Penicka

(ii) receive, if Employee is insurable under usual underwriting standards, term life insurance coverage on Employee's life, payable to whomever Employee directs, in an amount equal to three (3) times Employee's base salary, not to exceed a maximum of $1,500,000.00 in coverage, provided that Employee completes the required health statement and application and that Employee's physical condition does not prevent Employee from qualifying for such insurance coverage under reasonable terms and conditions;

(iii) participate in the Company's 401(k) retirement investment plan pursuant to the terms of the plan, as the same may be modified from time to time; and

(iv) participate in the Company's Executive Deferred Compensation Plan, as the same may be modified from time to time.

(d) Estate Planning and Other Perquisites. To the extent the Company provides tax and estate planning and related services, or any other perquisites and personal benefits to other officers of the Company generally from time to time, such services and perquisites shall be made available to Employee on the same terms and conditions.

(e) Club Membership. Employee shall be provided with access to a country club in accordance with the Company's country club membership policy, as modified from time to time.

(f) Relocation Benefits Package. Employee shall be provided with a relocation benefits package to assist with the relocation of his family from San Diego County, California, to a location in Massachusetts that is within thirty (30) minutes normal driving time of the Company's facilities in Chicopee, Massachusetts, as more fully described in the Relocation Benefits Package attached hereto as Exhibit C and incorporated herein by this reference.

6. TAX INDEMNIFICATION. Employee shall be indemnified by the Company for certain excise tax obligations, as more specifically set forth in Exhibit A to this Agreement.

7. BUSINESS ISSUES.

(a) Non-competition. To the fullest extent permitted by law, Employee agrees that, while employed by the Company, and for a period of one (1) year thereafter, Employee will not, alone or as an employee, officer, director, stockholder, agent, consultant, holder of a beneficial interest, creditor, or otherwise, engage in any employment, consulting, occupation or business activity or venture which:

(i) constitutes an actual or apparent conflict of interest with Employee's duties and obligations under this Agreement; or

(ii) which is directly or indirectly in competition with the business of the Company or any of its affiliates.

For purposes of this section, the ownership of any broadly based mutual fund shall not be deemed, of itself, to be "competition" under this Section 7. For purposes of this section, the geographic area of non-competition shall be defined to include any area in which the Company did business during the year preceding termination of employment.

(b) Non-solicitation: Other Employees. Except as may be required in the performance of his or her duties hereunder, Employee shall not cause or induce, or attempt to cause or induce, any person now or hereafter employed by the Company or any of its affiliates to terminate such employment.

This obligation shall remain in effect while Employee is employed by the Company and for a period of one (1) year thereafter.

(c) Non-solicitation: Suppliers. While employed by the Company, and for one (1) year thereafter, Employee shall not cause or induce, or attempt to cause or induce, any person or firm supplying goods, services or credit to the Company or any of its affiliates to diminish or cease furnishing such goods, services or credit.

(d) Non-Interference. While employed by the Company, and for one (1) year thereafter, Employee shall not in any way undertake to harm, injure or disparage the Company, its officers, directors, employees, agents, affiliates, vendors, products, or customers, or their successors, or in any other way exhibit an attitude of hostility toward them. Employee understands that it is the policy of the Company that only the Chief Executive Officer and President of the Company, or the Senior Vice President of Global Press and Public Relations of Callaway Golf Company, and their specific designees may speak to the press or media about the Company or its business, and agrees not to interfere with the Company's press and public relations by violating this policy.

8. TERMINATION.

(a) Termination at the Company's Convenience. Employee's employment under this Agreement may be terminated by the Company at its convenience at any time. In the event of a termination by the Company for its convenience, Employee shall be entitled to receive (i) any compensation accrued and unpaid as of the date of termination; and (ii) the immediate vesting of all unvested stock options held by Employee as of the date of such termination. In addition to the foregoing, Employee shall be eligible to receive Special Severance as described in Section 19.

(b) Termination by the Company for Substantial Cause. Employee's employment under this Agreement may be terminated immediately by the Company for substantial cause at any time. In the event of a termination by the Company for substantial cause, Employee shall be entitled to receive (i) any compensation accrued and unpaid as of the date of termination; and (ii) no other severance. "Substantial cause" shall mean for purposes of this subsection failure by Employee to substantially perform his or her duties, a material breach of this Agreement, or misconduct, including but not limited to, dishonesty, theft, use or possession of illegal drugs during work, and/or felony criminal conduct.

(c) Termination by Employee for Substantial Cause. Employee's employment under this Agreement may be terminated immediately by Employee for substantial cause at any time. In the event of a termination by Employee for substantial cause, Employee shall be entitled to receive (i) any compensation accrued and unpaid as of the date of termination; and (ii) the immediate vesting of all unvested stock options held by Employee as of the date of such termination. In addition to the foregoing, Employee shall be eligible to receive Special Severance as described in Section 19. "Substantial cause" shall mean for purposes of this subsection a material breach of this Agreement by the Company.

(d) Termination Due to Permanent Disability. Subject to all applicable laws, Employee's employment under this Agreement may be terminated immediately by the Company in the event Employee becomes permanently disabled. Permanent disability shall be defined as Employee's failure to perform or being unable to perform all or substantially all of Employee's duties under this Agreement for either (i) a continuous period of more than six (6) months on account of any physical or mental disability, either as mutually agreed to by the parties or as reflected in the opinions of three (3) qualified physicians, one of which has been selected by the Company, one of which has been selected by Employee, and one of which has been selected by the two other physicians jointly. In the event of a termination by the Company due to Employee's permanent disability, Employee shall be entitled to (i) any compensation accrued and unpaid as of the date of termination; (ii) severance payments equal to

Employee's then current base salary at the same rate and on the same schedule as in effect at the time of termination for a period of twelve (12) months from the date of termination; (iii) the immediate vesting of outstanding but unvested stock options held by Employee as of such termination date in a prorated amount based upon the number of days in the option vesting period that elapsed prior to Employee's termination; (iv) the payment of premiums owed for COBRA insurance benefits for a period of twelve (12) months from the date of termination; and (v) no other severance. The Company shall be entitled to take, as an offset against any amounts due pursuant to subsections (i) and (ii) above, any amounts received by Employee pursuant to disability or other insurance, or similar sources provided by the Company.

(e) Termination by Mutual Agreement of the Parties. Employee's employment pursuant to this Agreement may be terminated at any time upon the mutual agreement in writing of the parties. Any such termination of employment shall have the consequences specified in such agreement.

