

October 1, 2007

**Key Metrics**

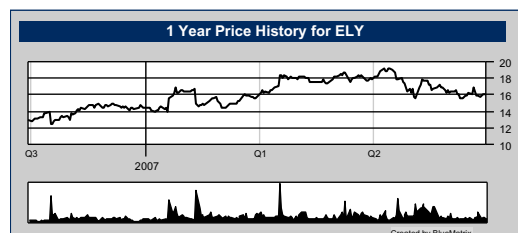
ELY - NYSE	\$16.64
Pricing Date	10/01/2007
Price Target	\$22.00
52-Week Range	\$19.49-\$12.26
Shares Outstanding (mm)	70.8
Market Capitalization (\$mm)	\$1,178.1
3-Mo Average Daily Volume	935,353
Institutional Ownership	82%
Debt/Total Capital	12.2%
ROE	4.8%
Book Value/Share	\$8.61
Price/Book	1.9x
Dividend Yield	1.8%
LTM EBITDA Margin	13.80%

**EPS(\$)** FY: December

	2006E	Prior 2007E	Curr. 2007E	Prior 2008E	Curr. 2008E
1Q-Mar	0.33A	--	0.48A	--	0.54E
2Q-Jun	0.35A	--	0.55A	--	0.64E
3Q-Sep	(0.15)A	(0.02)E	(0.06)E	--	0.01E
4Q-Dec	(0.13)A	(0.09)E	(0.11)E	--	(0.04)E
FY	0.42E	0.92E	0.86E	--	1.15E
P/E	39.6x		19.3x		14.5x

**Revenue(\$mm)**

	2006E	Prior 2007E	Curr. 2007E	Prior 2008E	Curr. 2008E
1Q-Mar	302.4	--	334.6A	--	350.0E
2Q-Jun	341.8	--	380.0A	--	395.0E
3Q-Sep	193.8	--	205.0E	--	220.0E
4Q-Dec	179.9	175.0E	165.0E	--	190.0E
FY	1,017.9	1,094.6E	1,084.6E	--	1,155.0E



**Company** Description: *Company* Description:  
 (www.callawaygolf.com) Callaway Golf Company, together with its subsidiaries, engages in the design, manufacture, and sale of golf clubs and golf balls. The company's products include drivers, fairway woods, hybrids, irons, wedges, putters, golf balls, golf bags, golf gloves, golf headwear, golf towels, golf umbrellas, and footwear. In addition, it licenses its trademarks and service marks in exchange for a royalty fee to third parties for use of its products.

## Callaway Golf Company

### Rating: Buy

#### 2008 Product Line Building Off Recent Successes With Some New Twists

**Investment Highlights:**

- **Early look at 2008 product line looks promising.** We got a sneak peek at Callaway's 2008 product line and would not be surprised to see Callaway's new products well represented on 2008 hot lists.
- **FT-i Squareway to be expanded into fairway wood category.** We expect Callaway to introduce the FT-i Squareway 3, 5, and 7 wood for men/women. While expected to retail at a lower price than the FT-i driver, which is normal for fairway woods, fairway woods tend to sell more units as a typical golfer carries multiple fairway woods vs. one driver.
- **Hybrid irons should add to an already strong line.** Callaway's X-20 and X-Forged irons should return in 2008. Adding to these top-selling products should be an FT i-brid set that brings a hybrid look and feel to the traditional 3, 4, and 5 irons within the set. A Big Bertha version should also be available at lower price points.
- **4-piece ball targeting high-end dollars.** While the HX Hot golf ball will still be available, we expect a newer and higher priced 4-piece ball to be released. The ball should compete with the Pro V1 for low handicappers' dollars.
- **New Top-Flite balls/clubs could add to mass retail channel distribution.** The re-launching of the Top-Flite brand should be expanded to include the Top-Flite Gamer (softer ball with more control) and Top-Flite The Freak (distance) golf balls and a series of Top Flite club sets offered at lower price ranges. This line could be a nice fit for mass retail channels.
- **Trimming 3Q/4Q non-peak selling quarters' estimated EPS.** Following three consecutive months of positive Y/Y rounds played reports, August rounds played, according to the National Golf Foundation DMA rounds report, declined 2.7%. While not a significant data point, we believe the current economic/retail climate calls for a more conservative stance. Therefore, we are lowering our EPS estimates slightly during the company's non-peak selling quarters.
- **No change to our high long-term expectations - Maintaining Buy rating.** While lowering our estimates slightly, we believe retailer reception to the new line has been positive and should limit concerns over challenging comparables in 2008. The strong product lines coupled with cost reductions should return EBIT margins to 15% in the next two to three years with free cash flow approaching \$100mm.

