Callaway Golf Company

2000 Annual Report

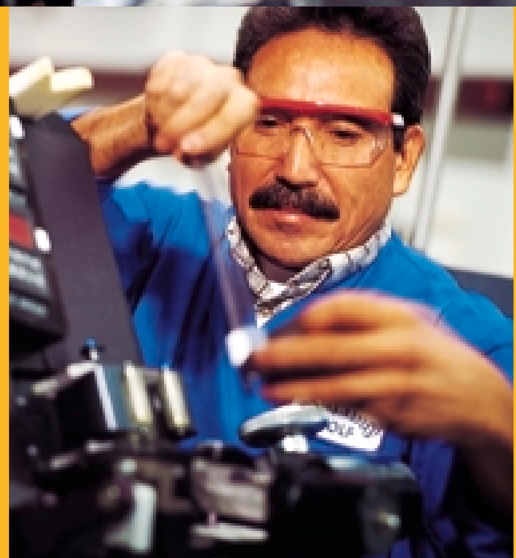
grow the game

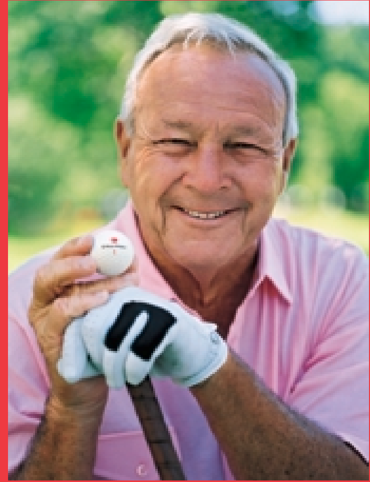
recreational golf

"Callaway Golf has always believed that the way to grow the game of golf is to make it more enjoyable for the average golfer. That is why we try to design, create, build and sell the most forgiving golf clubs in the history of the game – giving more golfers more opportunities to hit a few additional "great" shots each round. We intend to continue to try to grow the game by helping people enjoy the game." — *Ely Callaway*

Enjoy the game

we make golf

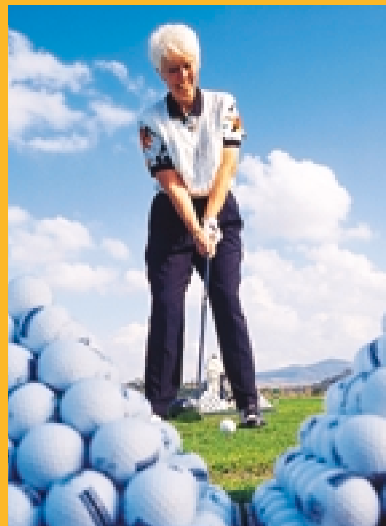




fun

for…

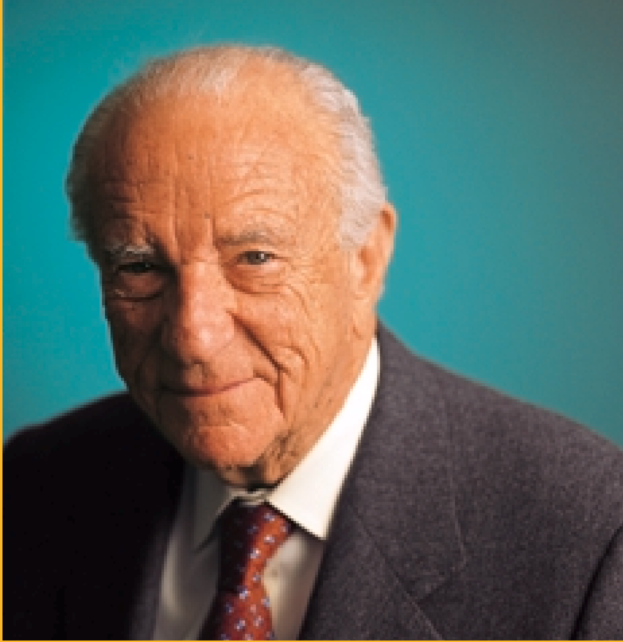
amateurs and



professionals,
Callaway
Callaway
GOLF

men and women

n, young and old.



Dear shareholders and friends

In my letter to you a year ago, I stated, "I am pretty sure that the operating results I will report [for the year 2000] probably will look good to most of you and will be encouraging to all except our competitors."

I think it is fair to say that we achieved our goals for 2000, and I hope that you have a feeling of encouragement as I predicted. In January, we reported for the year 2000 a 16% increase in revenues to $838 million and a 46% increase in net income to $81 million. We did this even though the golf club market in general remained relatively flat. At the same time, we launched our golf ball business with first year sales of $34 million. Our earnings per share increased 45% to $1.13.

Golf club sales grew 12% in 2000 as we made and sold about 6 million units. We launched the Big Bertha® Steelhead™ X-14® irons in 2000, and they were enthusiastically accepted by golfers worldwide. The Odyssey® brand grew to a 30% U.S. market share as it retained its position as the #1 putter in golf. Meanwhile, the Big Bertha Steelhead Plus™ and Great Big Bertha® Hawk Eye® Drivers and Fairway Woods sold very well, maintaining the #1 position in both units and revenues in the U.S. metal woods category.

At a major news conference last October, we launched the most-publicized new driver in golf equipment history – the Big Bertha ERC II™ Forged Titanium Driver. More later on that remarkable product, and on the exceptional new Big Bertha Hawk Eye VFT™ Driver and Fairway Woods, which we introduced at the same October event.

When all the dust settled, our first year in the golf ball business resulted in net sales of $34 million, with a reported loss of about $46 million. Clearly, that loss was far higher than we had expected. But there were a variety of operational issues that prevented us from achieving our goals, and we have discussed them in detail in our various press releases, filings and reports. We now believe that the operational improvements we made in the second half of the year already are paying dividends. We met our golf ball sales targets for the fourth quarter and we feel we have good momentum going into 2001 with new trial programs, more competitive pricing, staff programs and a focus on the "green grass" pro shop distribution of our golf balls. On the five major professional tours combined worldwide, the Callaway Golf ball became the #2 brand of golf ball in use in just one year, with more than 150 professionals putting the ball into play in 2000. Professionals using Rule 35® golf balls won more than $31 million in our first year of tour activity with this golf ball.

For the year 2001 we have said that we hope to increase our revenues, improve our gross margins and increase our pre-tax profit for the year. We cannot guarantee that we will hit these lofty targets,

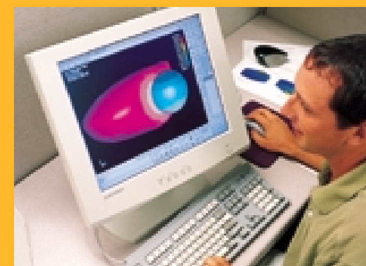
particularly in light of the gloomy outlook some have concerning the general economy, but we see good things for us and we will do our very best to achieve our goals.

The primary reason for our current optimism is our great new product line-up for 2001. We have introduced the Big Bertha ERC II Forged Titanium Driver, Big Bertha Hawk Eye VFT Titanium Drivers and Fairway Woods, Big Bertha Steelhead X-14 Pro Series Irons and Odyssey® TriHot™ Putters. We have also created the new Callaway Golf "CB1™" two-piece golf balls. This entire line of new products is the very best we have ever launched in a single year.

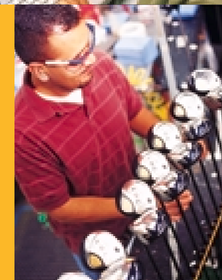
To support these new products, we have added two new business processes: a state-of-the-art "business-to-business" internet link between ourselves and our U.S. retailers; and a fantastic new collection of "store-in-store" retail fixtures for those customers. In addition we now have an outside sales force in the U.S. that is about 50% larger than we had at the start of 2000. Similar improvements are planned for future rollout in Europe, Japan and elsewhere.

These are all good reasons for us to be optimistic about the health of our company. There are, however, some areas of potential concern, both for our company and for the industry.

First, we are troubled by what we see as the continuing – and unprecedented – efforts of the 16 members of the United States Golf Association Executive Committee to prevent the sale of our ERC II Driver in the United States. To our knowledge, no rulemaking body in sports history has ever so aggressively and directly interfered with the sale of a branded commercial product to the public as has the USGA in this instance. The USGA has employed various methods to exert its vast influence among the golf committees and golf professionals of some of the top country clubs of America – including taking the highly unusual action of circulating a memo to country clubs emphasizing the USGA position that scores shot with the ERC II and other non-conforming drivers may not be turned in for handicapping purposes.



This ruling against the use of our ERC II Driver for handicapping purposes has been criticized in print by, among others, the former Senior Director of Handicapping for the USGA and by a former USGA Executive Director. Even so, the USGA Executive Committee has not changed its opinion. The USGA is, in our opinion, trying to harm our business. The rule makers are trying to ensure that the ERC II Driver is not sold, or, if it is sold that it is not used, or, if it is used, that it is used in shame. We are opposing the USGA, and will continue to do so, until this issue is resolved.



With regard to the industry as a whole, we remain concerned with figures showing that the game of golf is not growing as fast as it should be in the United States, our largest market. There are a number of reasons for this, but we think the root cause is the existence of a general mindset that drives away beginners as well as those who, for whatever reason, fail to become highly skilled at this very difficult game. We believe this accounts for at least 95% of all the people playing golf in the U.S. today.

Epitomized by the attitudes of most of the 16 members of the Executive Committee of the USGA, this exclusionary mindset is promoted by an elite few who have the time, the money and the natural talents to become accomplished golfers. The prevalent thinking among this group is that "the game is supposed to be hard" and that we all play "the same game" as Tiger Woods. In reality, the vast majority of the amateur golfers in the United States struggle mightily and do not play a golf game that in any way resembles that played by any of the touring pros. In fact, reports show that as many people quit golf each year as take it up for the first time.

We believe that these USGA Executive Committee members with an average handicap index of 4.7 do not relate to the 5 million amateur golfers whose average index is 17 for men and 31 for women, and that they certainly are out of touch with the remaining 20 million golfers who do not even have an established handicap index. We believe these 16 people are making the rules for the elite few rather than in the interest of growing this wonderful game.

Callaway Golf has always believed that the way to grow the game of golf is to make it more enjoyable for the average golfer. That is why we have always tried to design, create, build and sell the most forgiving golf clubs in the history of the game – giving more golfers more opportunities to hit a few additional "great" shots each round.

While it is true that professionals and highly skilled amateurs also have long used our clubs with great success, we fundamentally design our products for the average mid-to-high handicap golfer or recreational player. It happens that the Callaway Golf design features that benefit the average golfer – forgiveness, accuracy, and the chance to achieve extra distance off the tee – also benefit the highly skilled player.

This year we are making explicit in our corporate mission what has always been implicit: We intend to grow the game by helping people enjoy the game. That means:

- We will continue to create the very best "tools" for all golfers – from recreational golfers to the most highly skilled professionals. Our drivers will be easier to hit and designed to deliver maximum distance from a well struck tee shot and maximum forgiveness on off-center hits. Our fairway woods will help golfers get the ball in the air quickly. Our irons will be built to be forgiving and even more accurate than ever before. Our putters will be the best-engineered to get the ball rolling sooner to keep putts on line and our golf balls will deliver state-of-the-art aerodynamics, better feel, better distance and more durability.

- In the United States, where the USGA and other groups have chosen to try to prohibit the use of modern thin-faced drivers approved almost everywhere else in the world, we will offer our very best driver – the Big Bertha ERC II Forged Titanium Driver – only for use in recreational or social rounds of golf. In this way, the great many golfers who seldom play in competitive tournaments can enjoy the benefits of this exceptional golf club (which is approved by the R&A for use by all golfers in all rounds outside North America) without needing to challenge the U.S. competitive rules.

- We will continue to invest in the design of equipment that will make the game perhaps a little bit more enjoyable for the average, recreational player. In the vast majority of cases, we expect that these products will fully conform to the Rules of Golf. Indeed, all of our current products, including the ERC II Driver, conform to the Rules of Golf as published by the Royal and Ancient Golf Club of St. Andrews, Scotland, the oldest governing body in golf and the one that sets the rules in all but three countries in the world. We believe in the Rules of Golf governing play and our only disagreement with the USGA is over its interpretation of the equipment rule governing so-called "spring-like effect" in a driver.

- We believe that the best thing that can happen quickly for the game of golf is for the USGA to drop its distance restriction on drivers so we can return to having one set of equipment rules worldwide.

We have hoped that others associated with the game of golf would support our focus on growing the game, and in some cases our hopes have been rewarded. Outside the United States, it is our view that the R&A has been sensitive to the desires and needs of the average golfer when exercising its authority. The R&A's attitude that extra distance off the tee does not pose any threat to the integrity of the game – even from highly skilled professionals – has been reflected in the impressive acceptance of the ERC II Driver on the PGA European Tour, where it was the #1 driver model after the first seven weeks of competition. Perhaps these are some reasons why the game has seen its greatest growth internationally in the areas governed by the R&A.

Our greatest disappointment has been with the USGA and other bodies in the United States who are insistent that the drivers used by average amateurs should be subjected to the same design limitations

as are applied to the drivers used by the world's very best golfers. We think this unduly limits the enjoyment obtainable by 95% of our nation's golfers, and is bad for the game.

Whatever someone might think about the distances the professionals hit the golf ball off the tee today, we cannot understand why anyone would want to restrict average golfers and deny them the chance, once in a while, to experience the thrill of a really good drive that hangs in the air a bit longer and goes a bit further. But this is what the USGA did when it adopted its unique limit on driver rebound velocities ("COR"). And we cannot understand why the USGA would tell average golfers not to post their scores for handicapping if they use a non-conforming driver in a social round, while at the same time allowing these same golfers to post their scores if they take mulligans, grant "gimme" putts, use rangefinders, carry more than fourteen clubs, or otherwise do the many things that so many people do during their weekend rounds with friends or family.

In our opinion, these actions by the USGA and its supporters will tend to push average players and beginners away from the game, while reinforcing the outdated notion that golf is only for the elite few. We don't think this is the message that the most powerful body in golf in the United States should be sending. Furthermore, it is our opinion that these inconsistencies in the application of the rules have been intentional to single out the use of the ERC II Driver and to harm our business.