(f) Pre-Termination Rights. The Company shall have the right, at its option, to require Employee to vacate his or her office or otherwise remain off the Company's premises and to cease any and all activities on the Company's behalf without such action constituting a termination of employment or a breach of this Agreement.

9. RIGHTS UPON A CHANGE IN CONTROL.

(a) Notwithstanding anything in this Agreement to the contrary, if upon or at any time within one (1) year following any Change in Control (as defined in Exhibit B hereto) that occurs during the term of this Agreement there is a Termination Event (as defined below), Employee shall be treated as if he or she had been terminated for the convenience of the Company pursuant to Section 8(a).

(b) A "Termination Event" shall mean the occurrence of any one or more of the following, and in the absence of Employee's permanent disability (defined in Section 8(d)), Employee's death, or any of the factors enumerated in Section 8(b) providing for termination by the Company for substantial cause:

(i) the termination or material breach of this Agreement by the Company;

(ii) a failure by the Company to obtain the assumption of this Agreement by any successor to the Company or any assignee of all or substantially all of the Company's assets;

(iii) any material diminishment in the title, position, duties, responsibilities or status that Employee had with the Company immediately prior to the Change in Control;

(iv) any reduction, limitation or failure to pay or provide any of the compensation, reimbursable expenses, stock options, incentive programs, or other benefits or perquisites provided to Employee under the terms of this Agreement or any other agreement or understanding between the Company and Employee, or pursuant to the Company's policies and past practices as of the date immediately prior to the Change in Control; or

(v) any requirement that Employee relocate or any assignment to Employee of duties that would make it unreasonably difficult for Employee to maintain the principal residence he or she had immediately prior to the Change in Control.

10. SURRENDER OF EQUIPMENT, BOOKS AND RECORDS. Employee understands and agrees that all equipment, books, records, customer lists and documents connected with the business of the Company and/or its affiliates are the property of and belong to the Company. Under no circumstances shall Employee remove from the Company's facilities any of the Company's and/or its

affiliates' equipment, books, records, documents, lists or any copies of the same without the Company's permission, nor shall Employee make any copies of the Company's and/or its affiliates' books, records, documents or lists for use outside the Company's office except as specifically authorized by the Company. Employee shall return to the Company and/or its affiliates all equipment, books, records, documents and customer lists belonging to the Company and/or its affiliates upon termination of Employee's employment with the Company.

11. GENERAL RELATIONSHIP. Employee shall be considered an employee of the Company within the meaning of all federal, state and local laws and regulations, including, but not limited to, laws and regulations governing unemployment insurance, workers' compensation, industrial accident, labor and taxes.

12. TRADE SECRETS AND CONFIDENTIAL INFORMATION.

(a) As used in this Agreement, the term "Trade Secrets and Confidential Information" means information, whether written or oral, not generally available to the public, regardless of whether it is suitable to be patented, copyrighted and/or trademarked, which is received from the Company and/or its affiliates, either directly or indirectly, including but not limited to (i) concepts, ideas, plans and strategies involved in the Company's and/or its affiliates' products, (ii) the processes, formulae and techniques disclosed by the Company and/or its affiliates to Employee or observed by Employee, (iii) the designs, inventions and innovations and related plans, strategies and applications which Employee develops during the term of this Agreement in connection with the work performed by Employee for the Company and/or its affiliates; and (iv) third party information which the Company and/or its affiliates has/have agreed to keep confidential.

(b) Notwithstanding the provisions of subsection 12(a), the term "Trade Secrets and Confidential Information" does not include (i) information which, at the time of disclosure or observation, had been previously published or otherwise publicly disclosed; (ii) information which is published (or otherwise publicly disclosed) after disclosure or observation, unless such publication is a breach of this Agreement or is otherwise a violation of contractual, legal or fiduciary duties owed to the Company, which violation is known to Employee; or (iii) information which, subsequent to disclosure or observation, is obtained by Employee from a third person who is lawfully in possession of such information (which information is not acquired in violation of any contractual, legal, or fiduciary obligation owed to the Company with respect to such information, and is known by Employee) and who is not required to refrain from disclosing such information to others.

(c) While employed by the Company, Employee will have access to and become familiar with various Trade Secrets and Confidential Information. Employee acknowledges that the Trade Secrets and Confidential Information are owned and shall continue to be owned solely by the Company and/or its affiliates. Employee agrees that Employee will not, at any time, whether during or subsequent to Employee's employment by the Company and/or its affiliates, use or disclose Trade Secrets and Confidential Information for any competitive purpose or divulge the same to any person other than the Company or persons with respect to whom the Company has given its written consent, unless Employee is compelled to disclose it by governmental process. In the event Employee believes that Employee is legally required to disclose any Trade Secrets or Confidential Information, Employee shall give reasonable notice to the Company prior to disclosing such information and shall assist the Company in taking such legally permissible steps as are reasonable and necessary to protect the Trade Secrets or Confidential Information, including, but not limited to, execution by the receiving party of a non-disclosure agreement in a form acceptable to the Company.

(d) The provisions of this Section 12 shall survive the termination or expiration of this Agreement, and shall be binding upon Employee in perpetuity.

13. ASSIGNMENT OF RIGHTS.

(a) As used in this Agreement, "Designs, Inventions and Innovations," whether or not they have been patented, trademarked, or copyrighted, include, but are not limited to designs, inventions, innovations, ideas, improvements, processes, sources of and uses for materials, apparatus, plans, systems and computer programs relating to the design, manufacture, use, marketing, distribution and management of the Company's and/or its affiliates' products.

(b) As a material part of the terms and understandings of this Agreement, Employee agrees to assign to the Company or to Callaway Golf Company all Designs, Inventions and Innovations developed, conceived and/or reduced to practice by Employee, alone or with anyone else, in connection with the work performed by Employee for the Company during Employee's employment with the Company, regardless of whether they are suitable to be patented, trademarked and/or copyrighted.

(c) Employee agrees to disclose in writing to the Chief Executive Officer of the Company any Design, Invention or Innovation relating to the business of the Company and/or its affiliates, which Employee develops, conceives and/or reduces to practice in connection with any work performed by Employee for the Company, either alone or with anyone else, while employed by the Company and/or within twelve (12) months of the termination of employment. Employee shall disclose all Designs, Inventions and Innovations to the Company, even if Employee does not believe that he or she is required under this Agreement or any applicable law to assign his or her interest in such Design, Invention or Innovation to the Company. If the Company and Employee disagree as to whether or not a Design, Invention or Innovation is included within the terms of this Agreement, it will be the responsibility of Employee to prove that it is not included.