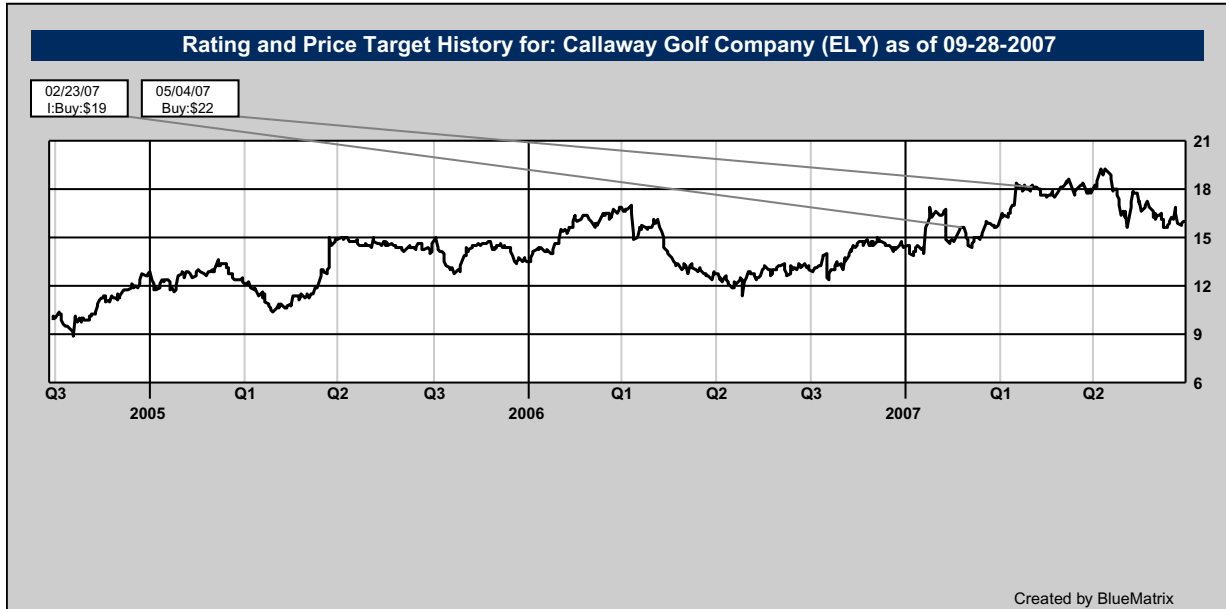
## Callaway Golf (ELY)

(In Millions, Except Per Share Data)