I don't think any reasonable person would now claim that permitting steel shafts or allowing the use of rangefinders has ruined the game. Nor would most rational people contend that the game has been harmed by sand wedges, graphite shafts, cavity-backed irons or any of the other technological improvements introduced in the last 100 years. But all these changes to the game were opposed at one time simply for the sake of opposing change – just as the ERC II Driver is being opposed today. That approach always failed in the past, and we believe it will eventually fail again.

No other manufacturer has supplied as many premium clubs to as many golfers around the world as we have done in our relatively short corporate life. We have succeeded in this way because our products satisfy golfers of all skill levels and give them added pleasure. In this way, we hope we are helping to make others like the game of golf as much as we do.

Today, for the first time in our history, your company faces a serious impediment intended to restrict our technological advances in the design, manufacture and sale of the very best golf clubs. That impediment is the USGA's campaign to prevent the purchase and use of our ERC II Driver in the United States. While the effect of this unprecedented effort may not be felt this year – because 99% of our products fully conform with the USGA's Rules of Golf and because foreign markets might gladly consume any ERC II Drivers that are not sold in the U.S. – its potential impact on the Company cannot be ignored. If this overt opposition is permitted to continue unchecked, the sales of ERC II Drivers in the U.S. in 2001 will almost certainly be hurt. Nevertheless, we feel that Callaway Golf must continue to push for a change in attitude over the long run that will address the needs of the average golfer and promote the growth of the game.

I look forward to continuing to serve as CEO of this great company of ours. I hope to see many of you at the Annual Meeting in May.

Ely Callaway
Founder, Chairman and CEO
Callaway Golf Company

innovation

Big Bertha ERC II Forged Titanium Driver

The ERC II is the best driver Callaway Golf has ever made. It is hot. It is forgiving. And it is conforming to the rules of golf in all but three countries in the world. The USGA, whose Rules of Golf are followed in the United States, Canada and Mexico, has decreed that the ERC II Driver does not conform to the rules for "spring-like effect". Callaway Golf recommends that golfers in the United States, Canada and Mexico use the ERC II in recreational rounds and not in tournaments. We recommend that all golfers around the rest of the world use the ERC II Driver in tournament competition (in the first seven weeks of the 2001 PGA European Tour season it was the #1 driver in play) and in recreational play. This exceptional driver was designed to help golfers of all skill levels experience the joyous feeling that comes from a well-struck shot off the tee.

Big Bertha Hawk Eye VFT Titanium Driver and Fairway Woods

These cast titanium drivers and fairway woods were carefully calibrated to deliver maximum results without exceeding the performance limitations imposed by the USGA. As a result, the tour-proven Hawk Eye VFT Titanium Driver inspires confidence off the tee and the matching fairway woods are versatile scoring weapons from nearly any lie. The entire line of Hawk Eye VFT Titanium Woods provides the forgiveness that has always been the hallmark of Callaway Golf clubs. They conform, and they perform.

technology

Financial Highlights

(in thousands, except per share data)	2000	1999	1998	1997	1996	1995	1994	1993	1992[5]
Net sales[1]	$837,627	$719,038	$703,060	$848,941	$683,536	$557,048	$451,779	$256,376	$132,956
Pretax income (loss)	$129,322	$85,497	$(38,899)	$213,765	$195,595	$158,401	$129,405	$69,600	$33,175
Net income (loss)	$80,999[3]	$55,322	$(26,564)	$132,704	$122,337	$97,736	$78,022	$42,862[4]	$19,280
Basic earnings (loss) per share[2]	$1.16[3]	$0.79	$(0.38)	$1.94	$1.83	$1.47	$1.14	$0.68[4]	$0.35
Diluted earnings (loss) per share[2]	$1.13[3]	$0.78	$(0.38)	$1.85	$1.73	$1.40	$1.07	$0.62[4]	$0.32
Shareholders' equity	$511,744	$499,934	$453,096	$481,425	$362,267	$224,934	$186,414	$116,577	$49,750
Market capitalization at December 31	$1,380,926	$1,349,595	$769,725	$2,120,813	$2,094,588	$1,604,741	$1,127,823	$901,910	$245,254

[1] Shipping revenues have been reclassified in accordance with Emerging Issues Task Force Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs." See accompanying Notes to Consolidated Financial Statements.

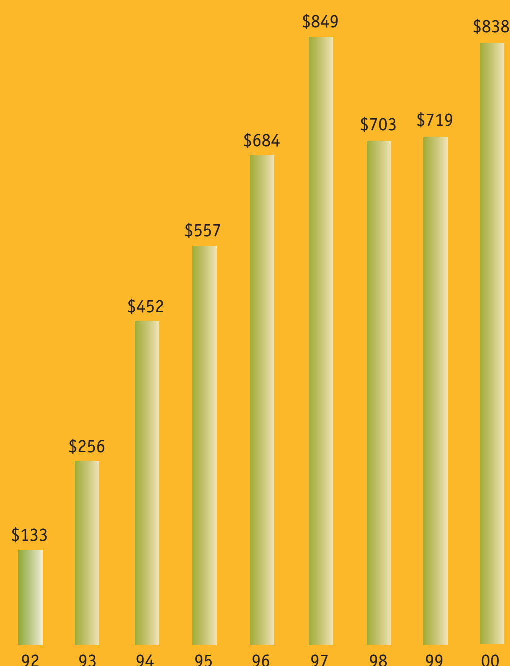
[2] Adjusted for all stock splits.

[3] Includes cumulative effect of accounting change of $957.

[4] Includes cumulative effect of accounting change of $1,658.

[5] The Company was not public until February 1992.

Net Sales (in millions)



Net Income (Loss) (in millions)

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Financials

Selected Financial Data[1]

(in thousands, except per share data)	Year ended December 31,				
	2000	1999	1998	1997	1996
Statement of Operations Data:					
Net sales	$837,627	$719,038	$703,060	$848,941	$683,536
Cost of goods sold	440,119	384,265	410,341	408,345	323,364
Gross profit	397,508	334,773	292,719	440,596	360,172
Selling, general and administrative expenses	240,874	221,043	241,775	189,109	154,190
Research and development costs	34,579	34,002	36,848	30,298	16,154
Restructuring costs (Note 14)		(5,894)	54,235		
Sumitomo transition costs (Note 16)		5,713			
Litigation settlement				12,000	
Income (loss) from operations	122,055	79,909	(40,139)	209,189	189,828
Interest and other income, net (Note 11)	8,791	9,182	3,911	4,586	5,804
Interest expense	(1,524)	(3,594)	(2,671)	(10)	(37)
Income (loss) before income taxes and cumulative effect of accounting change	129,322	85,497	(38,899)	213,765	195,595
Income tax provision (benefit)	47,366	30,175	(12,335)	81,061	73,258
Income before cumulative effect of accounting change	81,956	55,322	(26,564)	132,704	122,337
Cumulative effect of accounting change	(957)				
Net income (loss)	$ 80,999	$ 55,322	$ (26,564)	$132,704	$122,337
Earnings (loss) per common share:					
Basic					
Income before cumulative effect of accounting change	$1.17	$0.79	$(0.38)	$1.94	$1.83
Cumulative effect of accounting change	(0.01)				
Net income	$1.16	$0.79	$(0.38)	$1.94	$1.83
Diluted					
Income before cumulative effect of accounting change	$1.14	$0.78	$(0.38)	$1.85	$1.73
Cumulative effect of accounting change	(0.01)				
Net income	$1.13	$0.78	$(0.38)	$1.85	$1.73
Dividends paid per share	$0.28	$0.28	$ 0.28	$0.28	$0.24

(in thousands)	December 31,				
	2000	1999	1998	1997	1996
Balance Sheet Data:					
Cash and cash equivalents	$102,596	$112,602	$ 45,618	$ 26,204	$108,457
Working capital	$233,163	$205,198	$139,598	$209,402	$250,461
Total assets	$630,934	$616,783	$655,827	$561,714	$428,428
Long-term liabilities	$ 9,884	$ 11,575	$ 18,723	$ 7,905	$ 5,109
Total shareholders' equity	$511,744	$499,934	$453,096	$481,425	$362,267

[1]Shipping revenues and expenses have been reclassified in accordance with Emerging Issues Task Force Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs." See accompanying Notes to Consolidated Financial Statements.

Results of Operations

Years Ended December 31, 2000 and 1999

For the year ended December 31, 2000, net sales increased $118.6 million, or 16%, to $837.6 million from $719.0 million in the prior year. The increase is attributable to an increase in sales of irons, golf balls and other products, including putters and accessories, partially offset by a decrease in sales of metal woods. The increase in sales of irons of 40% to $310.2 million represents an increase in both unit and dollar sales and is primarily attributable to sales of Great Big Bertha® Hawk Eye® Tungsten Injected™ Titanium Irons, which were not sold in significant quantities during 1999. Also contributing to the increase in sales of irons were sales of Big Bertha® Steelhead™ X-14® Stainless Steel Irons, which were introduced in January 2000, and which generated higher revenues during 2000 than its predecessor, Big Bertha® Steelhead™ X-12® Stainless Steel Irons, did in 1999. This increase includes sales of $34.0 million of its Rule 35® golf balls during 2000. This product was not sold during 1999. The overall decrease in sales of metal woods of 3% to $416.2 million represents a decrease in both unit and dollar sales of titanium and non-current metal woods, partially offset by an increase in unit and dollar sales of stainless steel metal woods. The overall decrease in sales of metal woods is primarily attributable to sales of non-current products during 1999, which did not occur in significant quantities during the comparable period of 2000, and to a decrease in sales of Great Big Bertha® Hawk Eye® Titanium Metal Woods during 2000 as compared with 1999, the year in which they were introduced. However, sales of ERC™ Forged Titanium Drivers, which began shipping in significant quantities in the second quarter of 2000, and initial shipments of the Company's newly-introduced ERC II™ Forged Titanium Drivers and Big Bertha® Hawk Eye® VFT™ Titanium Metal Woods, which began shipping in limited quantities in December 2000, partially offset the decrease in sales of titanium metal woods. Also partially offsetting the decrease in sales of titanium metal woods was an increase in sales of stainless steel metal woods attributable to the January 2000 introduction of Big Bertha® Steelhead Plus™ Stainless Steel Metal Woods, which generated higher revenue in 2000 than their predecessor, Big Bertha® Steelhead™ Stainless Steel Metal Woods, did in 1999.

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

During 2000, sales increased in all regions as compared with 1999. Sales in the United States increased 8% to $451.2 million and sales in Europe also increased 9% to $125.5 million. Sales in Japan increased 118% to $122.0 million largely because the Company now sells directly to customers rather than through a distributor, as in prior years. Sales in the rest of Asia increased 13% to $82.3 million and sales in the rest of the world increased 1% to $56.5 million.

For the year ended December 31, 2000, cost of goods sold increased to $440.1 million from $384.3 million in 1999, and as a percentage of net sales remained constant at 53%. These amounts reflect the reclassification of shipping expense from "selling" expense that resulted from the application of EITF 00-10. This reclassification added $11.2 million to cost of goods sold during 2000 and $7.9 million in 1999. Cost of goods sold was adversely affected in 2000 by costs associated with manufacturing the Company's new golf balls, primarily from low plant utilization and production yields. This effect was offset by improvements in cost of goods sold attributable to golf club products. As a percentage of net sales, cost of goods sold for golf club products improved to 49% in 2000 from 53% in 1999. This improvement is attributable to reductions in manufacturing labor and overhead expenses, a favorable product sales mix primarily related to sales of ERC™ Forged Titanium Drivers and the negative effect that close-out sales at substantially reduced prices during 1999 had on that period's cost of goods sold as a percentage of net sales.

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

General and administrative expense decreased to $70.3 million in 2000 from $92.5 million in 1999, and as a percentage of net sales decreased to 8% from 13%. This decrease is primarily attributable to the shifting of costs associated with the Company's golf ball pre-production period from general and administrative expense in 1999 to cost of goods sold in 2000, as these costs were

related to production of golf balls in 2000. Also contributing to the decrease were reductions in legal and consulting fees and in depreciation expense. The overall decrease was partially offset by an increase in bad debt expense associated with the write-off of uncollectible accounts.

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

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

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

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

The Company adopted Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101") in the fourth quarter of 2000 with an effective date of January 1, 2000. SAB No. 101 summarizes the SEC's Division of Corporation Finance Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. As a result of the adoption of SAB No. 101, the Company recognized a cumulative effect adjustment of $1.0 million in the Consolidated Statement of Operations for the year ended December 31, 2000.

Years Ended December 31, 1999 and 1998

For the year ended December 31, 1999, net sales increased 2%, to $719.0 million from $703.1 million in the prior year. The increase is attributable to an increase in sales of metal woods, particularly titanium metal woods, partially offset by a decrease in sales of irons and by sales of non-current product, through a managed close-out process, at substantially reduced prices. The increase in metal woods sales of $39.1 million (10%) is largely attributable to the January 1999 introduction of Great Big Bertha® Hawk Eye® Titanium Metal Woods and increases in sales of Big Bertha® Steelhead™ Metal Woods, which were introduced in August 1998. Sales of irons decreased $7.8 million, primarily as a result of a $27.6 million decrease in sales of Big Bertha® Steelhead™ X-12® Irons, which were introduced in January 1998, partially offset by sales from the August 1999 introduction of Great Big Bertha® Hawk Eye® Tungsten Injected™ Titanium Irons of $27.7 million. Sales of Odyssey® and Callaway Golf® putters decreased $7.5 million (14%). Sales of other products decreased $6.9 million (30%). Also included in 1999 net sales were $56.6 million in sales of non-current product, most of which were sold at close-out prices.

Net sales reflect the effect of a reclassification of shipping revenues from "selling" expenses. This reclassification, which added $4.6 million to net sales in 1999 and $5.4 million in 1998, was required by EITF 00-10, and did not result in a change in the Company's earnings or earnings per share for either period.

In terms of net sales by region, sales in the United States decreased 5% to $418.4 million for the year ended December 31, 1999. Net sales in Japan decreased 9% to $55.9 million, as net purchases by the Company's distributor declined in anticipation of the transition of distribution of Callaway Golf® products from it to the Company's wholly-owned Japanese subsidiary. Net sales to Europe decreased 1% to $115.7 million and net sales to the rest of Asia and the rest of the world increased 114% and 16%, respectively, to $73.1 million and $55.9 million, respectively. Sales to the rest of Asia increased in 1999 over 1998 due largely to the economic recovery of the Korean market in 1999 and the introduction of higher-margin products in Korea during 1999. The Company does not expect that revenue in Korea will continue to increase at a rate comparable to 1999.

