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Company Update

EQUITY RESEARCH

October 31, 2008

Callaway Golf Company

Rating: Buy

3Q Roughly In-Line; New Products Could Expand 4Q Y/Y Sales; Buy

Key Metrics

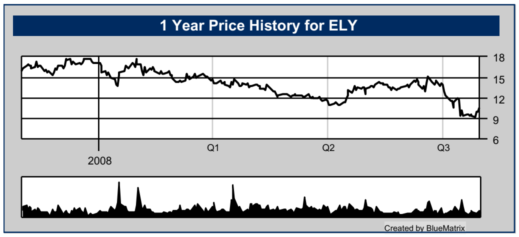
ELY - NYSE	$10.53
Pricing Date	10/30/2008
Price Target	$16.00
52-Week Range	$18.20-$9.00
Shares Outstanding (mm)	62.5
Market Capitalization ($mm)	$658.1
3-Mo Average Daily Volume	801,622
Institutional Ownership	82%
Debt/Total Capital	6.3%
ROE	9.9%
Book Value/Share	$9.54
Price/Book	1.1x
Dividend Yield	2.8%
LTM EBITDA Margin	11.65%

EPS($) FY: December

	2007A	Prior 2008E	Curr. 2008E	Prior 2009E	Curr. 2009E
1Q-Mar	0.48	--	0.61A	--	0.63E
2Q-Jun	0.55	--	0.63A	--	0.65E
3Q-Sep	0.06	(0.09)E	(0.08)A	--	0.05E
4Q-Dec	(0.24)	--	(0.21)E	--	(0.19)E
FY	0.88	--	0.96E	--	1.14E
P/E	12.0x		11.0x		9.2x

Revenue($mm)

	2007A	Prior 2008E	Curr. 2008E	Prior 2009E	Curr. 2009E
1Q-Mar	334.6	--	366.5A	--	360.0E
2Q-Jun	380.0	--	366.0A	--	365.0E
3Q-Sep	235.5	213.0E	213.5A	--	230.0E
4Q-Dec	174.4	--	185.0E	--	185.0E
FY	1,124.6	1,130.5E	1,130.9E	--	1,140.0E



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.*

Investment Highlights:

- **Callaway reported EPS of ($0.08), $0.01 better than our estimate.** Callaway reported EPS of ($0.08), excluding after-tax charges of $0.04 associated with the company's margin improvement initiatives. The lower Y/Y results were generated primarily from reduced sales levels and lower gross margins. Operating expenses declined slightly, in dollars, Y/Y.
- **Strong comps, second-year product lines, slowing economy reduce Y/Y sales 9%.** A drop in international sales during the final weeks of 3Q08, ongoing domestic weakness, and challenging comps (3Q07 sales up 22% Y/Y), lowered 3Q08 sales 9%. US and European sales declined 16% and 19%, respectively, with Japan continuing to demonstrate Y/Y gains. With two key products in the second year of a two-year life cycle, a 40% decline in wood sales, although more pronounced than projected, was expected. Easier comparisons and the introduction of select new products for the holiday season could turn sales trends positive in 4Q08.
- **Cost reductions appear on track, yet product mix hits margins.** Gross margins contracted 250bps due to reduced sales leverage and product mix as customers appeared to gravitate towards more lower priced and lower margined items. The gross margin initiative appears on track to eliminate another $20-$30mm in 2009 and 2010 cost savings. While uncertainties remain for next year, a new 2009 product line should aide profits with introductions of higher margin merchandise. Operating costs declined, in dollars Y/Y, as the company continues to monitor costs amidst this challenging environment.
- **Balance sheet remains strong; no long-term debt.** Callaway's balance sheet remained strong with $51mm in cash and $40mm in debt (zero long-term debt). Despite sales slowing very late in the quarter, inventories increased slightly Y/Y and appear on track to decline FY/FY.
- **2009 product line shaping up well; possibly stronger than 2007's.** Management continues to stress the strength of the company's new product line for 2009. Bookings are up for the 2009 line compared to 2007 and 2008; at the same time, sell through for 2009 products is apparently ahead of schedule for the holiday season.
- **We maintain our Buy rating and $16.00 price target.** Callaway continues to maintain a strong balance sheet, solid free cash flow, and improving EPS. While the global slowdown has most likely extended the time frame for Callaway to achieve 15% EBIT margins, an apparently strong 2009 product line, coupled with ongoing cost reductions, should provide solid near-term EPS gains with greater growth potential should economic conditions improve.

