G WILLI FOOD INTERNATIONAL LTD
Form 6-K
November 30, 2011

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF
THE SECURITIES EXCHANGE ACT OF 1934

For the month of November 2011

G. WILLI-FOOD INTERNATIONAL LTD.
(Translation of registrant's name into English)

4 Nahal Harif St., Yavne, Israel 81106
(Address of principal executive offices)

Indicate by check mark whether registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

FORM 20-F x FORM 40-F o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):..........

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):............

Indicate by check mark whether registrant by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

YES o NO x

If "YES" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-________.

Attached hereto and incorporated by reference herein is a press release ("Press Release") issued by G. Willi-Food International Ltd. (“Registrant”) on November 28, 2011.

The financial tables attached to the Press Release are hereby incorporated by reference in the Registration Statements on Form F-3 (File No. 333-11848 and 333-138200) of the Registrant.

SIGNATURES

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

G. WILLI-FOOD
INTERNATIONAL LTD.

Dated: November 28, 2011

By: /s/ Baruch Shusel
Name: Baruch Shusel
Title: Chief Financial Officer

FOR IMMEDIATE RELEASE

G. WILLI-FOOD REPORTS Q3 2011 SALES UP 7% OVER Q3 2010 SALES

2011 Q3 Net Income of US$ 0.6 million

YAVNE, Israel – November 28, 2011 -- G. Willi-Food International Ltd. (NASDAQ: WILC) (the "Company" or "Willi-Food"), a global company specializing in the development, manufacturing, marketing and international distribution of kosher foods, today announced its unaudited financial results for the third quarter and the nine-months ended September 30, 2011.

Third Quarter Fiscal 2011 Highlights

- Sales increased 7.1% over third quarter of 2010 to NIS 85.3 million (US$ 23.0 million)
- Gross profit decreased 14.7% over third quarter of 2010 to NIS 21.0 million (US$ 5.7 million), or 24.7% of sales
- Operating income decreased 51.7% over third quarter of 2010 to NIS 4.0 million (US$ 1.1 million), or 4.7% of sales
- Net income decreased 71.2% over third quarter of 2010 to NIS 2.26 million (US$ 0.6 million), or 2.6% of sales
- Net income attributed to the owners of the Company decreased 67.6% over third quarter of 2010 to NIS 2.35 million (US$ 0.63 million), or 2.7% of sales
- Cash and securities balance of NIS 194.2 million (US$ 52.3 million) as of September 30, 2011

Willi-Food's operating divisions include Willi-Food, a distributor of a broad variety of kosher foods, its wholly-owned Gold Frost - a designer, developer and distributor of branded kosher dairy food products, and Shamir Salads - an Israeli distributor and manufacturer of Mediterranean style salads.

Third Quarter Fiscal 2011 Summary

Sales for the third quarter of 2011 increased by 7.1% to NIS 85.3 million (US$ 23.0 million) compared to sales of NIS 79.7 million (US$ 21.5 million) in the third quarter of 2010. The growth in sales in the third quarter was primarily due to increased awareness to the Company's new products following intensified sales activities that the Company initiated during 2011.

Gross profit for the third quarter of 2011 decreased by 14.7% to NIS 21.0 million (US$ 5.7 million) compared to gross profit of NIS 24.7 million (US$ 6.6 million) in the third quarter of 2010. Third quarter gross margin was 24.7% compared to gross margin of 30.9% for the same period in 2010. The decrease in gross profit and gross margins was primarily due to the reductions in the prices of certain of our products as a result of continued pressure from our customers to reduce prices as a result of national protests against the cost of food products, due to an increase in global prices of food products compounded by the recent strengthening of the U.S. dollar versus the NIS (a depreciation of 8.7% of the value of the NIS in the third quarter of 2011) and due to the general effects of the global economic recession. The Company expects a further decline in its gross margins in the fourth quarter of 2011 and in the first quarter of 2012. To the extent that customer pressure to reduce prices continues, or that global prices of food products continue to increase, or that the depreciation of the NIS versus the U.S. dollar continues, the Company's gross margins may be impacted beyond the first quarter of 2012.

Mr. Zwi Williger, Chairman of Willi-Food commented, "Third quarter results were affected by the national protest against the cost of food products which led our customers to reduce the selling prices of food products, pressuring us to decrease our selling prices to them. This quarter was also affected by the increase in global purchase prices, the depreciation of the NIS versus the U.S. dollar, an environment of continued uncertainty in the global financial

markets, and a recession that is seen both in our home market and abroad. We believe that Willi-Food's results in the fourth quarter of 2011 and in 2012 will be affected by the economic situation and significant recession that has affected our customers and the global markets."