For the year ended December 31, 1999, cost of goods sold improved to $384.3 million from $410.3 million in the prior year, and as a percentage of net sales, improved to 53% from 58%. These amounts include the reclassification of shipping expense from "selling" expense that resulted from the application of EITF 00-10. This reclassification added $7.9 million to cost of goods sold during 1999 and $8.7 million in 1998. The decrease in cost of goods sold is primarily due to lower obsolescence charges in 1999 versus a $30.0 million excess inventory charge recorded in the

fourth quarter of 1998, and an increase in sales of metal woods. However, cost of goods sold was unfavorably affected by price reductions and the sales of non-current products through the Company's managed close-out program and an increase in distribution costs associated with the Company's foreign subsidiaries.

Selling expenses decreased to $128.6 million in 1999 from $143.7 million in the prior year. As a percentage of net sales, selling expenses decreased to 18% from 20%. These amounts reflect the reclassification of shipping revenue and expense, which were previously recorded in "selling" expense. The effect of this reclassification reduced selling expense by $3.3 million in 1999 and 1998. The decrease in selling expense is primarily attributable to planned reductions in advertising, pro tour and other promotional expenses, partially offset by an increase in employee compensation.

General and administrative expenses decreased to $92.5 million in 1999 from $98.0 million in 1998, or 13% and 14% of net sales, respectively. This decrease is largely due to decreases in consulting, bad debt expense and supplies expense, as well as a decrease in building-related costs associated with the Company's 1998 restructuring program. These amounts were partially offset by increases in costs associated with the ramp-up of the Company's golf ball operations and increased depreciation and amortization expense related to the Company's foreign operations.

Research and development expenses decreased to $34.0 million (5% of net sales) in 1999 from $36.8 million (5% of net sales) in 1998. This decrease was primarily the result of the shut-down of the Company's prototype foundry and a decrease in consulting fees, partially offset by increases in employee compensation and component prototype costs.

Restructuring income primarily relates to the reversal of a restructuring reserve recorded in 1998 for a lease obligation in New York City that was subsequently assigned to a third party. See Note 14 to the Consolidated Financial Statements for a discussion of this and other restructuring transactions.

Sumitomo Rubber Industries Ltd. ("Sumitomo") transition costs represent payments for non-current product which were associated with the transition of the distribution of Callaway Golf® products from Sumitomo to the Company. See Note 16 to the Consolidated Financial Statements for a discussion of this transaction.

Interest and other income increased to $9.2 million from $3.9 million for the year ended December 31, 1999 as compared with the prior year. This increase is primarily attributable to an increase in interest income resulting from higher average cash and deferred compensation investment balances during 1999 as compared with 1998, an increase in royalty income and an increase in other income due to the receipt of insurance proceeds related to the Company's deferred compensation plan.

Interest expense increased to $3.6 million in 1999 from $2.7 million in 1998. This increase is largely related to interest on the Company's interim finance agreement for pre-lease financing advances for the acquisition and installation costs of machinery and equipment. Also contributing to the increase was an increase in interest expense related to the Company's line of credit and accounts receivable securitization facilities associated with higher interest and yield rates and related fees.

During 1999, the Company recorded a tax provision of $30.2 million and recognized a decrease in deferred taxes of $9.6 million. During 1999, the Company realized tax benefits of $2.4 million related to the exercise of stock options, $1.4 million related to non-taxable income from insurance proceeds related to the Company's deferred compensation plan and $1.0 million related to the reorganization of a foreign subsidiary.

Liquidity and Capital Resources

At December 31, 2000, cash and cash equivalents decreased to $102.6 million from $112.6 million at December 31, 1999. The decrease is the result of cash used in financing activities of $70.5 million and cash used in investing activities of $28.6 million, partially offset by cash provided by operating activities of $91.1 million. Cash flows used in financing activities are primarily attributable to the acquisition of 4.8 million shares of the Company's Common Stock and to dividends paid, partially offset by cash flows from the issuance of Common Stock in connection with stock option exercises. Cash flows used in investing activities are primarily attributable to capital expenditures. Cash flows provided by operating activities reflect increases in accounts payable and accrued expenses, accrued warranty expense and income taxes payable, partially offset by increases in accounts receivable and inventory.

The Company's principal source of liquidity, both on a short-term and long-term basis, has been cash flow provided by operations and the Company's credit facilities. The Company currently expects this trend to continue. The Company has a revolving credit facility for up to $120.0 million (the "Amended Credit Agreement") and an $80.0 million accounts receivable securitization facility (the "Accounts Receivable Facility") (see Notes 4 and 5 to the Consolidated Financial Statements). During 2000, the Company did not utilize either its Accounts Receivable Facility or

its line of credit under the Amended Credit Agreement. At December 31, 2000, the Company had $117.3 million available, net of outstanding letters of credit, under the Amended Credit Agreement, subject to meeting certain availability requirements under a borrowing base formula and other limitations. In addition, at December 31, 2000, there were no advances under the Accounts Receivable Facility, leaving up to $80.0 million available under this facility.

In May 2000, the Company announced that its Board of Directors authorized it to repurchase its Common Stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities from time to time, up to a maximum cost to the Company of $100.0 million. The Company began its repurchase program in May 2000 and through December 31, 2000 has spent $80.5 million to repurchase 4.8 million shares of its Common Stock at an average cost of $16.71 per share. Pursuant to the authority granted in May 2000, the Company may purchase up to $19.5 million in additional shares. If the Company continues to repurchase its Common Stock under this program and/or under any future programs, the Company's liquidity would decrease.

As a result of the implementation of its plan to improve operating efficiencies (see "*Restructuring*" below), the Company incurred charges of $54.2 million in the fourth quarter of 1998. Of these charges, $25.5 million were estimated to be non-cash. Since the adoption of this restructuring plan in the fourth quarter of 1998, the Company has made cash outlays for employee termination costs, contract cancellation fees, excess lease costs and other expenses totaling $20.2 million, of which $1.4 million occurred in 2000. A portion of certain restructuring reserves totaling $8.6 million was reversed during 1999. At December 31, 2000, the Company had a contingent liability that expires in February 2003 of $5.6 million relating to a facility in New York City (see Note 13 to the Consolidated Financial Statements).

Although the Company's golf club operations are mature and historically have generated cash from operations, the Company's golf ball operations completed the first year of operations in 2000 and to date have not generated cash flows sufficient to fund these operations. The Company does not expect that its golf ball operations will generate sufficient cash to fund these operations in the next 12 months. However, based upon its current operating plan, analysis of its consolidated financial position and projected future results of operations, the Company believes that its operating cash flows, together with its credit facilities, will be sufficient to finance current operating requirements, including planned capital expenditures and purchase commitments. There can be no assurance, however, that future industry specific or other developments, general economic trends or other matters, will not adversely affect the Company's operations or its ability to meeting its future cash requirements (see "*Certain Factors Affecting Callaway Golf Company*" below).

Restructuring

During the fourth quarter of 1998, the Company recorded a restructuring charge of $54.2 million resulting from a number of cost reduction actions and operational improvements. These actions included the consolidation of the operations of the Company's wholly-owned subsidiary, Odyssey Golf, Inc. ("Odyssey"), into the operations of the Company while maintaining the distinct and separate Odyssey® brand image; the discontinuation, transfer or suspension of certain initiatives not directly associated with the Company's core business, such as the Company's involvement with interactive golf sites, golf book publishing, new player development and a golf venue in Las Vegas; and the re-sizing of the Company's core business to reflect current and expected business conditions. The restructuring charges primarily related to: 1) the elimination of job responsibilities, resulting in costs incurred for employee severance; 2) the decision to exit certain non-core business activities, resulting in losses on disposition of assets, as well as excess lease costs; and 3) consolidation of the Company's continuing operations resulting in impairment of assets, losses on disposition of assets and excess lease costs. During 1999, the Company completed its restructuring initiatives. At December 31, 2000, there was no remaining reserve balance. The decrease in the reserve balance since December 31, 1999 of $1.4 million represents cash paid for excess lease costs for a facility in New York City. The Company also has a contingent liability related to this facility (see Notes 13 and 14 to the Consolidated Financial Statements).

Certain Factors Affecting Callaway Golf Company

The financial statements included in this report and related discussion report 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.

Adverse Global Economic Conditions

The Company sells golf clubs, golf balls and golf accessories. These products are recreational in nature and are therefore discretionary purchases for consumers. Consumers are generally more willing to make discretionary purchases of golf products during favorable economic conditions. An adverse change in economic conditions in the United States or in the Company's international markets (which represent almost half of the Company's total sales), or even a decrease in consumer confidence as a result of anticipated adverse changes in economic conditions, could cause consumers to forgo or to postpone purchasing new golf products. Such forgone or postponed purchases could have a material adverse affect upon the Company.

Growth Opportunities

Golf Clubs. In order for the Company to grow significantly 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. Furthermore, the Company believes that since 1997 the overall worldwide premium golf club market has generally not experienced substantial growth in dollar volume from year to year. There is no assurance that the overall dollar volume of the worldwide premium golf club market will grow, or that it will not decline, in the future. The Company's future club sales growth therefore may be limited unless there is growth in the worldwide premium golf club market.

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

Golf Ball Costs

The cost of entering the golf ball business has been higher than the Company first anticipated. Much of these higher costs are attributable to higher than expected production costs as a result of yield and other ramp-up issues. To date, the development of the Company's golf ball business has had a significant negative impact on the Company's cash flows, financial position and results of operations. Although the Company believes it generally has resolved these issues, there is no assurance that the Company will be able to achieve the sales or production efficiencies necessary to make its golf ball business profitable. Until the golf ball business becomes profitable, the Company's results of operations, cash flows and financial position will continue to be negatively affected.

Manufacturing Capacity

The Company plans its manufacturing capacity based upon the forecasted demand for its products. Actual demand for such products may exceed or be less than forecasted demand. The Company's unique product designs often require sophisticated manufacturing techniques, which can require significant start-up expenses and/or limit the Company's ability to quickly expand its manufacturing capacity to meet the full demand for its products. If the Company is unable to produce sufficient quantities of new products in time to fulfill actual demand, especially during the Company's traditionally busy season, it could limit the Company's sales and adversely affect its financial performance. On the other hand, the Company invests in manufacturing capacity and commits to components and other manufacturing inputs for varying periods of time, which can limit the Company's ability to quickly react if actual demand is less than forecast. As in 1998, 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. The State of California is currently experiencing a severe shortage of electricity. The shortage may worsen during the summer months when demand for electricity is at its peak. Many companies in California have experienced periods of black-outs during

which electricity was not available. Although the Company has not yet experienced any such black-outs, the Company expects that it will experience some black-out periods. If the black-out periods are significant, the Company will experience significant disruptions in its manufacturing operations as the Company would be unable to manufacture any product during such black-out periods. Any extended or recurring disruptions could have a material adverse affect upon the Company.

Furthermore, the shortage of electricity is also resulting in increased prices for electricity. The Company has tried to mitigate fluctuations in electricity prices by entering into long-term contracts at fixed rates. The Company's current contract expires this summer and the Company is currently negotiating a new contract. The Company expects that the new contracted rate will be higher than its current rate. If the Company is unable to enter into a new contract for a reasonable rate, the Company's expenses for electricity could increase significantly. Such an increase could have a significant adverse affect upon the Company's cost of goods sold and results of operations.

In addition to electricity, the Company also uses natural gas to run the golf club and golf ball manufacturing facilities. There is currently a shortage of natural gas which has caused prices to increase significantly. The Company expects this shortage to continue at least through the cold weather months when demand for gas is greatest. Although the Company does not expect any interruptions in its supply of natural gas, if the prices continue to increase, such increased prices could have a significant adverse affect upon the Company's cost of goods sold and results of operations.

Dependence on Certain Vendors and Materials

The Company is dependent on a limited number of suppliers for its clubheads and shafts, some of which are single-sourced. In addition, some of the Company's products require specifically developed manufacturing techniques and processes which make it difficult to identify and utilize alternative suppliers quickly. The Company believes that suitable clubheads and shafts could be obtained from other manufacturers in the event its regular suppliers are unable to provide components. However, any significant production delay or disruption caused by the inability of current suppliers to deliver or the transition to other suppliers could have a material adverse impact on the Company's results of operations. The Company is also single-sourced or dependent on a limited number of suppliers for the materials it uses to make its golf balls. Many of the materials, including the golf ball cover, 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 is continually reviewing alternative methods of ground shipping to supplement its use and reduce its reliance on UPS. To date, a limited number of alternative vendors have been identified and are being used by the Company. Nevertheless, any interruption in UPS services could have a material adverse effect on the Company's sales and results of operations.

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 such materials 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. New product introductions, price reductions and "close-outs" by competitors continue to generate increased market competition. While the Company believes that its products and its marketing efforts continue to be competitive, there can be no assurance that successful marketing activities by competitors will not negatively impact the Company's future sales.

Golf Balls. The premium golf ball business is also highly competitive, and may be becoming even more competitive. There are a number of well-established and well-financed competitors, including one competitor with an estimated market share in excess of 50% of the premium golf ball business. There are also several recent entrants into the golf ball business, including Nike. Many of these competitors have introduced or will introduce golf ball designs that directly compete with the Company's products.

The Company will need to penetrate the market share held by existing competitors while competing with the other new entrants in order for its golf ball business to be successful. There can be no assurance that the Company's golf balls will obtain the market acceptance necessary to be commercially successful.

Market Acceptance of Products

A golf manufacturer's ability to compete is in part dependent upon its ability to satisfy the various subjective requirements of golfers, including a golf club's and golf ball's look and "feel," and the level of acceptance that a golf club and ball has among professional and recreational golfers. The subjective preferences of golf club and ball purchasers may be subject to rapid and unanticipated changes. There can be no assurance as to how long the Company's golf clubs and balls will maintain market acceptance and therefore no assurance that the demand for the Company's products will permit the Company to experience growth in sales, or maintain historical levels of sales, in the future.

New Product Introduction

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

The Company's new products have tended to incorporate significant innovations in design and manufacture, which have often resulted in higher prices for the Company's products relative to other products in the marketplace. For example, the Company's Rule 35® golf balls are premium golf balls and there are many lower priced non-premium golf balls sold by others. 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.

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 experienced some of these effects in 1999 with respect to golf clubs and could experience similar effects in future years as the Company from time to time introduces new golf club or golf ball products or misjudges demand.