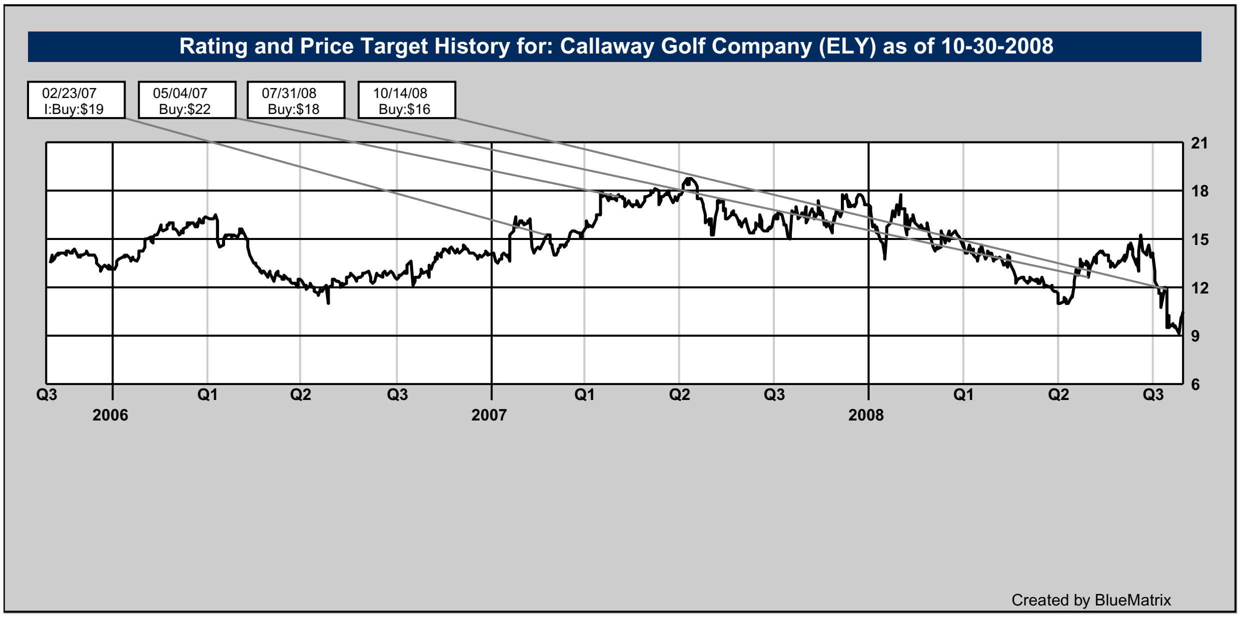
The Disclosure section may be found on pages 3 - 4 of this report.
The Valuation section may be found on page 3 of this report.

Callaway Golf (ELY)
(In Millions, Except Per Share Data)