Willi-Food's operating income for the third quarter of 2011 decreased 51.7% to NIS 4.0 million (US$ 1.1 million) over the third quarter of 2010. Selling expenses increased by 4.2% from the comparable quarter of 2010. Selling expenses as a percentage of sales decreased in the third quarter of 2011 to 13.1% compared to 13.4% in the third quarter of 2010. General and administrative expenses decreased by 13.8% from the comparable quarter of 2010. General and administrative expenses as a percentage of sales decreased in the third quarter of 2011 to 5.7% from 7.1% in the third quarter of 2010. Most of the other expenses that were recorded in the third quarter of 2011 are a one-time expense resulting from an impairment charge in the amount of NIS 1.1 million ($0.3 million) on intangible assets in Shamir Salads.

Willi-Food's income before taxes for the third quarter of 2011 decreased 67.2% to NIS 3.3 million (US$ 0.9 million) over the third quarter of 2010. Willi-Food's net income in the third quarter of 2011 decreased 71.2% to NIS 2.3 million (US$ 0.6 million) from NIS 7.8 million (US$ 2.1 million) recorded in the third quarter of 2010. Willi-Food's net income attributed to the owners of the Company in the third quarter of 2011 decreased 67.6% to NIS 2.3 million (US$ 0.6 million), or NIS 0.17 (US$ 0.05) per share, compared to NIS 7.2 million (US$ 2.0 million), or NIS 0.53 (US$ 0.14) per share, recorded in the third quarter of 2010.

Willi-Food generated NIS 9.6 million (US$ 2.6 million), or NIS 0.71 (US$ 0.19) per share from continuing operating activities in the third quarter of 2011.

Willi-Food ended the third quarter of 2011 with NIS 194.2 million (US$ 52.3 million) in cash and securities and NIS 3.3 million (US$ 0.9 million) in short-term debt (51% of the debt of Shamir Salads). Willi-Food's shareholders' equity at the end of September 2011 was NIS 322.5 million (US$ 86.9 million).

Nine-Month Results

Willi-Food's sales for the nine-month period ending September 30, 2011 increased by 2.9% to NIS 264.7 million (US$ 71.3 million) compared to sales of NIS 257.3 million (US$ 69.3 million) in the first nine-months of 2010. Gross profit for the period decreased 6.0% to NIS 70.9 million (US$19.1 million) compared to gross profit of NIS 75.4 million (US$ 20.3 million) for the nine-month period in 2010. First nine-month gross margins in 2011 were 26.8% compared to gross margins of 29.3% in the same period of 2010.

Operating income for the first nine months of 2011 decreased by 7.7% to NIS 22.5 million (US$ 6.1 million) from NIS 25.6 million (US$ 6.9 million) reported in the comparable period of last year. First nine-month of 2011 income before taxes decreased by 25.6% to NIS 20.8 million (US$ 5.6 million) compared to NIS 28.0 million (US$ 7.5 million) recorded in the first nine months of 2010. Net income for the first nine months of 2011 decreased by 28.7% to NIS 15.7 million (US$ 4.2 million) from NIS 22.1 million (US $5.9 million) in the first nine months of 2010. Net income attributable to the owners of the Company for the first nine months of 2011 decreased by 25.9% to NIS 15.4 million (US $4.1 million), or NIS 1.13 (US$ 0.30) per share compared to net income attributable to the owners of the Company for the first nine months of 2010 of NIS 20.7 million (US$ 5.6 million), or NIS 1.64 (US$ 0.44) per share.

Business Outlook

Mr. Williger commented, "Looking forward, we are facing a significant increase in the level of uncertainty in the global economy. In Israel, economic uncertainty is coupled with changes in the Israeli market that we expect will negatively affect our results in the remainder of 2011 and the beginning of 2012. On the other hand, our top line growth reflected the synergies we have created to channel the broad range of products coming from our own sourcing and that of our subsidiaries. We expect this growth to cease in the remainder of 2011 due to the global and Israeli economic situations, which we expect will affect our customer base, both in the retail and wholesale markets, in Israel and abroad. We therefore expect net income for the fourth quarter of 2011 and the first quarter of 2012 to be significantly lower compared to comparable prior quarters. Nevertheless, this period of economic uncertainty presents an opportunity for Willi-Food to utilize its cash on hand to purchase synergetic companies at lower prices than before.

We continue looking for opportunities to create additional value for our shareholders."

Mr. Williger concluded, “In light of the anticipated continued recession, our foreseeable challenges ahead will be to manage our expenses, and in particular the cost of our products, to an acceptable degree in order to accommodate our consumers' continued anticipated desire to acquire lower cost products. We hope that in these difficult times we will be able to maintain our customer base both in the retail and wholesale markets.”