It previously was the Company's practice to announce its new product line at the beginning of each calendar year. The Company recently departed from that practice and now announces its new product line in the fourth quarter to allow retailers to plan better. Such early announcements of new products could cause golfers, and therefore the Company's customers, to defer purchasing additional golf equipment until the Company's new products are available. Such deferments could have a material adverse effect upon sales of the Company's current products and/or result in close-out sales at reduced prices.

Conformance with Rules of Golf

New golf club and golf ball products generally seek to satisfy the standards established by the United States Golf Association ("USGA") and the Royal and Ancient Golf Club of St. Andrews ("R&A") because these standards are generally followed by golfers within their respective jurisdictions. The USGA rules are generally followed in the United States, Canada and Mexico and the R&A rules are generally followed in most other countries throughout the world.

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

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

Currently, all of the Company's products are believed to be "conforming" under the Rules of Golf as published by the R&A. In addition, all of the Company's products with the exception of the Company's ERC II™ Forged Titanium Driver (together with its predecessor, the ERC™ Forged Titanium Driver, the "ERC™ Drivers"), are

believed to be "conforming" under the Rules of Golf as published by the USGA and RCGA. Although the ERC™ Drivers conform to all existing R&A equipment rules, and most existing USGA and RCGA equipment rules, they do not conform to the USGA's so-called "spring-like effect" test protocol. There is no assurance that new designs will satisfy USGA and/or R&A standards, or that existing USGA and/or R&A standards will not be altered in ways that adversely affect the sales of the Company's products.

On October 18, 2000, the Company announced that it intended to sell its ERC II™ Forged Titanium Driver in the U.S. despite the fact that it has been ruled to be non-conforming by the USGA. On December 8, 2000, the USGA announced that scores in rounds played with clubs that do not conform to USGA rules, such as the ERC II™ Forged Titanium Driver, may not be posted for USGA handicap purposes. To the Company's knowledge, it is the first large, premium brand golf equipment company to sell non-conforming equipment in the U.S. By undertaking this approach, the Company hopes to expand participation in the game of golf in the United States-the source of approximately 55% of the Company's revenues-by making the game more enjoyable and accessible for more people, including those people who play the game primarily for fun, enjoyment and recreation.

While the Company believes that this is the best strategy for the Company and its shareholders, and one that is good for the game of golf as well, the strategy is not without risk. It is possible that a significant number of U.S. retailers may decline to carry a non-conforming product such as the ERC II™ Driver. It is also possible that a significant number of U.S. golfers may decide that they do not wish to purchase a driver that may not be used in competitions in the U.S. played subject to the USGA's rules or that may not be used for handicap purposes. Retailer and/or consumer backlash against the introduction of a non-conforming product may injure sales of other, conforming products, or otherwise damage the brand. These negative effects, if they materialize, could materially reduce U.S. sales of ERC II™ Drivers and other products in 2001 and in future years, and could even negatively affect in a material way the strength of the brand and the Company's business overseas despite the fact that the ERC II™ Driver fully conforms with the R&A's Rules. On the other hand, if the Company is correct in its belief that there are a large number of American golfers who do not play in tournaments subject to the USGA's Rules and are prepared to purchase an exceptional non-conforming driver for use in recreational play, and/or the Company's strategy is successful over time in attracting more people to the game of golf in the U.S., then the beneficial effects could be significant.

Golf Professional Endorsements

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

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

Golf Balls. Many golf ball manufacturers, including the leading U.S. manufacturer of premium golf balls, have focused a great deal of their marketing efforts on promoting the fact that tour professionals use their balls. Some of these golf ball competitors spend large amounts of money to secure professional endorsements, and the market leader has obtained a very high degree of tour penetration. While almost all of the Company's staff professionals, as well as other professionals who are not on the Company's staff, have decided to use the Company's golf balls in play, there is no assurance they will continue to do so. Furthermore, there are many other professionals who are already under contract with other golf ball manufacturers or who, for other reasons, may not

choose to play the Company's golf ball products. The Company does not plan to match the endorsement spending levels of the leading manufacturer, and will instead rely more heavily upon the performance of the ball and other factors to attract professionals to the product. In the future the Company may or may not increase its tour spending in support of its golf ball. It is not clear to what extent use by professionals is important to the commercial success of the Company's golf balls, but it is possible that the results of the Company's golf ball business could be significantly affected by its success or lack of success in securing acceptance on the professional tours.

Intellectual Property and Proprietary Rights

The golf club industry, in general, has been characterized by widespread imitation of popular club designs. The Company has an active program of enforcing its proprietary rights against companies and individuals who market or manufacture counterfeits and "knock off" products, and aggressively asserts its rights against infringers of its copyrights, patents, trademarks, and trade dress. However, there is no assurance that these efforts will reduce the level of acceptance obtained by these infringers. Additionally, there can be no assurance that other golf club manufacturers will not be able to produce successful golf clubs which imitate the Company's designs without infringing any of the Company's copyrights, patents, trademarks, or trade dress.

An increasing number of the Company's competitors have, like the Company itself, sought to obtain patent, trademark, copyright or other protection of their proprietary rights and designs for golf clubs and golf balls. From time to time others have 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 vendors. Suppliers, when engaged in joint research projects, are required to enter into additional confidentiality agreements. While these efforts are taken seriously, there can be no assurance that these measures will prove adequate in all instances to protect the Company's confidential information.

Seasonality and Adverse Weather Conditions

In the golf club and golf ball industries, sales to retailers are generally seasonal due to lower demand in the retail market during cold weather months. The Company's golf club business has generally experienced these seasonal fluctuations and the Company expects this to continue generally for both its golf club and golf ball businesses. Furthermore, unusual or severe weather conditions generally result in less golf rounds played, which generally results in less demand for golf clubs and golf balls. Consequently, sustained adverse weather conditions, especially during the warm weather months, could materially affect the Company's sales.

Product Returns

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

The Company monitors the level and nature of any golf club breakage and, where appropriate, seeks to incorporate design and production changes to assure its customers of the highest quality available in the market. Significant increases in the incidence of breakage or other product problems may adversely affect the Company's sales and image with golfers. While the Company

believes that it has sufficient reserves for warranty claims, there can be no assurance that these reserves will be sufficient if the Company were to experience an unusually high incidence of breakage or other product problems.

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

"Gray Market" Distribution

Some quantities of the Company's products find their way to unapproved outlets or distribution channels. This "gray market" for the Company's products can undermine authorized retailers and foreign wholesale distributors who promote and support the Company's products, and can injure the Company's image in the minds of its customers and consumers. On the other hand, stopping such commerce could result in a potential decrease in sales to those customers who are selling Callaway Golf® products to unauthorized distributors and/or an increase in sales returns over historical levels. For example, the Company experienced a decline in sales in the U.S. in 1998, and believes the decline was due, in part, to a decline in "gray market" shipments to Asia and Europe. While the Company has taken some lawful steps to limit commerce in its products in the "gray market" in both the U.S. and abroad, it has not stopped such commerce.

International Distribution

The Company's management believes that controlling the distribution of its products in certain major markets in the world has been and will be an element in the future growth and success of the Company. The Company has reorganized a substantial portion of its international operations, including the acquisition of distribution rights in certain key countries in Europe, Asia and North America. These efforts have resulted and will continue to result in additional investments in inventory, accounts receivable, employees, corporate infrastructure and facilities. The integration of foreign distribution into the Company's international sales operations will continue to require the dedication of management and other Company resources. The integration of foreign distribution also could result in disruptions in the distribution of the Company's products in some areas. There can be no assurance that the acquisition and integration of the Company's foreign distribution channels will be successful, and the Company's attempts to do so may adversely affect the Company's business. Additionally, the Company's plan to integrate foreign distribution increases the Company's exposure to fluctuations in exchange rates for various foreign currencies which could result in losses and, in turn, could adversely impact the Company's results of operations. There can be no assurance that the Company will be able to mitigate this exposure in the future through its management of foreign currency transactions.

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, like the one experienced in 1998 and 1999, primarily in the U.S., could result in increased delinquent or uncollectible accounts for some of the Company's significant customers. In addition, as the Company integrates its foreign distribution its exposure to credit risks increases as it no longer sells to a few wholesalers but rather directly to many retailers. A failure of a significant portion of the Company's customers to meet their obligations to the Company would adversely impact the Company's performance and financial condition.

Information Systems

Many of the countries in which the Company sells its products are Member States of the Economic and Monetary Union ("EMU"). Beginning January 1, 1999, Member States of the EMU have the option of trading in either their local currencies or the euro, the official currency of EMU participating Member States. Parties are free to choose the unit they prefer in contractual relationships until 2002 when their local currencies will be phased out. The current version of the Company's enterprise-wide business system does not support transactions denominated in euro. The Company is in the process of upgrading its business systems to support transactions denominated in euro. The Company intends to enable the euro functionality of its upgraded system no later than the end of its third quarter in 2001. Until such time as the upgrade has occurred and the euro functionality has been enabled, transactions denominated in euro will be processed manually. To date, the Company has not experienced, and does not anticipate in the

near future, a large demand from its customers to transact in euro. Additionally, the Company does not believe that it will incur material costs specifically associated with manually processing data or preparing its business systems to operate in either the transitional period or beyond. However, there can be no assurance that the conversion of EMU Member States to euro will not have a material adverse effect on the Company and its operations.

Market Risk

The Company is exposed to the impact of foreign currency fluctuations due to its international operations and certain export sales. The Company is exposed to both transactional currency/functional currency and functional currency/reporting currency exchange rate risks. The Company's foreign currency exposures include most European currencies, Japanese yen, Canadian dollars and Korean won. In the normal course of business, the Company employs established policies and procedures to manage its exposure to fluctuations in the value of foreign currencies. Pursuant to its foreign exchange hedging policy, the Company may use forward foreign currency exchange rate contracts to hedge certain firm commitments and the related receivables and payables. Foreign currency derivatives are used only to the extent considered necessary to meet the Company's objectives and the Company does not enter into forward contracts for speculative purposes. During 2000, the Company entered into such contracts on behalf of three of its wholly-owned subsidiaries, Callaway Golf Europe Ltd., Callaway Golf K.K. and Callaway Golf Canada Ltd. The Company also hedged certain euro-denominated accounts receivable in 2000. Also pursuant to its foreign exchange hedging policy, in the fourth quarter of 2000, the Company began hedging anticipated intercompany sales of inventory denominated in foreign currencies using forward foreign currency exchange rate contracts. The effect of these practices is to minimize variability in the Company's operating results arising from foreign exchange rate movements. These foreign exchange contracts generally do not subject the Company to risk due to exchange rate movements because gains and losses on these contracts offset losses and gains on the transactions being hedged, and the Company does not engage in hedging contracts which exceed the amounts of these transactions.

Additionally, the Company is exposed to interest rate risk from its Accounts Receivable Facility and Amended Credit Agreement (see Notes 4 and 5 to the Company's Consolidated Financial Statements) which are indexed to the London Interbank Offering Rate and Redwood Receivables Corporation Commercial Paper Rate. No amounts were advanced or outstanding under these facilities at December 31, 2000.

Sensitivity analysis is the measurement of potential loss in future earnings of market sensitive instruments resulting from one or more selected hypothetical changes in interest rates or foreign currency values. The Company used a sensitivity analysis model to quantify the estimated potential effect of unfavorable movements of 10% in foreign currencies to which the Company was exposed at December 31, 2000 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.

At December 31, 2000, the estimated maximum one-day loss in earnings from the Company's foreign-currency derivative financial instruments, calculated using the sensitivity analysis model described above, is $13.9 million attributable to hedges of anticipated intercompany sales and $0.9 million attributable to hedges of balance sheet exposures. 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.

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

Consolidated Balance Sheet

(in thousands, except share and per share data)	December 31, 2000	December 31, 1999
ASSETS		
Current assets:		
Cash and cash equivalents	$102,596	$112,602
Accounts receivable, net	58,836	54,252
Inventories, net	133,962	97,938
Deferred taxes	29,354	32,558
Other current assets	17,721	13,122
Total current assets	342,469	310,472
Property, plant and equipment, net	134,712	142,214
Intangible assets, net	112,824	120,143
Other assets	40,929	43,954
	$630,934	$616,783
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 44,173	$ 46,664
Accrued employee compensation and benefits	22,574	21,126
Accrued warranty expense	39,363	36,105
Accrued restructuring costs		1,379
Income taxes payable	3,196	
Total current liabilities	109,306	105,274
Long-term liabilities:		
Deferred compensation	9,884	11,575
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred Stock, $.01 par value, 3,000,000 shares authorized, none issued and outstanding at December 31, 2000 and 1999		
Common Stock, $.01 par value, 240,000,000 shares authorized, 78,958,963 and 76,302,196 issued December 31, 2000 and 1999	790	763
Paid-in capital	347,765	307,329
Unearned compensation	(1,214)	(2,784)
Retained earnings	349,681	288,090
Accumulated other comprehensive income	(6,096)	280
Less: Grantor Stock Trust (5,300,000 shares at December 31, 2000 and 1999) at market (Note 8)	(98,713)	(93,744)
	592,213	499,934
Less: Common Stock held in treasury, at cost, 4,815,241 shares at December 31, 2000 and none at December 31, 1999	(80,469)	
Total shareholders' equity	511,744	499,934
	$630,934	$616,783

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

Consolidated Statement of Operations

(in thousands, except per share data)	Year ended December 31, 2000		1999		1998	
Net sales	$837,627	100%	$719,038	100%	$703,060	100%
Cost of goods sold	440,119	53%	384,265	53%	410,341	58%
Gross profit	397,508	47%	334,773	47%	292,719	42%
Selling expenses	170,541	20%	128,565	18%	143,727	20%
General and administrative expenses	70,333	8%	92,478	13%	98,048	14%
Research and development costs	34,579	4%	34,002	5%	36,848	5%
Restructuring costs (Note 14)			(5,894)	(1%)	54,235	8%
Sumitomo transition costs (Note 16)			5,713	1%		
Income (loss) from operations	122,055	15%	79,909	11%	(40,139)	(6%)
Interest and other income, net (Note 11)	8,791		9,182		3,911	
Interest expense	(1,524)		(3,594)		(2,671)	
Income (loss) before income taxes and cumulative effect of accounting change	129,322	16%	85,497	12%	(38,899)	(6%)
Income tax provision (benefit)	47,366		30,175		(12,335)	
Income before cumulative effect of accounting change	81,956		55,322		(26,564)	
Cumulative effect of accounting change	(957)					
Net income (loss)	$ 80,999	10%	$ 55,322	8%	$ (26,564)	(4%)
Earnings (loss) per common share:						
Basic						
Income before cumulative effect of accounting change	$1.17		$0.79		$(0.38)	
Cumulative effect of accounting change	(0.01)					
	$1.16		$0.79		$(0.38)	
Diluted						
Income before cumulative effect of accounting change	$1.14		$0.78		$(0.38)	
Cumulative effect of accounting change	(0.01)					
	$1.13		$0.78		$(0.38)	
Common equivalent shares:						
Basic	69,946		70,397		69,463	
Diluted	71,412		71,214		69,463	