(d) The obligation to assign as provided in this Agreement does not apply to any Design, Invention or Innovation to the extent such obligation would conflict with any state or federal law. The obligation to assign as provided in this Agreement does not apply to any Design, Invention or Innovation that Employee developed entirely on Employee's own time without using the Company's equipment, supplies, facilities or Trade Secrets and Confidential Information except those Designs, Inventions or Innovations that either:

(i) Relate at the time of conception or reduction to practice to the Company's and/or its affiliates' business, or actual or demonstrably anticipated research of the Company and/or its affiliates; or

(ii) Result from any work performed by Employee for the Company and/or its affiliates.

(e) Employee agrees that any Design, Invention and/or Innovation which is required under the provisions of this Agreement to be assigned to the Company or to Callaway Golf Company shall be the sole and exclusive property of the assignee. Upon the Company's request, at no expense to Employee, Employee shall execute any and all proper applications for patents, copyrights and/or trademarks, assignments to the Company or to Callaway Golf Company, and all other applicable documents, and will give testimony when and where requested to perfect the title and/or patents (both within and without the United States) in all Designs, Inventions and Innovations.

(f) The provisions of this Section 13 shall survive the termination or expiration of this Agreement, and shall be binding upon Employee in perpetuity.

14. ASSIGNMENT. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and the successors and assigns of the Company. Employee shall have no right to

Robert A. Penicka

assign his rights, benefits, duties, obligations or other interests in this Agreement, it being understood that this Agreement is personal to Employee.

15. ENTIRE UNDERSTANDING. This Agreement sets forth the entire understanding of the parties hereto with respect to the subject matter hereof, and no other representations, warranties or agreements whatsoever as to that subject matter have been made by Employee or the Company. This Agreement shall not be modified, amended or terminated except by another instrument in writing executed by the parties hereto. This Agreement replaces and supersedes any and all prior understandings or agreements between Employee and the Company regarding employment.

16. NOTICES. Any notice, request, demand, or other communication required or permitted hereunder, shall be deemed properly given when actually received or within five (5) days of mailing by certified or registered mail, postage prepaid, to Employee at the address currently on file with the Company, and to the Company at:

TFGC Acquisition Corp.
c/o Callaway Golf Company
2180 Rutherford Road
Carlsbad, California 92008
Attn: Steven C. McCracken
Senior Executive Vice President, Chief Legal Officer

or to such other address as Employee or the Company may from time to time furnish, in writing, to the other.

17. APPLICABLE LAW; FORUM.

(a) Applicable Law. This Agreement shall be governed by the laws of the Commonwealth of Massachusetts and shall be governed and construed in accordance with the laws of said Commonwealth as to both interpretation and performance.

(b) Choice of Forum. Any dispute arising under this Agreement shall be brought in, and only in, courts located within the Commonwealth of Massachusetts, and the parties hereby consent to the jurisdiction of such courts over the subject matter of such actions and the necessary parties to such actions.

18. MISCELLANEOUS.

(a) Headings. The headings of the several sections and paragraphs of this Agreement are inserted solely for the convenience of reference and are not a part of and are not intended to govern, limit or aid in the construction of any term or provision hereof.

(b) Waiver. Failure of either party at any time to require performance by the other of any provision of this Agreement shall in no way affect that party's rights thereafter to enforce the same, nor shall the waiver by either party of any breach of any provision hereof be held to be a waiver of any succeeding breach of any provision or a waiver of the provision itself.

(c) Severability. In the event any provision or provisions of this Agreement is or are held invalid, the remaining provisions of this Agreement shall not be affected thereby.

(d) Advertising Waiver. Employee agrees to permit the Company and/or its affiliates, and persons or other organizations authorized by the Company and/or its affiliates, to use, publish and distribute advertising or sales promotional literature concerning the products of the Company and/or its affiliates, or the machinery and equipment used in the manufacture thereof, in which Employee's name and/or pictures of Employee taken in the course of Employee's provision of services to the Company and/or its affiliates, appear. Employee hereby waives and releases any claim or right Employee may otherwise have arising out of such use, publication or distribution.

(e) Counterparts. This Agreement may be executed in one or more counterparts which, when fully executed by the parties, shall be treated as one agreement.

19. SPECIAL SEVERANCE.

(a) Amount. Special Severance shall consist of (i) severance payments equal to Employee's then current base salary at the same rate and on the same payment schedule as in effect at the time of termination for a period of time equal to twelve (12) months from the date of termination; (ii) the payment of premiums owed for COBRA insurance benefits for a period of twelve (12) months from the date of termination; and (iii) no other severance.

(b) Conditions on Receiving Special Severance. Notwithstanding anything else to the contrary, it is expressly understood that any obligation of the Company to pay Special Severance pursuant to this Agreement shall be subject to Employee's continued compliance with the terms and conditions of Sections 7, 12, 13 and 17.

20. TREATMENT OF SPECIAL SEVERANCE . Any Special Severance shall be subject to usual and customary employee payroll practices and all applicable withholding requirements. Except for the amounts specifically provided pursuant to Sections 8 and 19, Employee shall not be entitled to any further compensation, bonus, damages, restitution, relocation benefits, or other severance benefits upon termination of employment. The amounts payable to Employee pursuant to these Sections shall not be treated as damages, but as compensation to which Employee may be entitled by reason of termination of employment under the applicable circumstances. The Company shall not be entitled to set off against the amounts payable to Employee pursuant to Sections 8 and 19 any amounts earned by Employee in other employment after termination of his or her employment with the Company pursuant to this Agreement, or any amounts which might have been earned by Employee in other employment had Employee sought such other employment. The provisions of Sections 8 and 19 shall not limit Employee's rights under or pursuant to any other agreement or understanding with the Company regarding any pension, profit sharing, insurance or other employee benefit plan of the Company to which Employee is entitled pursuant to the terms of such plan.