Conference Call

The Company will host a conference call to discuss results on Monday, November 28, 2011 at 11:00 AM Eastern time. Interested parties may participate in the conference call by dialing 1-877-941-2068 (US), or 1-480-629-9712 (International), approximately 10 minutes prior to the scheduled start time. Interested parties can also listen via a live Internet webcast, which will be available on the day of the call through the following link: http://viavid.net/dce.aspx?sid=000090F6

A replay of the conference call will be available for 14 days from 2:00 PM EST on November 28, 2011 through 11:59 PM EST on December 12, 2011 by dialing 1-877-870-5176 (US), or 1-858-384-5517 (International), access code 4491030. In addition, a recording of the call will be available via the link shown above for one year.

NOTE A: Convenience Translation to Dollars
The convenience translation of New Israeli Shekels (NIS) into U.S. dollars was made at the rate of exchange prevailing on September 30, 2011, U.S. $1.00 equals NIS 3.712. The translation was made solely for the convenience of the reader.

NOTE B: IFRS
The Company’s consolidated financial results for the three-month and nine-month ended September 30, 2011 are presented in accordance with International Financial Reporting Standards (“IFRS”).

NOTE C: Discontinued Operations
Discontinued operations are measured and presented in accordance with the provisions of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

The results of discontinued operations are presented in the income statement in a separate item below income from continuing operations.

ABOUT G. WILLI-FOOD INTERNATIONAL LTD.

G. Willi-Food International Ltd. (http://www.willi-food.com) is an Israeli-based company specializing in high-quality, great-tasting kosher food products. Willi-Food is engaged directly and through its subsidiaries in the design, import, manufacture, marketing and distribution of over 1,000 food products worldwide. As one of Israel's leading food importers, Willi-Food markets and sells its food products to over 1,500 customers in Israel and around the world including large retail and private supermarket chains, wholesalers and institutional consumers. The company's operating divisions include Willi-Food in Israel; Gold Frost, a wholly owned subsidiary who designs, develops and distributes branded kosher, dairy-food products; and Shamir Salads, an Israeli manufacturer and distributor of a broad line of over 400 Mediterranean-style chilled salads.

This press release contains forward-looking statements within the meaning of safe harbor provisions of the Private Securities Litigation Reform Act of 1995 relating to future events or our future performance, such as statements regarding trends, demand for our products and expected sales, operating results, and earnings. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity,

performance or achievements expressed or implied in those forward-looking statements. These risks and other factors include but are not limited to: monetary risks including changes in marketable securities or changes in currency exchange rates- especially the NIS/U.S. Dollar exchange rate, payment default by any of our major clients, the loss of one of more of our key personnel, changes in laws and regulations, including those relating to the food distribution industry, and inability to meet and maintain regulatory qualifications and approvals for our products, termination of arrangements with our suppliers, in particular Arla Foods, loss of one or more of our principal clients, increase or decrease in global purchase prices of food products, increasing levels of competition in Israel and other markets in which we do business, changes in economic conditions in Israel, including in particular economic conditions in the Company's core markets, our inability to accurately predict consumption of our products, our inability to successfully integrate our recent acquisitions, insurance coverage not sufficient enough to cover losses of product liability claims and risks associated with product liability claims. We cannot guarantee future results, levels of activity, performance or achievements. The matters discussed in this press release also involve risks and uncertainties summarized under the heading "Risk Factors" in the Company's Annual Report on Form 20-F for the year ended December 31, 2010, filed with the Securities and Exchange Commission on June 30, 2011. These factors are updated from time to time through the filing of reports and registration statements with the Securities and Exchange Commission. We do not assume any obligation to update the forward-looking information contained in this press release.

{FINANCIAL TABLES TO FOLLOW}

G. WILLI-FOOD INTERNATIONAL LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2011	December 31, 2010	September 30, 2011	December 31, 2010
	NIS		US dollars (*)	
	(in thousands)			
ASSETS				
Current assets				
Cash and cash equivalents	24,866	113,631	6,699	30,612
Financial assets carried at fair value through profit or loss	169,357	67,890	45,624	18,289
Trade receivables	87,633	85,902	23,608	23,141
Other receivables and prepaid expenses	1,960	2,307	528	621
Inventories	43,504	37,614	11,720	10,133
Total current assets	327,320	307,344	88,179	82,796
Non-current assets				
Property, plant and equipment	72,136	71,350	19,434	19,222
Less -Accumulated depreciation	23,195	20,512	6,249	5,526
	48,941	50,838	13,185	13,696
Prepaid expenses	2,366	2,405	637	648
Goodwill	1,936	1,936	522	522
Intangible assets	2,633	4,067	709	1,095
Deferred taxes	1,449	694	391	187
Total non-current assets	57,325	59,940	15,444	16,148
	384,645	367,284	103,623	98,944
EQUITY AND LIABILITIES				
Current liabilities				
Short-term bank credit	6,548	5,780	1,764	1,557
Trade payables	37,868	32,959	10,202	8,879
Employees Benefits	2,882	3,057	776	824
Accruals	465	268	125	72
Current tax liabilities	7,389	5,910	1,990	1,592
Other payables and accrued expenses	5,562	10,326	1,499	2,781
Total current liabilities	60,714	58,300	16,356	15,705
Non-current liabilities				
Long-term bank loans	-	309	-	83
Deferred taxes	164	522	44	141
Employees Benefits	1,254	1,281	338	345
Total non-current liabilities	1,418	2,112	382	569
Shareholders' equity				
Share capital NIS 0.10 par value (authorized - 50,000,000 shares, issued and outstanding – 13,573,679 shares at September 30, 2011 and December 31, 2010)	1,444	1,444	389	389