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

Consolidated Statement of Cash Flows

(in thousands)	Year ended December 31,		
	2000	1999	1998
Cash flows from operating activities:			
Net income (loss)	$ 80,999	$ 55,322	$ (26,564)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	40,249	39,877	35,885
Non-cash compensation	2,157	1,390	2,887
Tax benefit from exercise of stock options	6,806	2,377	3,068
Net non-cash foreign currency and hedging gains	(1,410)		
Deferred taxes	4,906	9,971	(36,235)
Non-cash restructuring costs		(8,609)	25,497
Loss on disposal of assets	342	315	1,298
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts receivable, net	(9,047)	19,690	51,575
Inventories, net	(39,402)	51,092	(42,665)
Other assets	(3,074)	(12,966)	(12,149)
Accounts payable and accrued expenses	2,638	12,225	(4,357)
Accrued employee compensation and benefits	1,623	9,875	(3,411)
Accrued warranty expense	3,258	286	7,760
Income taxes payable	4,088	(10,001)	9,652
Accrued restructuring costs	(1,379)	(3,476)	7,389
Deferred compensation	(1,691)	3,969	(299)
Accrued restructuring costs - long-term		(5,041)	11,117
Net cash provided by operating activities	91,063	166,296	30,448
Cash flows from investing activities:			
Capital expenditures	(28,386)	(56,244)	(67,859)
Acquisitions, net of cash acquired	(444)	(2,389)	(10,672)
Proceeds from sale of assets	244	5,095	3,417
Net cash used in investing activities	(28,586)	(53,538)	(75,114)
Cash flows from financing activities:			
Net proceeds from line of credit		(70,919)	70,919
Proceeds from note payable		35,761	12,971
Short-term debt retirement			(10,373)
Issuance of Common Stock	28,233	9,009	10,343
Acquisition of Treasury Stock	(80,469)		
Retirement of Common Stock			(917)
Proceeds from sale-leaseback of equipment	1,268		
Dividends paid, net	(19,538)	(19,760)	(19,485)
Net cash (used in) provided by financing activities	(70,506)	(45,909)	63,458
Effect of exchange rate changes on cash	(1,977)	135	622
Net (decrease) increase in cash and cash equivalents	(10,006)	66,984	19,414
Cash and cash equivalents at beginning of year	112,602	45,618	26,204
Cash and cash equivalents at end of year	$102,596	$112,602	$ 45,618
Supplemental disclosures:			
Non-cash financing (Note 4)		$ 48,732	
Cash paid for interest and fees	$ 805	$ 3,637	$ 2,162
Cash paid for income taxes	$ 29,245	$ 30,670	$ 8,165

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

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in thousands)

	Common Stock		Paid-in	Unearned	Retained	Accumulated Other Comprehensive		Treasury Stock			Current Year's Comprehensive
	Shares	Amount	Capital	Compensation	Earnings	Income	GST	Shares	Amount	Total	Income
Balance, December 31, 1997	74,252	$743	$337,403	$(3,575)	$298,728	$(559)	$(151,315)			$481,425	
Exercise of stock options	391	4	4,433							4,437	
Tax benefit from exercise of stock options			3,068							3,068	
Issuance of Restricted Common Stock	130	1	4,029	(4,030)							
Cancellation of Restricted Common Stock	(19)		(597)	597							
Compensatory stock and stock options			1,532	1,355						2,887	
Employee stock purchase plan	386	4	5,902							5,906	
Stock retirement	(45)	(1)	(765)		(151)					(917)	
Cash dividends					(20,969)					(20,969)	
Dividends on shares held by GST					1,484					1,484	
Adjustment of GST shares to market value			(96,990)				96,990				
Equity adjustment from foreign currency translation						2,339				2,339	$2,339
Net income					(26,564)					(26,564)	(26,564)
Balance, December 31, 1998	75,095	751	258,015	(5,653)	252,528	1,780	(54,325)			453,096	$(24,225)
Exercise of stock options	851	8	5,362							5,370	
Tax benefit from exercise of stock options			2,377							2,377	
Cancellation of Restricted Common Stock	(22)		(684)	684							
Compensatory stock and stock options			(795)	2,185						1,390	
Employee stock purchase plan	378	4	3,635							3,639	
Cash dividends					(21,244)					(21,244)	
Dividends on shares held by GST					1,484					1,484	
Adjustment of GST shares to market value			39,419				(39,419)				
Equity adjustment from foreign currency translation						(1,500)				(1,500)	$(1,500)
Net income					55,322					55,322	55,322
Balance, December 31, 1999	76,302	763	307,329	(2,784)	288,090	280	(93,744)			499,934	$53,822
Exercise of stock options	2,252	23	23,932							23,955	
Tax benefit from exercise of stock options			6,806							6,806	
Cancellation of Restricted Common Stock	(7)		(217)	217							
Acquisition of Treasury Stock								(4,815)	$(80,469)	(80,469)	
Compensatory stock and stock options			804	1,353						2,157	
Employee stock purchase plan	412	4	4,274							4,278	
Cash dividends					(21,022)					(21,022)	
Dividends on shares held by GST					1,484					1,484	
Adjustment of GST shares to market value			4,969				(4,969)				
Equity adjustment from foreign currency translation						(5,422)				(5,422)	$(5,422)
Unrealized loss on cash flow hedges, net of tax						(954)				(954)	(954)
Other			(132)		130					(2)	
Net income					80,999					80,999	80,999
Balance, December 31, 2000	78,959	$790	$347,765	$(1,214)	$349,681	$(6,096)	$(98,713)	(4,815)	$(80,469)	$511,744	$74,623

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

NOTE 1

THE COMPANY

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

NOTE 2

SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements for the periods presented include the accounts of the Company and its subsidiaries, Callaway Golf Sales Company, Golf Funding Corporation ("Golf Funding"), Callaway Golf Ball Company, Odyssey Golf, Inc. ("Odyssey"), CGV, Inc., All-American Golf LLC ("All-American"), Callaway Golf Media Ventures ("CGMV"), Callaway Golf Europe Ltd., Callaway Golf Europe, S.A., Callaway Golf K.K. (formerly named ERC International Company), Callaway Golf (Germany) GmbH, Callaway Golf Canada Ltd. and Callaway Golf Korea, Ltd. All significant intercompany transactions and balances have been eliminated. Callaway Golf Ball Company and Odyssey were merged with the Company as of December 29, 2000 and December 22, 1999, respectively. The Company sold the business of All-American in 1998 and its interest in CGMV in March 1999 (Note 15). Callaway Golf Europe, S.A. was merged with Callaway Golf Europe Ltd. in 1999 (Note 15).

Financial Statement Preparation

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Examples of such estimates include provisions for warranty, uncollectible accounts receivable, inventory obsolescence and restructuring costs (Note 14). Actual results could differ from those estimates, which could materially affect future results of operations.

Revenue Recognition

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

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, trade receivables and payables, forward foreign currency exchange contracts, its revolving line of credit and note payable (Note 4) and its accounts receivable securitization facility (Note 5). The carrying amounts of these instruments approximate fair value because of their short maturities and variable interest rates.

Advertising Costs

The Company advertises primarily through television and print media. The Company's policy is to expense advertising costs, including production costs, as incurred. Advertising expenses for 2000, 1999 and 1998 were $35,100,000, $26,202,000 and $32,944,000, respectively.

Foreign Currency Translation and Transactions

The Company's foreign subsidiaries utilize their local currency as their functional currency. The accounts of these foreign subsidiaries have been translated into United States dollars at appropriate rates of exchange. Cumulative translation gains or losses are recorded as accumulated other comprehensive income in shareholders' equity. Gains or losses resulting from foreign currency transactions (transactions denominated in a currency other than the entity's local currency) are included in the consolidated statement of operations. The Company recorded transaction losses of $147,000 and $793,000 in 2000 and 1999, respectively, and transaction gains of $1,598,000 in 1998.

Derivatives and Hedging

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments and hedging activities and

requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives are recorded each period in income or other comprehensive income, depending on whether the derivatives are designated as hedges and, if so, the types and effectiveness of hedges. SFAS No. 133 is effective for all periods beginning after June 15, 2000; the Company elected to adopt early SFAS No. 133 on January 1, 1999.

Adoption of this statement did not significantly affect the way in which the Company currently accounts for derivatives to hedge payments due on intercompany transactions, as described in Note 6. Accordingly, no cumulative effect adjustments were made. In the fourth quarter of 2000, the Company began hedging anticipated intercompany sales of inventory denominated in foreign currencies using forward foreign currency exchange rate contracts. The purpose of these derivative instruments is to minimize the variability of cash flows associated with the anticipated transactions being hedged. As changes in foreign currency rates impact the United States dollar value of anticipated transactions, the fair value of the forward contracts also changes, providing a synthetic offset to foreign currency rate fluctuations.

The forward contracts used to hedge anticipated transactions are cash flow hedges and are recorded as either assets or liabilities in the balance sheet at fair value. Gains and losses on such contracts are recorded in other comprehensive income and will be recorded in income when the anticipated transactions occur. The ineffective portion of all hedges are recognized in current period earnings.

Additional information about the Company's use of derivative instruments is presented in Note 6.

Earnings per Common Share

Basic earnings per common share is calculated by dividing net income for the period by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income for the period by the weighted-average number of common shares outstanding during the period, increased by dilutive potential common shares ("dilutive securities") that were outstanding during the period. Dilutive securities include shares owned by the Callaway Golf Company Grantor Stock Trust (Note 8), options issued pursuant to the Company's stock option plans (Note 10), potential shares related to the Employee Stock Purchase Plan (Note 10) and rights to purchase preferred shares under the Callaway Golf Company Shareholder Rights Plan (Note 10). Dilutive securities related to the Callaway Golf Company Grantor Stock Trust and the Company's stock option plans are included in the calculation of diluted earnings per common share using the treasury stock method. Dilutive securities related to the Employee Stock Purchase Plan are calculated by dividing the average withholdings during the period by 85% of the lower of the offering period price or the market value at the end of the period. The dilutive effect of rights to purchase preferred shares under the Callaway Golf Shareholder Rights Plan have not been included as dilutive securities because the conditions necessary to cause these rights to be redeemed were not met. A reconciliation of the numerators and denominators of the basic and diluted earnings per common share calculations for the years ended December 31, 2000, 1999 and 1998 is presented in Note 9.

Cash Equivalents

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

Inventories

Inventories are valued at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives of two to 30 years. The Company's property, plant and equipment generally are depreciated over the following periods:

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

Normal repairs and maintenance are expensed as incurred. Expenditures that materially increase values, change capacities or extend useful lives are capitalized. Replacements are capitalized and the property, plant, and equipment accounts are relieved of the items being replaced. The related costs and accumulated depreciation of disposed assets are eliminated and any resulting gain or loss on disposition is included in income.

The Company capitalizes certain software development and implementation costs for internal use. Development and implementation costs are expensed until management has determined that the software will result in probable future economic benefit and management has committed to funding the project. Thereafter, all direct external implementation costs, as well as purchased software costs, are capitalized and amortized using the straight-line method over the remaining estimated useful lives.

In September 2000, the Company completed an extensive upgrade of its enterprise-wide business software system to a more

current release. The upgrade includes improved functionalities and provides the Company the opportunity to build upon its investment in the software. As a result of this upgrade, the Company expects that this business system will have a greater useful life to the Company than originally estimated. Therefore, the Company has extended the estimated useful life of its business system by three years. The effect of this change in accounting estimate reduced depreciation expense by $1,319,000 for the year ended December 31, 2000. The resulting increase in net income increased the Company's earnings per share by $0.01 for the year ended December 31, 2000.

Long-Lived Assets

The Company assesses potential impairments of its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss would be recognized when the sum of the expected future net cash flows is less than the carrying amount of the asset. During the fourth quarter of 1998, the Company implemented a restructuring plan that included a number of cost reduction actions and operational improvements (Note 14). As a result of this plan, impairment losses were recorded in 1998 for certain of the Company's long-lived assets.

Intangible Assets

Intangible assets consist primarily of trade name, trademark, trade dress, patents and goodwill resulting from the 1997 purchase of substantially all of the assets and certain liabilities of Odyssey Sports, Inc. and goodwill associated with the purchase of certain foreign distributors (Note 15). Intangible assets are amortized using the straight-line method over periods ranging from three to 40 years. During 2000, 1999 and 1998, amortization of intangible assets was $7,195,000, $7,476,000 and $5,466,000 respectively.

Stock-Based Compensation

The Company measures compensation expense for its stock-based employee compensation awards using the intrinsic value method. Pro forma disclosures of net income and earnings per share, as if the fair value-based method had been applied in measuring compensation expense, are presented in Note 10. Compensation expense for non-employee stock-based compensation awards is measured using the fair-value method.

Income Taxes

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

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

Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income," requires that all components of comprehensive income be reported in the financial statements in the period in which they are recognized. The components of comprehensive income for the Company include net income, unrealized gains or losses on cash flow hedges and foreign currency translation adjustments. Since the Company has met the indefinite reversal criterion, it does not accrue income taxes on foreign currency translation adjustments. During 2000, the Company recorded $954,000, net of tax benefit of $645,000, related to net unrealized losses on cash flow hedges. No amounts were reclassified to earnings during 2000.

Segment Information

The Company utilizes the management approach to report segment information. The management approach designates the international organization that is used by management for making operating decisions and assessing performance as the source of the Company's reportable segments. The Company also discloses information about products and services, geographic areas and major customers. This information is presented in Note 16.

Diversification of Credit Risk

The Company's financial instruments that are subject to concentrations of credit risk consist primarily of cash equivalents and trade receivables.