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

EMPLOYEE	COMPANY
	TFGC Acquisition Corp., a Delaware corporation
/s/ Robert A. Penicka - --------------------------------------- Robert A. Penicka	By: /s/ Ronald A. Drapeau ---------------------------- Ronald A. Drapeau Chairman of the Board and Chief Executive Officer

Robert A. Penicka

EXHIBIT A

TAX INDEMNIFICATION

Pursuant to Section 6 of Employee's Officer Employment Agreement ("Section 6"), the Company agrees to indemnify Employee with respect to certain excise tax obligations as follows:

1. Definitions. For purposes of Section 6 and this Exhibit A, the following terms shall have the meanings specified herein:

(a) "Claim" shall mean any written claim (whether in the form of a tax assessment, proposed tax deficiency or similar written notification) by the Internal Revenue Service or any state or local tax authority that, if successful, would result in any Excise Tax or an Underpayment.

(b) "Code" shall mean the Internal Revenue Code of 1986, as amended. All references herein to any section, subsection or other provision of the Code shall be deemed to refer to any successor thereto.

(c) "Excise Tax" shall mean (i) any excise tax imposed by Section 4999 of the Code or any comparable federal, state or local tax, and (ii) any interest and/or penalties incurred with respect to any tax described in 1(c)(i).

(d) Gross-Up Payment shall mean a cash payment as specified in Section 2.

(e) "Overpayment" and "Underpayment" shall have the meanings specified in Section 4.

(f) "Payment" shall mean any payment, benefit or distribution (including, without limitation, cash, the acceleration of the granting, vesting or exercisability of stock options or other incentive awards, or the accrual or continuation of any other payments or benefits) granted or paid to or for the benefit of Employee by the Company or by any person or persons whose actions result in a Taxable Event (as defined in this Section), or by any person affiliated with the Company or such person(s), whether paid or payable pursuant to the terms of this Agreement or otherwise. Notwithstanding the foregoing, a Payment shall not include any Gross-Up Payment required under Section 6 and this Exhibit A

(g) "Taxable Event" shall mean any change in control or other event which triggers the imposition of any Excise Tax on any Payment.

2. In the event that any Payment is determined to be subject to any Excise Tax, then Employee shall be entitled to receive from the Company a Gross-Up Payment in an amount such that, after the payment of all income taxes, Excise Taxes and any other taxes imposed with respect to the Gross-Up Payment (together with payment of all interest and penalties imposed with respect to any such taxes), Employee shall retain a net amount of the Gross-Up Payment equal to the Excise Tax imposed with respect to the Payments.

3. All determinations required to be made under Section 6 and this Exhibit A, including, without limitation, whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment, and the assumptions to be utilized in arriving at such determinations, shall be made by a nationally recognized public accounting firm selected by the Company, consistent with the Company's policies and applicable law (hereinafter referred to as the "Accounting Firm"). The Accounting Firm shall provide detailed supporting calculations to the Company and to Employee regarding the amount of Excise Tax (if any) which is payable, and the Gross-Up Payment (if any) required hereunder, with

respect to any Payment or Payments, with such calculations to be provided at such time as may be requested by the Company but in no event later than fifteen (15) business days following receipt of a written notice from Employee that there has been a Payment that may be subject to an Excise Tax. All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment as determined pursuant to Section 6 and this Exhibit A shall be paid by the Company to Employee within five (5) business days after receipt of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable by Employee, the Accounting Firm shall furnish Employee with a written opinion that failure to disclose, report or pay the Excise Tax on Employee's federal or other applicable tax returns will not result in the imposition of a negligence penalty, understatement penalty or other similar penalty. All determinations by the Accounting Firm shall be binding upon the Company and Employee in the absence of clear and indisputable mathematical error. Following receipt of a Gross-Up Payment as provided herein, Employee shall be obligated to properly and timely report his/her Excise Tax liability on the applicable tax returns or reports and to pay the full amount of Excise Tax with funds provided through such Gross-Up Payment. Notwithstanding the foregoing, if the Company reasonably determines that Employee will be unable or otherwise may fail to make such Excise Tax payment, the Company may elect to pay the Excise Tax to the Internal Revenue Service and/or other applicable tax authority on behalf of Employee, in which case the Company shall pay the net balance of the Gross-Up Payment (after deduction of such Excess Tax payment) to Employee.

4. As a result of uncertainty in the application of Section 4999 of the Code, it is possible that a Gross-Up Payment will not have been made by the Company that should have been made (an "Underpayment") or that a Gross-Up Payment is made that should not have been made (an "Overpayment"). In the event that Employee is required to make a payment of any Excise Tax, due to an Underpayment, the Accounting Firm shall determine the amount of Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to Employee in which case Employee shall be obligated to make a timely payment of the full amount of the applicable Excise Tax to the applicable tax authority, provided, however, the Company may elect to pay the Excise Tax to the applicable tax authority on behalf of Employee consistent with the provisions of Section 3, in which case the Company shall pay the net balance of the Underpayment (after deduction of such Excise Tax payment) to Employee. In the event that the Accounting Firm determines that an Overpayment has been made, any such Overpayment shall be repaid by Employee to the Company within ninety (90) days after written demand to Employee by the Company, provided, however, that Employee shall have no obligation to repay any amount of the Overpayment that has been paid to, and not recovered from, a tax authority, provided further, however, in such event the Company may direct Employee to prosecute a claim for a refund of such amount consistent with the principles set forth in Section 5.

5. Employee shall notify the Company in writing of any Claim. Such notice (a) shall be given as soon as practicable, but in no event later than fifteen (15) business days, following Employee's receipt of written notice of the Claim from the applicable tax authority, and (b) shall include a compete and accurate copy of the tax authority's written Claim or otherwise fully inform the Company of the nature of the Claim and the date on which any payment of the Claim must be paid, provided that Employee shall not be required to give notice to the Company of facts of which the Company is already aware, and provided further that failure or delay by Employee to give such notice shall not constitute a breach of Section 6 or this Exhibit A except to the extent that the Company is prejudiced thereby. Employee shall not pay any portion of a Claim prior to the earlier of (a) the expiration of thirty (30) days following the date on which Employee gives the foregoing notice to the Company, (b) the date that any Excise Tax payment under the Claim is due, or (c) the date the Company notifies Employee that it does not intend to contest the Claim. If, prior to expiration of such period, the Company notifies Employee in writing that it desires to contest the Claim, Employee shall:

(a) give the Company any information reasonably requested by the Company relating to the Claim;

(b) take such action in connection with contesting the Claim as the Company shall reasonably request in writing from time to time, including, without limitation, accepting legal representation with respect to the Claim by an attorney selected and compensated by the Company who is reasonably acceptable to Employee;

(c) cooperate with the Company in good faith in order to effectively contest the Claim; and