Quarter End	FY 2006	Q1 Mar-07	Q2 Jun-07	Q3 Sep-07	Q4 Dec-07	FY 2007	Q1 Mar-08	Q2 Jun-08	Q3 Sep-08	Q4E Dec-08	FYE 2008	Q1E Mar-09	Q2E Jun-09	Q3E Sep-09	Q4E Dec-09	FYE 2009
Sales	**1017.9**	**334.6**	**380.0**	**235.5**	**174.4**	**1124.6**	**366.5**	**366.0**	**213.5**	**185.0**	**1130.9**	**360.0**	**365.0**	**230.0**	**185.0**	**1140.0**
% Increase	2.0%	10.6%	11.2%	21.6%	-3.0%	10.5%	9.5%	-3.7%	-9.4%	6.1%	0.6%	-1.8%	-0.3%	7.8%	0.0%	0.8%
Cost of Goods Sold	614.6	173.9	202.9	137.4	109.6	623.9	190.9	190.3	129.7	113.8	624.6	182.9	185.1	128.1	109.2	605.2
As % Sales	60.4%	52.0%	53.4%	58.3%	62.8%	55.5%	52.1%	52.0%	60.8%	61.5%	55.2%	50.8%	50.7%	55.7%	59.0%	53.1%
% Increase	6.9%	2.1%	1.4%	10.1%	-8.2%	1.5%	9.8%	-6.3%	-5.6%	3.8%	0.1%	-4.2%	-2.7%	-1.2%	-4.1%	-3.1%
Gross Profit	**403.3**	**160.7**	**177.1**	**98.1**	**64.8**	**500.7**	**175.5**	**175.8**	**83.8**	**71.2**	**506.3**	**177.1**	**179.9**	**101.9**	**75.9**	**534.8**
Margin	39.6%	48.0%	46.6%	41.7%	37.2%	44.5%	47.9%	48.0%	39.2%	38.5%	44.8%	49.2%	49.3%	44.3%	41.0%	46.9%
% Increase	-4.6%	21.6%	25.0%	42.3%	7.1%	24.1%	9.2%	-0.7%	-14.6%	9.9%	1.1%	0.9%	2.4%	21.6%	6.5%	5.6%
Selling Expense	251.2	75.3	80.9	65.8	60.0	282.0	80.2	80.5	65.7	60.5	286.8	81.0	82.1	65.1	63.1	291.3
As % Sales	24.7%	22.5%	21.3%	27.9%	34.4%	25.1%	21.9%	22.0%	30.8%	32.7%	25.4%	22.5%	22.5%	28.3%	34.1%	25.6%
% Increase	-13.3%	11.1%	6.0%	17.8%	17.1%	12.2%	6.5%	-0.6%	-0.2%	0.9%	1.7%	1.0%	2.1%	-0.9%	4.3%	1.6%
G&A	79.7	21.6	24.2	19.4	23.9	89.1	22.5	22.8	20.2	24.0	89.5	22.7	22.6	23.9	25.0	94.2
As % Sales	7.8%	6.4%	6.4%	8.2%	13.7%	7.9%	6.1%	6.2%	9.5%	13.0%	7.9%	6.3%	6.2%	10.4%	13.5%	8.3%
% Increase	17.4%	6.6%	33.6%	-7.2%	16.8%	11.7%	4.3%	-5.8%	4.2%	0.3%	0.5%	0.9%	-0.7%	18.4%	4.1%	5.3%
R & D	26.8	8.0	7.9	7.9	8.2	32.0	7.9	7.5	6.7	8.0	30.1	8.0	7.6	8.0	7.5	31.1
As % Sales	2.6%	2.4%	2.1%	3.4%	4.7%	2.8%	2.2%	2.1%	3.1%	4.3%	2.7%	2.2%	2.1%	3.5%	4.1%	2.7%
% Increase	-0.8%	17.8%	27.7%	16.8%	16.7%	19.5%	-1.1%	-4.7%	-16.1%	-2.1%	-6.0%	1.0%	0.8%	20.3%	-6.3%	3.3%
Operating Expense	357.7	104.9	113.0	93.1	92.0	403.0	110.6	110.8	92.6	92.5	406.4	111.7	112.4	97.0	95.6	416.6
As % Sales	35.1%	31.3%	29.7%	39.5%	52.8%	35.8%	30.2%	30.3%	43.4%	50.0%	35.9%	31.0%	30.8%	42.2%	51.7%	36.5%
Operating Profit	**45.6**	**55.9**	**64.1**	**5.0**	**(27.2)**	**97.7**	**65.0**	**65.0**	**(8.8)**	**(21.3)**	**99.9**	**65.4**	**67.6**	**4.9**	**(19.7)**	**118.2**