Quarter End	FY 2005	Q1 Mar-06	Q2 Jun-06	Q3 Sep-06	Q4 Dec-06	FY 2006	Q1 Mar-07	Q2 Jun-07	Q3E Sep-07	Q4E Dec-07	FYE 2007	Q1E Mar-08	Q2E Jun-08	Q3E Sep-08	Q4E Dec-08	FYE 2008
<b>Sales</b>	<b>998.1</b>	<b>302.4</b>	<b>341.8</b>	<b>193.8</b>	<b>179.9</b>	<b>1017.9</b>	<b>334.6</b>	<b>380.0</b>	<b>205.0</b>	<b>165.0</b>	<b>1084.6</b>	<b>350.0</b>	<b>395.0</b>	<b>220.0</b>	<b>190.0</b>	<b>1155.0</b>
<i>% Increase</i>	6.8%	0.9%	5.8%	-12.2%	16.4%	2.0%	10.6%	11.2%	5.8%	-8.3%	6.6%	4.6%	3.9%	7.3%	15.2%	6.5%
Cost of Goods Sold	575.2	170.3	200.1	124.8	119.4	614.6	173.9	202.0	115.8	97.4	589.1	179.2	205.4	118.8	106.6	610.0
<i>As % Sales</i>	57.6%	56.3%	58.5%	64.4%	66.4%	60.4%	52.0%	53.2%	56.5%	59.0%	54.3%	51.2%	52.0%	54.0%	56.1%	52.8%
<i>% Increase</i>	2.7%	3.7%	14.3%	-4.2%	13.1%	6.9%	2.1%	0.9%	-7.2%	-18.5%	-4.2%	3.1%	1.7%	2.6%	9.5%	3.6%
<b>Gross Profit</b>	<b>422.9</b>	<b>132.2</b>	<b>141.7</b>	<b>68.9</b>	<b>60.5</b>	<b>403.3</b>	<b>160.7</b>	<b>178.0</b>	<b>89.2</b>	<b>67.7</b>	<b>495.6</b>	<b>170.8</b>	<b>189.6</b>	<b>101.2</b>	<b>83.4</b>	<b>545.0</b>
<i>Margin</i>	42.4%	43.7%	41.5%	35.6%	33.6%	39.6%	48.0%	46.8%	43.5%	41.0%	45.7%	48.8%	48.0%	46.0%	43.9%	47.2%
<i>% Increase</i>	12.9%	-2.6%	-4.3%	-23.6%	23.7%	-4.6%	21.6%	25.6%	29.3%	11.8%	22.9%	6.3%	6.5%	13.5%	23.3%	10.0%
Selling Expense	289.9	67.8	76.4	55.9	51.2	251.2	75.3	80.9	63.6	51.2	270.9	78.1	83.7	67.5	57.8	287.1
<i>As % Sales</i>	29.0%	22.4%	22.3%	28.8%	28.5%	24.7%	22.5%	21.3%	31.0%	31.0%	25.0%	22.3%	21.2%	30.7%	30.4%	24.9%
<i>% Increase</i>	10.2%	-10.4%	-15.7%	-19.9%	-5.1%	-13.3%	11.1%	6.0%	13.7%	-0.1%	7.8%	3.7%	3.5%	6.3%	12.9%	6.0%
G&A	67.9	20.2	18.1	20.9	20.5	79.7	21.6	24.2	24.6	21.1	91.5	22.4	24.9	24.2	22.8	94.3
<i>As % Sales</i>	6.8%	6.7%	5.3%	10.8%	11.4%	7.8%	6.4%	6.4%	12.0%	12.8%	8.4%	6.4%	6.3%	11.0%	12.0%	8.2%
<i>% Increase</i>	-11.9%	10.3%	-6.1%	44.8%	29.1%	17.4%	6.6%	33.6%	17.7%	3.1%	14.7%	3.9%	2.9%	-1.6%	8.0%	3.1%
R & D	27.0	6.8	6.2	6.8	7.0	26.8	8.0	7.9	7.8	6.9	30.6	8.3	8.2	7.3	7.2	31.0
<i>As % Sales</i>	2.7%	2.2%	1.8%	3.5%	3.9%	2.6%	2.4%	2.1%	3.8%	4.2%	2.8%	2.4%	2.1%	3.3%	3.8%	2.7%
<i>% Increase</i>	-11.7%	9.0%	-12.6%	-4.6%	6.9%	-0.8%	17.8%	27.7%	14.8%	-1.0%	14.4%	3.5%	3.5%	-6.7%	4.5%	1.2%
Operating Expense	384.8	94.8	100.6	83.6	78.7	357.7	104.9	113.0	95.9	79.2	393.0	108.7	116.8	99.0	87.8	412.4
<i>As % Sales</i>	38.5%	31.3%	29.4%	43.1%	43.7%	35.1%	31.3%	29.7%	46.8%	48.0%	36.2%	31.1%	29.6%	45.0%	46.2%	35.7%
<b>Operating Profit</b>	<b>38.2</b>	<b>37.4</b>	<b>41.1</b>	<b>-14.6</b>	<b>-18.2</b>	<b>45.6</b>	<b>55.9</b>	<b>65.0</b>	<b>-6.8</b>	<b>-11.6</b>	<b>102.6</b>	<b>62.1</b>	<b>72.8</b>	<b>2.2</b>	<b>-4.4</b>	<b>132.6</b>
<i>Margin</i>	3.8%	12.4%	12.0%	-7.5%	-10.1%	4.5%	16.7%	17.1%	-3.3%	-7.0%	9.5%	17.7%	18.4%	1.0%	-2.3%	11.5%
<i>% Increase</i>	904.7%	5.4%	31.8%	NA	33.7%	19.6%	49.4%	58.4%	53.7%	36.5%	124.8%	11.1%	12.0%	132.4%	61.9%	29.3%