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

The Company operates in the golf equipment industry and primarily sells its products to golf equipment retailers, directly and through wholly-owned domestic and foreign subsidiaries, and to foreign distributors. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral from these customers. The Company maintains

reserves for potential credit losses, which it considers adequate to cover any such losses.

During 2000, 1999 and 1998, approximately 46%, 42% and 38%, respectively, of the Company's net sales were made to foreign customers. An adverse change in either economic conditions abroad or the Company's relationship with significant foreign retailers could negatively impact the volume of the Company's international sales and the Company's results of operations, cash flows and financial position.

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

Recent Accounting Pronouncement

In September 2000, the FASB issued Statement of Financial Accounting Standards No. 140 ("SFAS No. 140"), "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 140 replaces Statement of Financial Accounting Standards No. 125 ("SFAS No. 125"), "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." It revises the standards for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most the SFAS No. 125's provisions without reconsideration. SFAS No. 140 is effective for transactions after March 31, 2001, but certain disclosure requirements are effective for periods ending after December 15, 2000. The Company does not expect that SFAS No. 140 will have any effect on its results of operations, financial position or cash flows. Required disclosures are presented in Note 5.

Reclassifications

In July 2000, the Emerging Issues Task Force ("EITF") finalized its consensus on Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs." Pursuant to EITF Issue No. 00-10 and the Securities and Exchange Commission's position on this issue, all amounts billed to customers for shipping and handling should be included in "net sales" and costs incurred related to shipping and handling should be included in "cost of goods sold." The Company had previously included shipping and handling revenues and costs in "selling" expenses. The Company's Statement of Operations for all periods presented has been reclassified and reflects the classification required by EITF Issue No. 00-10.

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

Note 3

Selected Financial Statement Information

(in thousands)	December 31, 2000	December 31, 1999
Accounts receivable, net:		
Trade accounts receivable	$ 65,063	$ 59,543
Allowance for doubtful accounts	(6,227)	(5,291)
	$ 58,836	$ 54,252
Inventories, net:		
Raw materials	$ 56,936	$ 45,868
Work-in-process	1,293	1,403
Finished goods	83,453	65,661
	141,682	112,932
Reserve for obsolescence	(7,720)	(14,994)
	$133,962	$ 97,938
Property, plant and equipment, net:		
Land	$ 12,358	$ 12,358
Buildings and improvements	90,301	87,910
Machinery and equipment	60,399	50,942
Furniture, computers and equipment	65,140	64,334
Production molds	25,610	22,714
Construction-in-process	5,766	5,032
	259,574	243,290
Accumulated depreciation	(124,862)	(101,076)
	$134,712	$142,214
Intangible assets, net:		
Trade name	$ 69,629	$ 69,629
Trademark and trade dress	29,841	29,841
Patents, goodwill and other	33,759	34,911
	133,229	134,381
Accumulated amortization	(20,405)	(14,238)
	$112,824	$120,143
Accounts payable and accrued expenses:		
Accounts payable	$ 5,552	$ 11,297
Accrued expenses	38,621	35,367
	$ 44,173	$ 46,664
Accrued employee compensation and benefits:		
Accrued payroll and taxes	$ 16,178	$ 15,303
Accrued vacation and sick pay	5,111	4,571
Accrued commissions	1,285	1,252
	$ 22,574	$ 21,126

Note 4

Bank Line of Credit and Note Payable

In February 1999, the Company consummated the amendment of its credit facility to increase the facility to up to $120,000,000 (the "Amended Credit Agreement"). The Amended Credit Agreement expires in February 2004 and is secured by substantially all of the assets of the Company. The Amended Credit Agreement bears interest at the Company's election at the London Interbank Offering Rate ("LIBOR") plus a margin or the higher of the base rate on corporate loans at large U.S. money center commercial banks (prime rate), or the Federal Funds Rate plus 50 basis points. The line of credit requires the Company to maintain certain minimum financial ratios, including a fixed charge coverage ratio, as well as other restrictive covenants. As of December 31, 2000, up to $117,276,000 of the credit facility remained available for borrowings (including a reduction of $2,724,000 for outstanding letters of credit), subject to meeting certain availability requirements under a borrowing base formula and other limitations.

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

Note 5

Accounts Receivable Securitization

The Company's wholly-owned subsidiary, Callaway Golf Sales Company, sells trade receivables on an ongoing basis to its wholly-owned subsidiary, Golf Funding. Pursuant to an agreement effective February 1999 with a securitization company (the "Accounts Receivable Facility"), Golf Funding, in turn, sells such receivables to the securitization company on an ongoing basis, which yields proceeds of up to $80.0 million at any point in time. Golf Funding's sole business is the purchase of trade receivables from Callaway Golf Sales Company. Golf Funding is a separate corporate entity with its own separate creditors, which in the event of its liquidation will be entitled to be satisfied out of Golf Funding's assets prior to any value in Golf Funding becoming available to the Company. The Accounts Receivable Facility expires in February 2004.

Under the Accounts Receivable Facility, the receivables are sold at face value with payment of a portion of the purchase price being deferred. During 2000 and as of December 31, 2000, no amount was outstanding under the Accounts Receivable Facility. Fees incurred in connection with the facility and discounts associated with the sale of accounts receivable for years ended December 31, 2000 and 1999 were $303,000 and $923,000 and were recorded as interest expense.

Note 6

Derivatives and Hedging

During 2000, 1999 and 1998, the Company entered into forward foreign currency exchange rate contracts to hedge payments due on intercompany transactions by certain of its wholly-owned foreign subsidiaries. The Company also hedged certain yen-denominated transactions with its Japanese distributor in 1999 and 1998. Realized and unrealized gains and losses on these contracts are recorded in income. The effect of this practice is to minimize variability in the Company's operating results arising from foreign exchange rate movements. The Company does not engage in foreign currency speculation. These foreign exchange contracts generally do not subject the Company to risk due to exchange rate movements because gains and losses on these contracts offset losses and gains on the intercompany transactions being hedged, and the Company does not engage in hedging contracts which exceed the amount of the intercompany transactions. At December 31, 2000, 1999 and 1998, the Company had approximately $10,457,000, $7,117,000 and $11,543,000, respectively, of these foreign exchange contracts outstanding. The contracts outstanding at December 31, 2000 mature between January and March of 2001. The Company had net realized and unrealized gains on foreign exchange contracts of $5,299,000, $358,000 and $57,000 in 2000, 1999 and 1998, respectively.

During the fourth quarter of 2000, the Company utilized forward foreign currency exchange rate contracts to hedge cash flows associated with forecasted intercompany sales of inventory. These forward contracts are accounted for as cash flow hedges. The Company only hedges transactions that it deems to be more likely than not to occur. During 2000, the Company hedged only those transactions forecasted to occur by December 31, 2001. As of December 31, 2000, the Company had approximately $107,779,000 of cash flow hedges outstanding. The Company assesses the effectiveness of these derivatives using the spot rate. Changes in the spot-forward differential are excluded from the test of hedge effectiveness and are recorded currently in earnings as a component of "Interest and other income, net." Assessments of hedge effectiveness are performed using the dollar offset method and applying a

hedge effectiveness ratio of between 80% and 125%. Given that both the hedged item and the hedged instrument are evaluated using the same spot rate, the Company anticipates hedges of anticipated intercompany inventory sales to be highly effective. The effectiveness of each derivative is assessed monthly. During 2000, a loss of $174,000, representing the ineffective portion of the Company's derivative instruments, was recorded in earnings.

The effective portion of the fair value of the derivatives is deferred on the balance sheet in other comprehensive income ("OCI"), a component of "Accumulated other comprehensive income." Amounts recorded in OCI will be released to earnings in the same period that the hedged transaction will impact the Company's consolidated earnings. This transaction date is assumed to occur when the underlying sale of product to a third party occurs. At December 31, 2000, $1,599,000 of deferred net losses is expected to be reclassified into earnings within the next 12 months. During 2000, no gains or losses were reclassified into earnings as a result of the discontinuance of any cash flow hedges.

Note 7

TREASURY STOCK

On May 3, 2000, the Company announced that its Board of Directors authorized it to repurchase its Common Stock in the open market or in private transactions, subject to the Company's assessment of market conditions and buying opportunities from time to time, up to a maximum cost to the Company of $100,000,000. The Company began its repurchase program in May 2000. During 2000, the Company spent $80,469,000 to repurchase 4,815,000 shares of its Common Stock at an average cost of $16.71 per share.

The Company's repurchases of shares of Common Stock are recorded at average cost in "Common Stock held in treasury" and result in a reduction of "Shareholders' equity". At December 31, 2000, retained earnings was restricted in the amount of $80,469,000 million, representing the cost of 4,815,000 shares of Common Stock held in treasury.

Note 8

GRANTOR STOCK TRUST

In July 1995, the Company established the Callaway Golf Company Grantor Stock Trust (the "GST"). In conjunction with the formation of the GST, the Company sold 4,000,000 shares of newly issued Common Stock to the GST at a purchase price of $60,575,000 ($15.14 per share). In December 1995, the Company sold an additional 1,300,000 shares of newly issued Common Stock to the GST at a purchase price of $26,263,000 ($20.20 per share). The sale of these shares had no net impact on shareholders' equity. During the term of the GST, shares in the GST may be used to fund the Company's obligations with respect to one or more of the Company's non-qualified or qualified employee benefit plans.

Shares owned by the GST are accounted for as a reduction to shareholders' equity until used in connection with employee benefits. Each period, the shares owned by the GST are valued at the closing market price, with corresponding changes in the GST balance reflected in capital in excess of par value.

Note 9

EARNINGS PER COMMON SHARE

For the years ended December 31, 2000 and 1999, 8,931,000 and 10,979,000 options, respectively, were excluded from the calculations, as their effect would have been antidilutive. For the year ended December 31, 1998, all dilutive securities were excluded from the calculation of diluted loss per share, as their effect would have been antidulutive.

The schedule below summarizes the elements included in the calculation of basic and diluted earnings (loss) per common share for the years ended December 31, 2000, 1999 and 1998.

(in thousands, except per share data)	Year Ended December 31,		
	2000	1999	1998
Net income (loss)	$80,999	$55,322	$(26,564)
Weighted-average shares outstanding:			
Weighted-average shares outstanding - Basic	69,946	70,397	69,463
Dilutive securities	1,466	817	
Weighted-average shares outstanding - Diluted	71,412	71,214	69,463
Earnings (loss) per common share:			
Basic			
Income before cumulative effect of accounting change	$1.17	$0.79	$(0.38)
Cumulative effect of accounting change	(0.01)		
	$1.16	$0.79	$(0.38)
Diluted			
Income before cumulative effect of accounting change	$1.14	$0.78	$(0.38)
Cumulative effect of accounting change	(0.01)		
	$1.13	$0.78	$(0.38)

NOTE 10

STOCK OPTIONS AND RIGHTS

Options

The Company had the following fixed stock option plans, under which shares were available for grant at December 31, 2000: the 1991 Stock Incentive Plan (the "1991 Plan"), the 1995 Employee Stock Incentive Plan (the "1995 Plan"), the 1996 Stock Option Plan (the "1996 Plan"), the 1998 Stock Incentive Plan (the "1998 Plan"), the Promotion, Marketing and Endorsement Stock Incentive Plan (the "Promotion Plan") and the Non-Employee Directors Stock Option Plan (the "Directors Plan").

The 1991 Plan, the 1996 Plan and the 1998 Plan permit the granting of options or other stock awards to the Company's officers, employees and consultants. Under the 1991 Plan, option prices may be less than the market value at the date of grant, while under the 1996 Plan and the 1998 Plan options may not be granted at option prices that are less than fair market value at the date of grant. The 1995 Plan permits the granting of options or other stock awards to only non-executive officer employees and consultants of the Company at option prices that may be less than market value at the date of grant. The 1995 Plan and 1996 Plan were amended in 2000 to increase the maximum number of shares of Common Stock to be issued upon exercise of an option to 9,300,000 and 9,000,000 shares respectively.

During 1996 and 1995, the Company granted options to purchase shares to two key officers, under separate plans, in conjunction with terms of their initial employment (the "Key Officer Plans"). No shares are available for grant under the Key Officer Plans as of December 31, 2000.

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

The following table presents shares authorized, available for future grant and outstanding under each of the Company's plans as of December 31, 2000:

(in thousands)	Authorized	Available	Outstanding
1991 Plan	10,000	60	2,076
Promotion Plan	3,560	816	1,014
1995 Plan	9,300	2,363	6,135
1996 Plan	9,000	2,275	5,967
1998 Plan	500	250	250
Key Officer Plans	1,100		820
Directors Plan	840	52	496
TOTAL	34,300	5,816	16,758

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

The following summarizes stock option transactions for the years ended December 31, 2000, 1999 and 1998:

(in thousands, except per share data)	Year ended December 31,					
	2000		1999		1998	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	15,747	$20.46	13,637	$22.62	11,257	$22.41
Granted	4,461	$13.71	4,012	$11.30	4,020	$25.04
Exercised	(2,252)	$10.64	(851)	$ 6.40	(441)	$10.16
Canceled	(1,198)	$25.01	(1,051)	$24.95	(1,199)	$34.86
Outstanding at end of year	16,758	$19.66	15,747	$20.46	13,637	$22.62
Options exercisable at end of year	12,394	$19.99	11,066	$18.64	6,039	$17.78
Price range of outstanding options	$2.50 - $40.00		$0.44 - $40.00		$0.44 - $40.00	

The exercise price of all options granted during 2000 was equal to the market value on the date of grant. The following table summarizes additional information about outstanding stock options at December 31, 2000:

OPTIONS OUTSTANDING AND EXERCISABLE BY PRICE RANGE AS OF DECEMBER 31, 2000:

Range of Exercise Price	Number Outstanding (in thousands)	Weighted-Average Remaining Contractual Life - Years	Weighted-Average Exercise Price	Number Exercisable (in thousands)	Weighted-Average Exercise Price
$2.50 - $10	494	1.53	$ 3.39	482	$ 3.22
$10 - $15	7,145	6.17	$12.50	4,915	$12.12
$15 - $25	2,916	5.05	$18.20	2,185	$18.46
$25 - $40	6,203	4.50	$29.88	4,812	$30.39
$2.50 - $40	16,758	5.22	$19.66	12,394	$19.99

During 2000, the Company, at its discretion, extended the expiration terms or accelerated the vesting of 622,000 options held by certain employees and officers. Also, during 1999, the Company, at its discretion, extended the expiration terms of 1,532,000 options held by certain employees and officers. At the time of the modifications, the exercise prices of the options were in excess of the then-current market price and accordingly this action did not result in compensation expense for the Company.