Margin	4.5%	16.7%	16.9%	2.1%	-15.6%	8.7%	17.7%	17.8%	-4.1%	-11.5%	8.8%	18.2%	18.5%	2.1%	-10.7%	10.4%
% Increase	19.6%	49.4%	56.1%	134.2%	NM	114.1%	16.3%	1.4%	NM	NM	2.3%	0.7%	4.0%	NM	NM	18.3%
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	(2.1)	(1.3)	(1.9)	1.2	0.1	(1.9)	0.7	(2.6)	(1.7)	0.0	(3.6)	0.0	0.0	0.0	0.0	0.0
Pretax Profit	**43.6**	**54.5**	**62.2**	**6.2**	**(27.1)**	**95.8**	**65.7**	**62.4**	**(10.5)**	**(21.3)**	**96.3**	**65.4**	**67.6**	**4.9**	**(19.7)**	**118.2**
Margin	4.3%	16.3%	16.4%	2.6%	-15.6%	8.5%	17.9%	17.0%	-4.9%	-11.5%	8.5%	18.2%	18.5%	2.1%	-10.7%	10.4%
% Increase	22.8%	44.7%	56.3%	139.7%	NM	119.8%	20.4%	0.3%	NM	NM	0.6%	-0.3%	8.3%	NM	NM	22.7%
Taxes(benefit)	15.1	21.7	24.4	2.4	(11.9)	36.6	26.0	22.3	(5.3)	(8.2)	34.8	25.2	26.0	1.9	(7.6)	45.5
Rate	34.8%	39.8%	39.2%	39.1%	43.8%	38.2%	39.6%	35.7%	50.6%	38.5%	36.1%	38.5%	38.5%	38.5%	38.5%	38.5%
Net Income--Oper.	**28.4**	**32.8**	**37.8**	**3.8**	**(15.2)**	**59.2**	**39.7**	**40.1**	**(5.2)**	**(13.1)**	**61.5**	**40.2**	**41.6**	**3.0**	**(12.1)**	**72.7**
Margin	2.8%	9.8%	10.0%	1.6%	-8.7%	5.3%	10.8%	11.0%	-2.4%	-7.1%	5.4%	11.2%	11.4%	1.3%	-6.6%	6.4%
% Increase	8.2%	39.8%	57.8%	136.1%	NM	108.3%	20.8%	6.0%	NM	NM	3.9%	1.5%	3.6%	NM	NM	18.2%
EPS--Operations	**0.41**	**0.48**	**0.55**	**0.06**	**(0.24)**	**0.88**	**0.61**	**0.63**	**(0.08)**	**(0.21)**	**0.96**	**0.63**	**0.65**	**0.05**	**(0.19)**	**1.14**
% Increase	9.3%	43.5%	56.3%	135.7%	NM	111.5%	27.3%	14.9%	NM	NM	9.9%	3.0%	3.7%	NM	NM	18.0%
Shares Out. Diluted	68.5	68.3	69.3	67.6	63.8	67.5	64.8	63.9	62.5	63.2	63.8	63.9	63.9	63.9	63.9	63.9

Source: Company Reports and Morgan Joseph estimates

Required Disclosures



Price Target

Our price target is $16.

Valuation Methodology

Our $16 price target is derived from a 6.5x multiple to our FTM estimated EV/EBITDA.

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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		Investment Banking Services/Past 12 Mos.
Rating	**Percent**	**Percent**
BUY [B]	**56.38**	**37.74**
HOLD [H]	**42.55**	**30.00**
SELL [S]	**1.06**	**0.00**

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 over 12-18 months.

Other Disclosures

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