(d) permit the Company to participate (at its expense) in any and all proceedings and conferences pertaining to the Claim; provided, however, that the Company shall bear and pay directly all costs and expenses (including, without limitation, additional interest and penalties and attorneys' fees) incurred in connection with any such contest, and shall indemnify and hold Employee harmless, on an after-tax basis, for any Excise Tax or income tax (including, without limitation, interest and penalties with respect thereto) and all costs imposed or incurred in connection with such contests. Without limitation upon the foregoing provisions of this Section 5, and except as provided below, the Company shall control all proceedings concerning any such contest and, at its sole option, may pursue or forego any and all administrative appeals, proceedings, hearings and conferences with tax authorities pertaining to the Claim. At the written request of the Company, and upon payment to Employee of an amount at least equal to the Claim plus any additional amount necessary to obtain the jurisdiction of the appropriate tribunal and/or court, Employee shall pay the same and sue for a refund or otherwise contest the Claim in any permissible manner as directed by the Company. Employee agrees to prosecute any contest of a Claim to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine, provided, however, that if the Company requests Employee to pay the Claim and sue for a refund, the Company shall indemnify and hold Employee harmless, on an after-tax basis, from any Excise Tax or income tax (including, without limitation, interest and penalties with respect thereto) and costs imposed or incurred in connection with such contest or with respect to any imputed income attributable to any advances or payments by the Company hereunder. Any extension of the statute of limitations relating to assessment of any Excise Tax for the taxable year of Employee which is the subject of a Claim is to be limited solely to the Claim. Furthermore, the Company's control of a contest as provided hereunder shall be limited to issues for which a Gross-Up Payment would be payable hereunder, and Employee shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other tax authority.

6. If Employee receives a refund from a tax authority of all or any portion of an Excise Tax paid by or on behalf of Employee with amounts advanced by the Company pursuant to Section 6 and this Exhibit A, Employee shall promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). Employee shall, if so directed by the Company, file and otherwise prosecute a claim for refund of any Excise Tax payment made by or on behalf of Employee with amounts advanced by the Company pursuant to Section 6 and this Exhibit A, with any such refund claim to be effected in accordance with the principles set forth in Section 5. If a determination is made that Employee shall not be entitled to any refund and the Company does not notify Employee in writing of its intent to contest such denial of refund prior to the expiration of thirty (30) days after such determination, then Employee shall have no further obligation hereunder to contest such denial or to repay to the Company the amount involved in such unsuccessful refund claim. The amount of any advances which are made by the Company in connection with any such refund claim hereunder, to the extent not refunded by the applicable tax authority to Employee, shall offset, as appropriate consistent with the purposes of Section 6 and this Exhibit A, the amount of any Gross-Up Payment required hereunder to be paid by the Company to Employee.

Robert A. Penicka

EXHIBIT B

CHANGE IN CONTROL

A "Change in Control" means the following and shall be deemed to occur if any of the following events occurs:

1. Any person, entity or group, within the meaning of Section 13(d) or 14(d) of the Securities Exchange Act of 1934 (the "Exchange Act") but excluding the Company and its affiliates and any employee benefit or stock ownership plan of the Company or its affiliates and also excluding an underwriter or underwriting syndicate that has acquired the Company's securities solely in connection with a public offering thereof (such person, entity or group being referred to herein as a "Person") becomes the beneficial owner (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 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

2. 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, 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

3. 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

(a) 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 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 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

(b) 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

4. Approval by the shareholders of the Company or an order by a court of competent jurisdiction of a plan of liquidation of the Company.

For purposes of this Exhibit B only, "Company" shall mean Callaway Golf Company or The Top-Flite Golf Company.

Robert A. Penicka

EXHIBIT C

RELOCATION BENEFITS PACKAGE
FOR ROBERT A. PENICKA
[REV. 9-16-03]

The following package of relocation benefits addresses the relocation of you and your family from San Diego County, California, to a location in Massachusetts that is within thirty (30) minutes normal driving time of The Top-Flite Golf Company facilities in Chicopee, Massachusetts.

Your move must be completed by September 30, 2004. All eligible expenses must be submitted for reimbursement within this timeframe. If you voluntarily cancel your move, all relocation payments will cease.

We are in the process of retaining a relocation coordination company (likely Armstrong Relocation) to help coordinate the details of your move in conjunction with the benefits listed. After an agreement is executed, Steve Yackey of Armstrong will be contacting you to begin planning your relocation.

Callaway Golf will provide assistance and/or reimbursement for the following expenses:

1. MOVING EXPENSES

You will be provided with moving services best suited to provide you with quality service based on your point of origin and destination. Once a moving service is selected, a representative will be contacting you to arrange for a pre-move survey. This person will work with you in all subsequent scheduling of packing, moving, delivery and unpacking. Callaway Golf will pay for insurance during transport and storage.

There are two separate moves included in your relocation (if you choose):

- San Diego to Massachusetts to temporary housing or storage (one shipment)

- Temporary housing and/or storage to your permanent Massachusetts residence (up to two shipments)

Payment for moving services and insurance will be direct billed to Callaway Golf and is non-taxable to you so no tax assistance will be provided for this portion of your relocation.

Please note that the following expenses and services are not covered:

- Shipment of hazardous materials such as explosives, chemicals, flammable materials or firearms.

- Shipment of firewood, lumber or other building materials.

- Valuables such as jewelry, currency, dissertations or publishable papers, collectibles or items of extraordinary value.

- Shipment of plants, food, or other perishables.

- Removal, disassembly, or installation of carpeting, drapery rods, storage sheds or other permanent fixtures.

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- Shipment of recreational vehicles including snowmobiles and boats. Unusually heavy or cumbersome hobby materials, or inoperable automobiles.

- Satellite dishes.

- Voluntary tips to movers.

- Maid or cleaning service.

This list is not all-inclusive, and you should discuss any specific questions around what you may or may not ship with the carrier.

Insurance at full replacement value is provided for your personal property while in transit. The standard coverage is $75,000 and the Company will pay for additional coverage (for an additional premium payment of $1,200.00) to cover your full replacement value. The insurance does not cover: jewelry, bills, deeds, evidence of debt, currency, letters of credit, passports, airline or other tickets, securities, items of extraordinary value, including collections. Please consult with your carrier regarding these or any other high value items, including tax and bank records.