During 1998, the Company modified certain terms of 720,000 options held by directors, certain officers and employees. These modifications, which largely resulted from the Company's restructuring plan, included acceleration of vesting and extension of expiration terms at the Company's discretion. At the time of modification, the exercise prices of the options were in excess of the then-current market price and accordingly this action did not result in compensation expense for the Company.

Also during 1998, the Company canceled 150,000 options held by non-employees with option prices in excess of the then-current market price of the Company's stock. The Company then reissued an equivalent number of options to these non-employees at the then-current market price and extended certain expiration terms, and recorded the related compensation expense of $71,000. An additional $195,000 was recorded in unearned compensation, and is being amortized over the remaining vesting periods.

Rights

The Company has granted officers, consultants, and employees rights to receive an aggregate of 826,800 shares of Common Stock for services or other consideration. During 1998, 80,000 rights were exercised while none were granted. No rights were granted or exercised during 2000 or 1999. At December 31, 2000, no rights to receive shares of Common Stock remained outstanding.

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

Restricted Common Stock

During 1998, the Company granted 130,000 shares of Restricted Common Stock to 26 officers of the Company. Of these shares, 68,250 shares have been canceled due to the service requirement not being met. The shares, which are restricted as to sale or transfer until vesting, will vest on January 1, 2003. The related net compensation expense of $1,914,000 is being recognized ratably over the vesting period, based on the difference between the exercise price and market value of the stock on the measurement date.

Employee Stock Purchase Plan

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

During 2000, 1999 and 1998, approximately 412,000, 378,000 and 386,000 shares, respectively, of the Company's Common Stock were purchased under the 1999 ESPP or the ESPP. As of December 31, 2000, 1,588,000 shares were reserved for future issuance under the 1999 ESPP.

Compensation Expense

During 2000, 1999 and 1998, the Company recorded $2,162,000, $1,370,000 and $2,321,000, respectively, in compensation expense for Restricted Common Stock and certain options to purchase shares of Common Stock granted to employees, officers, professional endorsers and consultants of the Company. The valuation of options granted to non-employees is estimated using the Black-Scholes option pricing model.

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

Pro Forma Disclosures

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

(in thousands, except per share data)	Year Ended December 31,		
	2000	1999	1998
Net income (loss):			
As reported	$80,999	$55,322	$(26,564)
Pro forma	$58,761	$34,422	$(46,847)
Earnings (loss) per common share:			
As reported			
Basic	$1.16	$0.79	$(0.38)
Diluted	$1.13	$0.78	$(0.38)
Pro forma			
Basic	$0.84	$0.49	$(0.67)
Diluted	$0.83	$0.48	$(0.67)

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

	Year Ended December 31,		
	2000	1999	1998
Dividend yield	1.1%	1.4%	1.9%
Expected volatility	53.0%	45.6%	42.0%
Risk free interest rates	5.18% - 5.56%	5.36% - 6.24%	4.66% - 4.72%
Expected lives	3 - 4 years	3 - 4 years	3 - 6 years

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

Note 11

Employee Benefit Plans

The Company has a voluntary deferred compensation plan under Section 401(k) of the Internal Revenue Code (the "401(k) Plan") for all employees who satisfy the age and service requirements under the 401(k) Plan. Each participant may elect to contribute up to 10% of annual compensation, up to the maximum permitted under federal law, and the Company is obligated to contribute annually an amount equal to 100% of the participant's contribution up to 6% of that participant's annual compensation. Employees contributed $6,119,000, $5,486,000 and $5,601,000 to the 401(k) Plan in 2000, 1999 and 1998, respectively. In accordance with the provisions of the 401(k) Plan, the Company matched employee contributions in the amount of $4,706,000, $4,510,000 and $4,673,000 during 2000, 1999 and 1998, respectively. Additionally, the Company can make discretionary contributions based on the profitability of the Company. For the years ended December 31, 2000 and 1999, the Company recorded compensation expense for discretionary contributions of $3,799,000 and $3,605,000. No discretionary contributions were made for the year ended December 31, 1998.

The Company also has an unfunded, nonqualified deferred compensation plan. The plan allows officers, certain other employees and directors of the Company to defer all or part of their compensation, to be paid to the participants or their designated beneficiaries upon retirement, death or separation from the Company. For the years ended December 31, 2000, 1999 and 1998, the total participant deferrals, which are reflected in long-term liabilities, were $843,000, $997,000 and $908,000, respectively. Included in other income during 1999 were net proceeds from an insurance policy related to the deferred compensation plan of $3,622,000.

Note 12

Income Taxes

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

(in thousands)	Year Ended December 31,		
	2000	1999	1998
United States	$101,890	$75,799	$(34,555)
Foreign	27,432	9,698	(4,344)
	$129,322	$85,497	$(38,899)

The provision (benefit) for income taxes is as follows:

(in thousands)	Year Ended December 31,		
	2000	1999	1998
Current tax provision:			
United States	$26,616	$14,779	$ 21,345
State	5,130	2,774	2,296
Foreign	10,623	3,044	250
Deferred tax expense (benefit):			
United States	7,463	8,956	(31,173)
State	(1,596)	1,162	(4,847)
Foreign	(870)	(540)	(206)
Income tax provision (benefit):	$47,366	$30,175	$(12,335)

During 2000, 1999 and 1998, the Company recognized certain tax benefits related to stock option plans in the amount of $6,806,000, $2,377,000 and $3,068,000, respectively. Such benefits were recorded as a reduction of income taxes payable and an increase in additional paid-in capital.

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2000 and 1999 are as follows:

(in thousands)	December 31,	
	2000	1999
Deferred tax assets:		
Reserves and allowances	$22,365	$28,052
Depreciation and amortization	12,225	16,601
Compensation and benefits	7,208	7,010
Effect of inventory overhead adjustment	1,934	1,977
Compensatory stock options and rights	3,473	2,573
Foreign net operating loss carryforwards	107	798
Revenue recognition	1,320	
Other	1,793	441
Restructuring charges		
Long-lived asset impairment	1,738	1,740
Rental/lease arrangements		557
Capital loss carryforward	834	829
Tax credit carryforwards	3,200	2,827
Total deferred tax assets	56,197	63,405
Valuation allowance for deferred tax assets	(1,354)	(4,190)
Deferred tax assets, net of valuation allowance	54,843	59,215
Deferred tax liabilities:		
State taxes, net of federal income tax benefit	(2,157)	(2,128)
Net deferred tax assets	$52,686	$57,087

At December 31, 2000, the Company had tax credit carryforwards primarily relating to state investment tax credits which have expiration dates beginning with December 31, 2006.

A valuation allowance has been established due to the uncertainty of realizing certain tax credits, carryforwards, and a portion of other deferred tax assets. The valuation allowance was decreased by $2,836,000 during 2000, of which $2,373,000 was attributable to state research and investment tax credits. Based on management's assessment, it is more likely than not that all the net deferred tax assets will be realized through future earnings or implementation of tax planning strategies.

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

(in thousands)	Year Ended December 31,		
	2000	1999	1998
Amounts computed at statutory U.S. tax rate	$45,263	$29,924	$(13,615)
State income taxes, net of U.S. tax benefit	4,112	3,046	(1,501)
State tax credits, net of U.S. tax benefit	(325)	(2,075)	
Nondeductible foreign losses	65	(476)	1,226
Expenses with no tax benefit	931	814	1,064
Nondeductible capital losses		130	588
Foreign sales corporation tax benefits	(1,487)	(1,471)	(236)
Nontaxable insurance proceeds		(1,408)	
Change in tax valuation allowance	(2,836)	2,431	
Other	1,643	(740)	139
Income tax provision (benefit)	$47,366	$30,175	$(12,335)

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

Note 13

Commitments and Contingencies

On July 24, 2000, Bridgestone Sports Co., Ltd. ("Bridgestone") filed a complaint for patent infringement in the United States District Court for the Northern District of Georgia, Civil Action No. 100-CV-1871, against Callaway Golf Company, Callaway Golf Ball Company (collectively "Callaway Golf"), and a golf retailer located in Georgia (the "U.S. Action"). Bridgestone alleges in the U.S. Action that the manufacture and sale of the Company's Rule 35® golf ball infringes four U.S. golf ball patents owned by Bridgestone. Bridgestone is seeking unspecified damages and

injunctive relief. On September 12, 2000, Callaway Golf answered the complaint and asserted affirmative counterclaims against Bridgestone seeking a judicial declaration that Callaway Golf does not infringe the Bridgestone patents, that the patents are invalid, and that Bridgestone engaged in inequitable conduct in the United States Patent and Trademark Office. On October 13, 2000, Bridgestone and the retailer defendant entered into a consent judgment discontinuing the U.S. Action against the retailer. The parties are engaged in discovery. No trial date has been set by the District Court.

On December 14, 2000, Bridgestone filed an action in the Tokyo, Japan, District Court asserting patent infringement against Callaway Golf's wholly-owned subsidiary, Callaway Golf K.K., based on its sale of Rule 35® golf balls in Japan (the "Japan Action"). Only one of the Bridgestone golf ball patents at issue in the U.S. Action has issued in Japan. Callaway Golf K.K. has denied the claims asserted in the Japan Action.

The Company and its subsidiaries, incident to their business activities, are parties to a number of legal proceedings, lawsuits and other potential claims. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, management is unable to ascertain the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance, or the financial impact with respect to these matters as of December 31, 2000. However, management believes that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon the Company's annual consolidated financial position, results of operations or cash flows.

The Company leases certain warehouse, distribution and office facilities, as well as office and manufacturing equipment under operating leases. Lease terms range from one to 10 years with options to renew at varying terms. The Company has guaranteed the residual value of equipment leased pursuant to an operating lease which is subject to renewal. The residual value guarantee, which approximates estimated fair market value of the equipment at each option period, is reduced over time. Commitments for minimum lease payments under non-cancelable operating leases having initial or remaining non-cancelable terms in excess of one year as of December 31, 2000 are as follows:

(in thousands)

2001	$12,264
2002	7,114
2003	2,041
2004	1,889
2005	1,744
Thereafter	4,113
	$29,165

Future minimum lease payments have not been reduced by future minimum sublease rentals of $1,928,000 under an operating lease. At December 31, 2000, the Company is contingently liable for $5,625,000 through February 2003 under an operating lease that was assigned to a third party (Note 14). Rent expense for the years ended December 31, 2000, 1999 and 1998 was $3,197,000, $2,315,000 and $17,654,000, respectively. Rent expense for 1999 does not include a credit of $6,076,000 related to the reversal of a restructuring reserve for excess lease costs (Note 14). Rent expense for 1998 includes $13,466,000 in excess lease costs related to the Company's restructuring activities (Note 14). The Company had no capital leases at December 31, 2000.

NOTE 14

RESTRUCTURING

During the fourth quarter of 1998, the Company recorded a restructuring charge of $54,235,000 resulting from a number of cost reduction actions and operational improvements. These actions included: the consolidation of the operations of the Company's wholly-owned subsidiary, Odyssey, into the operations of the Company while maintaining the distinct and separate Odyssey® brand; the discontinuation, transfer or suspension of certain initiatives not directly associated with the Company's core business, such as the Company's involvement with interactive golf sites, golf book publishing, new player development and a golf venue in Las Vegas; and the re-sizing of the Company's core business to reflect current and expected business conditions. These initiatives were completed during 1999, with the exception of cash outlays related to the assignment of a lease obligation for a facility in New York City that continued through July 2000. The restructuring charges (shown below in tabular format) primarily related to: 1) the elimination of job responsibilities, resulting in costs incurred for employee severance; 2) the decision to exit certain non-core business activities, resulting in losses on disposition of the Company's 80% interest in CGMV (Note 15), a loss on the sale of the business of All-American (Note 15), as well as excess lease costs; and 3) consolidation of the Company's continuing operations resulting in impairment of assets, losses on disposition of assets and excess lease costs.

Employee reductions occurred in almost all areas of the Company, including manufacturing, marketing, sales, and administrative areas. At December 31, 1998, the Company had reduced its non-temporary work force by approximately 750 positions. Although substantially all reductions occurred prior to December 31, 1998, a small number of reductions occurred in the first quarter of 1999.

During the restructuring, the Company consolidated its operations and sold certain of its buildings, which housed a portion of its manufacturing and research and development activities. Other write-downs were recorded during 1998 for idle assets, assets whose manner of use had changed significantly and equipment replaced as a result of capital improvements. The impaired assets included buildings, building improvements, and machinery and equipment used in certain of the Company's manufacturing and research and development activities.

The projected future cash flows from these assets were less than the carrying values of the assets. The carrying values of the assets held for sale and the assets to be held and used were reduced to their estimated fair values based on independent appraisals of selling values and values of similar assets sold, less costs to sell. In 1998, the Company recorded losses from impairment of assets of $12,634,000, which were recorded as restructuring costs. The Company completed the dispositions in 1999. At December 31, 1998, subsequent to the write-down for impairments, the carrying amount of the assets held for disposal and assets to be held and used was $13,678,000 and $4,582,000, respectively. The Company continued to depreciate the assets that were held and used but did not further depreciate the assets held for disposition. The effect on depreciation for the years ended December 31, 2000 and 1999 did not materially impact the Company's results of operations and management does not expect this effect to materially impact future results of operations.

Details of the one-time charge are as follows:

(in thousands)	Cash/ Non-Cash	One-Time Charge	Activity	Reserve Balance at 12/31/98	Activity [1]	Reserve Balance at 12/31/99	Activity	Reserve Balance at 12/31/00
Elimination of Job Responsibilities		$11,664	$8,473	$3,191	$3,191			
Severance packages	Cash	11,603	8,412	3,191	3,191			
Other	Non-cash	61	61					
Exiting Certain Non-Core Business Activities		$28,788	$12,015	$16,773	$15,394	$1,379	$1,379	
Loss on disposition of subsidiaries	Non-cash	13,072	10,341	2,731	2,731 [2]	1,379	1,379	
Excess lease costs	Cash	12,660	146	12,514	11,135			
Contract cancellation fees	Cash	2,700	1,504	1,196	1,196			
Other	Cash	356	24	332	332			
Consolidation of Operations		$13,783	$2,846	$10,937	$10,937			
Loss on impairment/disposition of assets	Non-cash	12,364	2,730	9,634	9,634 [3]			
Excess lease costs	Cash	806	4	802	802 [4]			
Other	Cash	613	112	501	501			

[1] Includes reversal of reserve totaling $8,609,000, as actual amounts differed from estimates. Significant reversals are noted below in [2] through [4].