Interest Expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Income	-2.7	0.3	-1.3	-1.1	0.0	-2.1	-1.3	-1.9	-0.5	-0.5	-4.2	-0.5	-0.5	-0.5	-0.5	-2.0
<b>Pretax Profit</b>	<b>35.5</b>	<b>37.7</b>	<b>39.8</b>	<b>-15.7</b>	<b>-18.2</b>	<b>43.6</b>	<b>54.5</b>	<b>63.1</b>	<b>-7.3</b>	<b>-12.1</b>	<b>98.3</b>	<b>61.6</b>	<b>72.3</b>	<b>1.7</b>	<b>-4.9</b>	<b>130.6</b>
<i>Margin</i>	3.6%	12.5%	11.6%	-8.1%	-10.1%	4.3%	16.3%	16.6%	-3.5%	-7.3%	9.1%	17.6%	18.3%	0.8%	-2.6%	11.3%
<i>% Increase</i>	641.3%	9.9%	35.6%	NA	34.6%	22.8%	44.7%	58.7%	53.7%	33.8%	125.7%	12.9%	14.5%	123.2%	59.4%	32.9%
Taxes(benefit)	9.2	14.2	15.8	-5.3	-9.7	15.0	21.7	24.7	-2.8	-4.6	39.0	23.7	27.8	0.7	-1.9	50.3
<i>Rate</i>	26.0%	37.7%	39.7%	33.8%	53.2%	34.5%	39.8%	39.2%	38.5%	38.5%	39.7%	38.5%	38.5%	38.5%	38.5%	38.5%
<b>Net Income--Oper.</b>	<b>26.3</b>	<b>23.5</b>	<b>24.0</b>	<b>-10.4</b>	<b>-8.5</b>	<b>28.5</b>	<b>32.8</b>	<b>38.4</b>	<b>-4.5</b>	<b>-7.4</b>	<b>59.3</b>	<b>37.9</b>	<b>44.5</b>	<b>1.0</b>	<b>-3.0</b>	<b>80.3</b>
<i>Margin</i>	2.6%	7.8%	7.0%	-5.4%	-4.7%	2.8%	9.8%	10.1%	-2.2%	-4.5%	5.5%	10.8%	11.3%	0.5%	-1.6%	7.0%
<i>% Increase</i>	256.6%	12.9%	17.0%	NA	-44.8%	8.6%	39.8%	60.1%	57.0%	13.1%	107.9%	15.3%	15.8%	123.2%	59.4%	35.4%
<b>EPS--Operations</b>	<b>0.38</b>	<b>0.33</b>	<b>0.35</b>	<b>-0.15</b>	<b>-0.13</b>	<b>0.42</b>	<b>0.48</b>	<b>0.55</b>	<b>-0.06</b>	<b>-0.11</b>	<b>0.86</b>	<b>0.54</b>	<b>0.64</b>	<b>0.01</b>	<b>-0.04</b>	<b>1.15</b>
<i>% Increase</i>	248.8%	10.5%	17.1%	NA	42.9%	9.8%	43.5%	58.5%	58.2%	16.9%	105.9%	12.5%	14.6%	122.9%	59.4%	33.8%
Shares Out. Diluted	69.2	70.1	68.6	67.0	67.0	68.5	68.3	69.3	69.0	70.0	69.1	70.0	70.0	70.0	70.0	70.0

Source: Company reports and Morgan Joseph estimates

**Required Disclosures**



**Price Target**

Our price target is \$22.00.

**Valuation Methodology**

Our price target is derived from a 10.0x multiple on our FTME TEV/EBITDA. This multiple is in line with the company's five-year historical average.

**Risk Factors**

- Sales are susceptible to seasonality and unpredictable weather.
- Innovation and competition pose potential market share threats.
- The USGA regulates equipment guidelines and their impact on the sport.
- International business exposes Callaway to foreign currency risks.

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Rating	Investment Banking Services/Past 12 Mos.	
	Percent	Percent
<b>BUY [B]</b>	<b>65.38</b>	<b>33.82</b>
<b>HOLD [H]</b>	<b>31.73</b>	<b>9.09</b>
<b>SELL [S]</b>	<b>2.88</b>	<b>0.00</b>

## Meaning of Ratings

- A) Buy means reasonable outperformance relative to the market over 12-18 months.
- B) Hold means market-type risk adjusted performance; potential source of funds.
- C) Sell means expected to underperform the market.

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