2. STORAGE FEES

Depending on when you decide to purchase a permanent residence, Callaway Golf will pay on your behalf, up to three (3) months of temporary storage. Payment for moving services and storage for the first thirty (30) days is non-taxable, so no tax assistance will be provided with respect to the first month's storage costs. Thereafter, payment of storage by Callaway Golf is considered taxable income. Tax assistance for up to two (2) months storage will be provided. Storage fees will be direct billed to Callaway Golf.

3. HOME SALE ASSISTANCE

You have requested that Callaway Golf immediately purchase your home in San Diego County in order to expedite your move to Massachusetts and the purchase of a new home there, and the Company has agreed to do so. Callaway Golf will enter into a contract with a third party agency ("Relocation Company") to purchase your current home for fair market value. At this time we anticipate that the Relocation Company will be PrimacY, but we reserve the right to select another company based on the best interests of Callaway Golf. As described below, the Relocation Company will provide you with an offer to purchase your home. You will not receive reimbursement for commission and closing costs associated with the sale of your home in San Diego County, California, because Callaway Golf will pay those costs to the Relocation Company. Please do not enter into a listing agreement with any realtor with respect to the sale of your home. Callaway Golf will be responsible for any loss on the sale of your home by the Relocation Company and retain all resale profits on the sale of your home, if any are generated.

The Relocation Company will assist Callaway Golf in determining the price to be paid for your home. The Relocation Company will provide you with a list of qualified relocation appraisers. You will be asked to select three (3) appraisers from the list (you may not select an appraiser who has appraised your home within the last six (6) months). Notify the Relocation Company of your choices, and it will order two (2) appraisals using two of the appraisers you have selected. In turn, each appraiser will contact you (or the person you designate) to schedule an appointment.

The two appraisers will determine the anticipated sales price of your home; the price at which the property is anticipated to sell in a competitive and open market, assuming an arm's length transaction, in a short period of time. In estimating the sales price, the appraisers will look at competing listings, recent comparable sales, and other market variables through the eyes of a typical buyer. Based on the appraisals, the Relocation Company will recommend to Callaway Golf an Appraised Value Offer to be made to you.

In conjunction with the appraisal process, the Relocation Company will order all appropriate inspections for your area. Other inspections may be ordered, as recommended by the appraisers, realtors, or inspectors. The Appraised Value Offer cannot be released without the results of all inspections.

The appraisers will contact the Relocation Company with the results of their appraisals and will follow up with written appraisal reports. The reports will be reviewed for accuracy and consistency. Approximately three (3) weeks from the date the last appraiser visits your home, the Relocation Company will contact you to present an Appraised Value Offer and all inspection results.

The Appraised Value Offer will be the average of the two (2) appraisals performed on your home. If the two appraisals differ by more than five percent (5%), a third appraisal will be ordered (using the third appraiser you selected from the list provided to you by the Relocation Company). If three appraisals are needed, then the Appraised Value Offer will be the average of the two (2) closest appraisals.

You will have sixty (60) days to accept the offer starting upon the day the Appraised Value Offer is communicated to you. During that sixty-day period you may choose to market the home to seek a higher price. If you are successful in marketing the home on your own, the Relocation Company will work with you to accomplish the sale in a timely manner so that the equity is available to you quickly. If you choose to accept the Appraised Value Offer from the Relocation Company, Contracts of Sale, a deed package, and all necessary documents required to sell your home to the Relocation Company will be forwarded to you. Execution and notarization of these documents will be required if you elect to accept the Appraised Value Offer.

If you wish to remain in your home after acceptance of the Appraised Value Offer, you may do so for up to thirty (30) days from the date of your acceptance. Please be aware that the Relocation Company will be marketing the property on behalf of Callaway Golf during the time you remain in the home. Your cooperation in keeping it in order and scheduling showings is expected and appreciated.

Callaway Golf, through the Relocation Company, will assume responsibility of all mortgage payments, utilities, and maintenance of the home as of the date of possession. Possession is defined as the day you contract or vacate, whichever is later. Before possession is turned over to the Relocation Company, all expenses will remain your responsibility.

Your equity will be the Appraised Value Offer minus the mortgage balance, mortgage interest prorations, tax prorations, costs of any repairs and all other liens against the property. The equity will be paid to you directly by the Relocation Company or Callaway Golf so that you may purchase a new home in Massachusetts.

Disclosure: it is the duty of the seller to make known or public to a buyer the condition of the property, particularly any defect that could affect its value, habitability, or desirability. If you do not disclose complete and accurate information that is subsequently discovered, you may be held responsible for all expenses involved in correcting the defect(s).

4. HOME FINDING TRIPS

To assist you in this phase of your move, you, your spouse and two children are eligible for two (2) home finding trips to Massachusetts. You will be reimbursed the actual and reasonable costs for the following:

- Roundtrip airfare, first class travel

Robert A. Penicka

- Transportation, lodging and meal expenses for seven (7) days (six (6) nights lodging), each trip

Reimbursement will be coordinated through Callaway Golf and is considered taxable income. Tax assistance will be provided.

5. HOME PURCHASE IN MASSACHUSETTS

Your new home purchase in Massachusetts must be completed by September 30, 2004. Callaway Golf will arrange for you to be reimbursed for most typical buyer's expenses in your new location. Fees and charges most commonly covered include:

- Reasonable legal fees and disbursements or conveyance taxes, title insurance, notary and conveyance fees, escrow/attorney's fees, inspections such as pest, structural/mechanical, water/well, septic, and radon

- Mortgage application fee

- Loan origination and points up to one percent (1%) of the mortgage amount. Should the mortgage interest rate exceed 8.01%, loan fees are increased by one percent (1%). [The interest rate used will be based upon the FNMA posted yield on the thirty-year mortgage commitment (priced at par), for delivery within sixty (60) days. This rate is published daily in the "Money Rates" section of the Wall Street Journal.]

The following costs will NOT be reimbursed:

- Buy down points or fees, other than the terms listed above

- Property tax, insurance or interest

- Expenses normally charged to the seller

- Soil Reports (Geological Surveys)

- Home Warranty Insurance Program

- Private Mortgage Insurance

- Improvement Assessments by State, City, County taxing authorities

- Homeowner's Association Dues/Assessments

Reimbursement of the approved buyer's closing costs will be coordinated by Callaway Golf and will be considered taxable income. Loan origination fees/discount points are considered tax deductible and WILL NOT BE tax-assisted. The remaining closing costs WILL BE tax-assisted.