[2] Includes reversal of $6,076,000 of reserve due to the assignment of lease obligation at terms significantly more favorable than estimated at the establishment of the reserve.

[3] Includes reversal of $1,470,000 of reserve related to disposition of two buildings at higher sales prices than estimated.

[4] Includes reversal of $491,000 of reserve due to the sublease of a facility at terms more favorable than estimated at the establishment of the reserve.

During 1999, the Company incurred charges of $1,295,000 on the disposition of building improvements eliminated during the consolidation of manufacturing operations, as well as other charges of $671,000. These charges did not meet the criteria for accrual in 1998. Additionally, in 1999, the Company incurred charges of $749,000 related to asset dispositions and other restructuring activities for which reserves were not established in 1998. No charges were incurred during 2000.

Note 15

AQUISITIONS AND REORGANIZATIONS

On December 29, 2000, the Company consolidated a wholly-owned subsidiary, Callaway Golf Ball Company, with the Company. During 1999, the Company acquired distribution rights and substantially all of the assets from its distributor in Ireland for $810,000. Also in 1999, the Company merged its subsidiary, Callaway Golf Europe, S.A., with another of its subsidiaries, Callaway Golf Europe, Ltd. and now operates in France through a satellite office. During 1998, the Company acquired distribution rights and substantially all of the assets from its distributors in Korea, Canada, France, Belgium, Norway and Denmark, as well as the remaining 20% interest in Callaway Golf Trading GmbH (Note 17), the results of which are consolidated in the results of Callaway Golf (Germany) GmbH. The aggregate purchase price for these transactions was $27,229,000, excluding the assumption and subsequent retirement of short-term debt obligations of $10,373,000. The excess of the purchase price over net assets acquired of $20,935,000 was allocated to goodwill and is being amortized over estimated useful lives of three to 10 years. These acquisitions, along with the acquisition of the remaining 80% interest in All-American (discussed below) are not considered significant business combinations. Accordingly, pro forma financial information is not presented.

In May 1998, the Company acquired for $4,526,000 the remaining 80% interest in All-American, which operates a nine-hole golf course, performance center, training facility and driving range located in Las Vegas, Nevada. On December 30, 1998, as part of its business plan to discontinue certain non-core business activities, the Company sold the business of All-American in exchange for barter trade credits, which were recorded at the fair market value of the asset exchanged. The Company recorded a loss on the disposition of this business of $10,341,000 in December 1998 (Note 14).

Note 16

SEGMENT INFORMATION

The Company's operating segments are organized on the basis of products and include golf clubs and golf balls. The Golf Clubs segment consists of Callaway Golf® titanium and stainless steel metal woods and irons, Callaway Golf® and Odyssey® putters and wedges and related accessories. The Golf Balls segment consists of golf balls that are designed, manufactured, marketed and distributed by the Company. All Other segments, including interactive golf sites, golf book publishing, new player development and a driving range venture, are aggregated as they do not meet requirements for separate disclosure set forth in SFAS No. 131. In accordance with its restructuring, the Company is no longer pursuing these initiatives (Note 14). There are no significant intersegment transactions. In 2000, management changed its method of allocating certain corporate costs and other income (expense) used in evaluating segment income (loss) before tax. As a result, certain amounts are not attributable to the segments in the determination of segment income (loss) before tax. Prior period amounts have been reclassified to reflect the current allocation methodology. The tables below contain information utilized by management to evaluate its operating segments.

(in thousands)	2000	1999	1998
Net sales			
Golf Clubs	$803,663	$719,038	$703,060
Golf Balls	33,964		
All Other			
	$837,627	$719,038	$703,060
Income (loss) before tax			
Golf Clubs	$213,786	$175,794	$ 47,493
Golf Balls	(45,918)	(36,097)	(21,826)
All Other			(26,089)
Reconciling items[1]	(38,546)	(54,200)	(38,477)
	$129,322	$ 85,497	$ (38,899)
Depreciation and amortization			
Golf Clubs	$ 34,326	$ 36,151	$ 34,121
Golf Balls	5,923	3,726	1,072
All Other			692
	$ 40,249	$ 39,877	$ 35,885
Additions to long-lived assets			
Golf Clubs	$ 24,703	$ 10,210	$ 39,854
Golf Balls	3,683	46,912[2]	47,721
All Other			1,408
	$ 28,386	$ 57,122	$ 88,983

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

[2] Includes amounts converted to an operating lease in 1999.

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

The Company, through a distribution agreement, had appointed Sumitomo as the sole distributor of Callaway Golf® clubs in Japan. The distribution agreement, which began in February 1993 and ended on December 31, 1999, required Sumitomo to purchase specified minimum quantities. In 1999 and 1998, sales to Sumitomo

accounted for 7% and 8%, respectively, of the Company's net sales. In the fourth quarter of 1999, the Company successfully completed negotiations with Sumitomo to provide a smooth transition of its business. As a result of this transition agreement, the Company recorded a net charge of $8.6 million in the fourth quarter of 1999 for buying certain current inventory, payments for non-current inventory and other transition expenses, including foreign currency transaction losses. Odyssey® brand products are sold through the Company's wholly-owned Japanese subsidiary, Callaway Golf K.K., and beginning January 1, 2000, Callaway Golf® brand products were sold through this subsidiary.

(in thousands)	Sales	Long-Lived Assets
2000		
United States	$451,264	$228,920
Europe	125,511	11,229
Japan	122,003	3,229
Rest of Asia	82,371	994
Other foreign countries	56,478	3,164
Total	$837,627	$247,536
1999		
United States	$418,397	$241,241
Europe	115,673	14,027
Japan	55,927	2,634
Rest of Asia	73,121	974
Other foreign countries	55,920	3,481
Total	$719,038	$262,357
1998		
United States	$442,043	$277,611
Europe	117,107	17,789
Japan	61,460	857
Rest of Asia	34,189	1,194
Other foreign countries	48,261	3,122
Total	$703,060	$300,573

Note 17

TRANSACTIONS WITH RELATED PARTIES

During 1998, the Company entered into an agreement with Callaway Editions, Inc. to form CGMV, a limited liability company that was owned 80% by the Company and 20% by Callaway Editions, Inc. ("Callaway Editions"). Callaway Editions is a publishing and media company which is owned 9% by Ely Callaway, Chairman, President and Chief Executive Officer of the Company, and 81% by his son, Nicholas Callaway. CGMV was formed to produce print and other media products that relate to the game of golf. Pursuant to the agreement, the Company agreed to loan CGMV up to $20,000,000 for working capital, subject to CGMV's achievement of certain milestones to the satisfaction of the Company in its sole discretion. Also pursuant to the agreement, CGMV was obligated to pay an annual management fee of $450,000 to Callaway Editions. In conjunction with the Company's restructuring plan, the Company committed to sell or assign its interest in CGMV to Callaway Editions. Accordingly, the Company recorded a charge in operations to December 1998 based on the December 31, 1998 book value of CGMV (Note 14).

During 1999, the Company forgave the existing loan balance from CGMV of approximately $2,142,000, sold its interest to Callaway Editions for a nominal amount and paid $1,000,000 as consideration for release from its obligation to loan CGMV up to $20,000,000. These transactions did not result in a charge in 1999, as they were adequately accrued in the 1998 restructuring reserve (Note 14).

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

Report of Independent Accountants

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

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of cash flows and of shareholders' equity present fairly, in all material respects, the financial position of Callaway Golf Company and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company changed its revenue recognition policy effective January 1, 2000.

PricewaterhouseCoopers LLP

San Diego, California
March 19, 2001

Summarized Quarterly Financial Data (Unaudited)[1]

(in thousands, except per share data)	Fiscal Year 2000 Quarters[3]				
	1st	2nd	3rd	4th	Total
Net sales	$197,406	$289,922	$208,081	$142,218	$837,627
Gross profit	$ 88,265	$144,507	$102,031	$ 62,705	$397,508
Net income	$ 12,141	$ 44,189	$ 20,055	$ 4,614	$ 80,999
Earnings per common share[2]					
Basic	$0.17	$0.63	$0.29	$0.07	$1.16
Diluted	$0.17	$0.61	$0.29	$0.07	$1.13

	Fiscal Year 1999 Quarters				
	1st	2nd	3rd	4th	Total
Net sales	$186,747	$231,205	$184,488	$116,598	$719,038
Gross profit	$ 82,868	$107,479	$ 89,545	$ 55,881	$334,773
Net income	$ 12,823	$ 24,771	$ 17,572	$ 156	$ 55,322
Earnings per common share[2]					
Basic	$0.18	$0.35	$0.25	$0.00	$0.79
Diluted	$0.18	$0.35	$0.25	$0.00	$0.78

[1] Shipping revenues and expenses have been reclassified in accordance with Emerging Issues Task Force Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs."
[2] Earnings per share is computed individually for each of the quarters presented; therefore, the sum of the quarterly earnings per share may not necessarily equal the total for the year.
[3] Effective January 1, 2000, Callaway Golf adopted Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements”. Accordingly, Callaway Golf has restated its results for all quarters of the year ended December 31, 2000.

Market for Common Shares and Related Shareholder Matters

The Company’s Common Shares are traded on the New York Stock Exchange (NYSE). The Company’s symbol for its Common Shares is “ELY.” As of March 5, 2001, the approximate number of holders of record of the Company’s Common Stock was 9,000.

Stock Price Information

	Year ended December 31,					
	2000			1999		
Period:	High	Low	Dividend	High	Low	Dividend
First Quarter	$17.75	$11.00	$0.07	$11.44	$10.00	$0.07
Second Quarter	$20.56	$14.81	$0.07	$16.69	$12.19	$0.07
Third Quarter	$16.69	$12.44	$0.07	$14.63	$ 9.31	$0.07
Fourth Quarter	$19.56	$14.50	$0.07	$18.00	$11.69	$0.07

DIRECTORS AND OFFICERS

Directors

ELY CALLAWAY
Founder, Chairman, President
and Chief Executive Officer

CHARLES J. YASH
Vice Chairman of the Board and
Senior Executive Vice President,
Growth in Golf

WILLIAM C. BAKER
Director, The Meditrust Companies

VERNON E. JORDAN, JR.
Senior Managing Director,
Lazard Freres and Co., LLC

YOTARO KOBAYASHI
Chairman, Fuji Xerox Co., Ltd.

AULANA L. PETERS
Retired Partner, Gibson, Dunn &
Crutcher LLP
Director of the Public Oversight Board

RICHARD L. ROSENFIELD
Co-Founder and Co-Chairman of the
Board, California Pizza Kitchen, Inc.

Officers

ELY CALLAWAY
Founder, Chairman, President
and Chief Executive Officer

CHARLES J. YASH
Vice Chairman of the Board and
Senior Executive Vice President,
Growth in Golf

RONALD A. DRAPEAU
Senior Executive Vice President,
Manufacturing

RICHARD C. HELMSTETTER
Senior Executive Vice President,
Chief of New Products

STEVEN C. McCRACKEN
Senior Executive Vice President,
Chief Legal Officer and Secretary

BRADLEY J. HOLIDAY
Executive Vice President and
Chief Financial Officer

MICHAEL W. McCORMICK
Executive Vice President, Global Sales

IAN B. ROWDEN
Executive Vice President,
Global Advertising

JAMES P. CHENEVEY
Senior Vice President,
International Sales

LARRY DORMAN
Senior Vice President, Global Press and
Public Relations

MICHAEL J. GALESKI
Senior Vice President, Pro Tour Relations

GEOFFREY P. M. GOODMAN
Senior Vice President,
Research and Development

CHRISTOPHER J. HOLIDAY
Senior Vice President, U.S. Sales

DONNA L. KAPTAIN
Senior Vice President, Human Resources

CAROL A. KERLEY
Senior Vice President, I.S. and
Chief Information Officer

ROBERT A. PENICKA
Senior Vice President, Golf Ball
Manufacturing

KENNETH E. WOLF
Senior Vice President, Finance, Planning
and Analysis

Corporate Data

The 2001 Annual Meeting of Shareholders will be held at 10:00 a.m. on Wednesday, May 2, 2001, at the Four Seasons Resort Aviara, 7100 Four Seasons Point, Carlsbad, California 92009

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San Diego, California 92101

Transfer Agent and Registrar
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www.chasemellon.com

Independent Counsel
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Jamboree Center
4 Park Plaza
Irvine, California 92614

Copy of Form 10-K
A copy of the Company's annual report on Form 10-K as filed with the Securities and Exchange Commission, without exhibits, may be obtained without charge by any shareholder via e-mail to invrelations@callawaygolf.com or upon written request to:
Ms. Krista Mallory
Director of Investor Relations
Callaway Golf Company
2180 Rutherford Road
Carlsbad, California 92008-7328

Visit our Web Site
Visit Callaway Golf Company on the Internet at: www.callawaygolf.com for more information on the following:

- Callaway Golf® clubs
- Callaway Golf® balls
- Odyssey® putters
- Callaway Golf® & Odyssey® accessories
- Callaway Golf tour player profiles, stats and news
- Corporate information & news releases
- Customer service
- International locations and news

Or, call our Investor Relations Department at: 760-931-1771

Important Notice to Shareholders

Statements used in this report that relate to future plans, events, financial results or performance are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are based upon current information and expectations. Actual results may differ materially from those anticipated as a result of certain risks and uncertainties. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers also are urged to review and consider carefully the various disclosures made by the Company which describe certain factors which affect the Company's business, including the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations – Certain Factors Affecting Callaway Golf Company," as well as the Company's periodic reports on Forms 10-K and 10-Q and Current Reports on Form 8-K filed with the Securities and Exchange Commission from time to time. Readers also should be aware that while the Company does, from time to time, 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. Reports issued by securities analysts are not the responsibility of the Company and shareholders 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: Biggest Big Bertha – Big Bertha – CB1 – Callaway – Callaway Golf – Demonstrably Superior and Pleasingly Different – Dual Force – ERC – ERC II – Firmfeel – Gems – Ginty – Great Big Bertha – Hawk Eye – Odyssey – Odyssey Golf – RCH – Rule 35 – Softfeel – S2H2 – Steelhead – Steelhead Plus – TriHot – Tungsten Titanium – Tungsten•Injected – VFT – War Bird – White Hot – X-12 – X-14

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