6. TEMPORARY HOUSING AND AUTO RENTAL

The Company will reimburse you for three (3) months' temporary housing for you and your family, including utilities, excluding renter's insurance.

The Company will reimburse you the cost of renting two cars (one for you and one for your spouse) while your autos are being transported to Massachusetts. This rental expense shall not exceed one (1) month.

Reimbursement will be coordinated through Callaway Golf and is considered taxable income. Tax assistance will be provided.

Robert A. Penicka

7. MISCELLANEOUS RELOCATION EXPENSE PAYMENT

The relocation benefits described in this document cover most expenses associated with your move. However, to offset other expenses, Callaway Golf will provide you with a miscellaneous relocation expense allowance payment. No receipts are required. The miscellaneous allowance is a one-time payment equal to $5,000.00 (net).

The miscellaneous allowance is to be used to cover all expenses that are otherwise not described in this document as reimbursable. Examples of some items not reimbursed by Callaway Golf that may be covered with the miscellaneous allowance are:

- Driver's License/Automobile Registration
- Pet Boarding
- Cable Hook-Up
- Utility Hook-Up/Installation
- Cleaning of New Residence
- Trash Removal
- Non-reimbursable home sale and/or home purchase expenses
- Shipment of items not covered under the movement of the household goods program
- Voluntary tips to movers
- Renter's insurance
- Tuition

The miscellaneous allowance is considered taxable income, and tax assistance will be provided.

8. EXPENSE REIMBURSEMENT

Callaway Golf will reimburse your relocation expenses. Please use the relocation reimbursement forms provided. The forms must be complete, with original receipts attached and signed in ink by you. Submitting your relocation reimbursement forms weekly should ensure an easy cash flow for your personal finances during this transitional time.

Submit all completed relocation reimbursement forms to Dawn Thompson in the Callaway Golf Company Payroll Department.

9. FINAL MOVE

You will be reimbursed for the one-way, first class travel incurred by you, your spouse and your two daughters associated with your final move. Airfare must be coordinated through Callaway Golf's Travel Department. The cost of transportation of your dog will also be reimbursed.

10. TAX ASSISTANCE

The IRS considers all those expenses paid to you, or on your behalf, as compensation except those expenses associated with:

- Sale of your home
- Household goods shipment

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- Thirty (30) days of household goods storage

- Final move expenses, excluding meals

Reimbursement payments will appear on your W-2 for the year that the payment was disbursed to you. Payments that are considered taxable income are subject to tax withholding in compliance with IRS regulations. To help minimize your tax burden and to assist with the additional federal, state, and Medicare tax liability that results from the reimbursed moving expenses, Callaway Golf will provide tax assistance on many of the payments made to you. Those payments that are not tax-assisted are identified as such in this document, as well as noted on the tax summary information table provided herewith. The tax assistance is based on taxable payments, other Company income, and your filing status.

Please note the following:

- It is imperative that you keep records and receipts of all your expenses to manage the tax return filing process at year end.

- A year end tax statement that will itemize all your relocation expenses will be prepared and sent to you by January 31 for the tax year(s) after your move. As it is likely you will receive relocation benefits for tax years 2003 and 2004, you will receive statements in January 2004 for relocation benefits paid in 2003 and in January 2005 for relocation benefits paid in 2004. You will receive tax assistance when the statement is prepared.

- Consult a professional tax advisor for details on the tax implications of your relocation. Along with seeking the assistance of a professional tax advisor, consider reading the following IRS information guides:

    [ ] Publication 521 - Moving Expenses

    [ ] Publication 523 - Tax Information on Selling Your Home.

To order these guides or necessary tax forms call 1-800-TAX-FORM.

Attachment: Tax Summary Information Table

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THE TABLE BELOW DESCRIBES HOW PAYMENTS ARE TREATED:

TAX SUMMARY

REIMBURSEMENT	ADDED TO W-2	TAXABLE INCOME	TAX ASSISTANCE
CA Home Sale Assistance			
- - if CGC buys home	No	No	No
- - if sold by Penicka's	Yes	Yes	Yes
Home Finding Trip	Yes	Yes	Yes
Miscellaneous Allowance	Yes	Yes	Yes
Final Move	No	No	No
New Home Closing Costs	Yes	Yes	Yes(1)
Shipment of Household Goods	No	No	No
Storage of Household Goods-			
- - First 30 days	No	No	No
- - Days 31-90	Yes	Yes	Yes
Temporary Living	Yes	Yes	Yes
Auto Rental	Yes	Yes	Yes
Pet Transportation	Yes	Yes	Yes

- ---------------------
(1) Due to their deductibility, loan origination fees and discount points are not grossed up.

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EXHIBIT 10.60

SECOND AMENDMENT TO SECOND AMENDED
EXECUTIVE OFFICER EMPLOYMENT AGREEMENT

This Second Amendment to the Second Amended Executive Officer Employment Agreement ("Second Amendment") is made effective as of September 15, 2003 by and between CALLAWAY GOLF COMPANY, a Delaware corporation (the "Company") and RONALD A. DRAPEAU ("Employee").

A. The Company and Employee are parties to that certain Second Amended Executive Officer Employment Agreement entered into as of June 1, 2002, as amended by a First Amendment entered into as of March 1, 2003 (as amended, the "Second Amended Agreement").

B. The Company and Employee desire to amend the Second Amended Agreement pursuant to Section 15 of the Agreement, in the manner set forth herein.

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

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

> "(a) Effective September 15, 2003, Mr. Drapeau shall serve as Chairman of the Board and Chief Executive Officer of the Company. Mr. Drapeau's duties shall be the usual and customary duties of the offices in which Mr. Drapeau serves. Mr. Drapeau shall report to the Board of Directors of the Company."

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

3. This Second Amendment is subject to the approval of the Board of Directors of the Company or appropriate committee thereof.

IN WITNESS WHEREOF, the parties have executed this Second Amendment on the dates set forth below, to be effective as of the date first written above.

EMPLOYEE	COMPANY
	Callaway Golf Company, a Delaware corporation
/s/ RONALD A. DRAPEAU/	By: /s/ STEVEN C. McCRACKEN
Ronald A. Drapeau	Steven C. McCracken Senior Executive Vice President and Chief Legal Officer
Dated: 9/23/03	Dated: 09-23-03

EXHIBIT 10.61

SECOND AMENDMENT TO FIRST AMENDED EXECUTIVE OFFICER EMPLOYMENT AGREEMENT

This Second Amendment to First Amended Executive Officer Employment Agreement ("Second Amendment") is made effective as of September 15, 2003 by and between CALLAWAY GOLF COMPANY, a Delaware corporation (the "Company") and STEVEN C. MCCRACKEN ("Employee").

A. The Company and Employee are parties to that certain First Amended Executive Officer Employment Agreement entered into as of June 1, 2002, as amended by a First Amendment entered into as of March 1, 2003 (as amended, the "First Amended Agreement").

B. The Company and Employee desire to amend the First Amended Agreement pursuant to Section 15 of the First Amended Agreement, in the manner set forth herein.

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

1. Section 4(a) of the First Amended Agreement is amended to read as follows:

> "(a) Effective September 15, 2003, the Company agrees to pay Employee a base salary at the rate of $550,000.00 per year, payable in equal increments in accordance with the Company's current pay schedule."

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

3. This Second Amendment is subject to the approval of the Board of Directors of the Company or appropriate committee thereof.

IN WITNESS WHEREOF, the parties have executed this Second Amendment on the dates set forth below, to be effective as of the date first written above.

EMPLOYEE	COMPANY
	Callaway Golf Company, a Delaware corporation
/s/ STEVEN C. McCRACKEN	By: /s/ RONALD A. DRAPEAU
Steven C. McCracken	Ronald A. Drapeau Chairman of the Board and Chief Executive Officer
Dated: 09-23-03	Dated: 9/23/03

EXHIBIT 10.62

SECOND AMENDMENT TO
FIRST AMENDED EXECUTIVE OFFICER EMPLOYMENT AGREEMENT

This Second Amendment to First Amended Executive Officer Employment Agreement ("Second Amendment") is made effective as of September 15, 2003 by and between CALLAWAY GOLF COMPANY, a Delaware corporation (the "Company") and BRADLEY J. HOLIDAY ("Employee").

A. The Company and Employee are parties to that certain First Amended Executive Officer Employment Agreement entered into as of June 1, 2002, as amended by a First Amendment entered into as of March 1, 2003 (as amended, the "First Amended Agreement").

B. The Company and Employee desire to amend the First Amended Agreement pursuant to Section 15 of the First Amended Agreement, in the manner set forth herein.

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

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

> "(a) Effective September 15, 2003, Employee shall serve as Senior Executive Vice President & Chief Financial Officer of the Company. Employee's duties shall be the usual and customary duties of the offices in which Employee serves. Employee shall report to such person as the Chief Executive Officer shall designate. The Board of Directors and/or the Chief Executive Officer of the Company may change Employee's title, position and/or duties at any time."

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

> "(a) Effective September 15, 2003, the Company agrees to pay Employee a base salary at the rate of $500,000.00 per year, payable in equal increments in accordance with the Company's current pay schedule."

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

4. This Second Amendment is subject to the approval of the Board of Directors of the Company or appropriate committee thereof.

IN WITNESS WHEREOF, the parties have executed this Second Amendment on the dates set forth below, to be effective as of the date first written above.

EMPLOYEE	COMPANY
	Callaway Golf Company, a Delaware corporation
/s/ BRADLEY J. HOLIDAY/	By: /s/ RONALD A. DRAPEAU/
Bradley J. Holiday	Ronald A. Drapeau Chairman of the Board and Chief Executive Officer
Dated: 9/23/03	Dated: 9/23/03

EXHIBIT 10.63

SECOND AMENDMENT TO
EXECUTIVE OFFICER EMPLOYMENT AGREEMENT

This Second Amendment to Executive Officer Employment Agreement ("Second Amendment") is made effective as of September 15, 2003 by and between CALLAWAY GOLF COMPANY, a Delaware corporation (the "Company") and PATRICE HUTIN ("Employee").

A. The Company and Employee are parties to that certain Executive Officer Employment Agreement entered into as of November 6, 2002, as amended by the First Amendment entered into as of March 1, 2003 (as amended, the "Agreement").

B. The Company and Employee desire to amend the Agreement pursuant to Section 15 of the Agreement, in the manner set forth herein.

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

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

> "(a) Effective September 15, 2003, Employee shall serve as President & Chief Operating Officer of the Company. Employee's duties shall be the usual and customary duties of the offices in which Employee serves. Employee shall report to such person as the Chief Executive Officer shall designate. The Board of Directors and/or the Chief Executive Officer of the Company may change Employee's title, position and/or duties at any time."

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

> "(a) Effective September 15, 2003, the Company agrees to pay Employee a base salary at the rate of $550,000.00 per year, payable in equal increments in accordance with the Company's current pay schedule."

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

4. This Second Amendment is subject to the approval of the Board of Directors of the Company or appropriate committee thereof.

IN WITNESS WHEREOF, the parties have executed this Second Amendment on the dates set forth below, to be effective as of the date first written above.

EMPLOYEE	COMPANY
	Callaway Golf Company, a Delaware corporation
/s/ PATRICE HUTIN/	By: /s/ RONALD A. DRAPEAU/
Patrice Hutin	Ronald A. Drapeau Chairman of the Board and Chief Executive Officer
Dated: 09/23/03	Dated: 9/23/03

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Ronald A. Drapeau, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callaway Golf Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ RONALD A. DRAPEAU

Ronald A. Drapeau
Chairman and Chief
Executive Officer

Dated: November 12, 2003

A signed original of this Certification has been provided to Callaway Golf Company and will be retained by Callaway Golf Company and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Bradley J. Holiday, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Callaway Golf Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ BRADLEY J. HOLIDAY

Bradley J. Holiday
Senior Executive Vice President and
Chief Financial Officer

Dated: November 12, 2003

A signed original of this Certification has been provided to Callaway Golf Company and will be retained by Callaway Golf Company and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.1

CERTIFICATION PURSUANT
TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Callaway Golf Company, a Delaware corporation (the "Company"), does hereby certify with respect to the Quarterly Report of the Company on Form 10-Q for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission (the "10-Q Report"), that:

(1) the 10-Q Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the 10-Q Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

The undersigned have executed this Certification effective as of November 12, 2003.

/s/ RONALD A. DRAPEAU

Ronald A. Drapeau
Chairman and Chief Executive Officer

/s/ BRADLEY J. HOLIDAY

Bradley J. Holiday
Senior Executive Vice President and
Chief Financial Officer

A signed original of this Certification has been provided to Callaway Golf Company and will be retained by Callaway Golf Company and furnished to the Securities and Exchange Commission or its staff upon request.