Additional paid in capital	128,863	128,863	34,716	34,715
Capital fund	247	247	67	67
Foreign currency translation reserve	649	736	175	198
Retained earnings	185,423	170,060	49,952	45,813
Noncontrolling interest	5,887	5,522	1,586	1,488
	322,513	306,872	86,885	82,670
	384,645	367,284	103,623	98,944

(*) Convenience translation into U.S. dollars

G. WILLI-FOOD INTERNATIONAL LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Nine-months ended September 30,		Three months ended September 30,		Nine-months ended September 30,	
	2011	2010	2011	2010	2011	2010
	NIS				US dollars (*)	
	In thousands (except per share and share data)					
Sales	264,663	257,304	85,342	79,710	71,300	69,317
Cost of sales	193,770	181,885	64,299	55,051	52,202	48,999
Gross profit	70,893	75,419	21,043	24,659	19,098	20,318
Selling expenses	31,294	32,800	11,162	10,714	8,431	8,836
General and administrative expenses	16,190	17,019	4,884	5,666	4,362	4,585
Other income	900	(33)	1,003	3	242	(9)
Total operating expenses	48,384	49,786	17,049	16,383	13,035	13,412
Operating income	22,509	25,633	3,994	8,276	6,063	6,906
Financial income	(940)	3,218	(580)	2,143	(253)	867
Financial expense	764	890	108	345	205	240
Total financial income (expenses)	(1,704)	2,328	(688)	1,798	(458)	627
Income before taxes on income	20,805	27,961	3,306	10,074	5,605	7,533
Taxes on income	5,077	6,716	1,051	2,246	1,368	1,809
Income from continuing operations	15,728	21,245	2,255	7,828	4,237	5,724
Income from discontinued operations	-	830	-	-	-	224
Net income	15,728	22,075	2,255	7,828	4,237	5,948
Owners of the Company	15,363	20,741	2,345	7,247	4,139	5,589
Non-controlling interest	365	1,334	(90)	581	98	359
Net income	15,728	22,075	2,255	7,828	4,237	5,948
Earnings per share data:						
Earnings per share:						
Basic from continuing operations	1.13	1.57	0.17	0.53	0.30	0.45
	-	0.07	-	-	-	0.02

Basic from discontinued operations						
Basic	1.13	1.64	0.17	0.53	0.30	0.47
Diluted from continuing operations	1.13	1.57	0.17	0.53	0.30	0.45
Diluted from discontinued operations	-	0.07	-	-	-	0.02
Diluted	1.13	1.64	0.17	0.53	0.30	0.47
Shares used in computing basic and diluted earnings per ordinary share:	13,573,679	12,641,278	13,573,679	13,573,679	13,573,679	12,641,278

(*) Convenience translation into U.S. dollars.

G. WILLI-FOOD INTERNATIONAL LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine-months		Three months		Nine-months	
	ended September 30,				ended September 30,	
	2011	2010	2011	2010	2011	2010
	NIS				US dollars (*)	
	(in thousands)					
CASH FLOWS - OPERATING ACTIVITIES						
Profit from continuing operations	15,728	21,245	2,255	7,828	4,237	5,724
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	5,530	3,623	2,569	1,230	1,490	976
Deferred expenses	-	695	-	237	-	187
Deferred income taxes	(1,113)	(104)	(257)	172	(300)	(28)
Capital Gain on disposal of property plant and equipment	(86)	(33)	16	3	(23)	(9)
Unrealized loss on marketable securities	5,482	(1,521)	2,188	(2,058)	1,478	(410)
Revaluation of loans from banks and others	-	(11)	-	(8)	-	(3)
Employees benefit, net	(27)	77	(71)	50	(7)	21
Changes in assets and liabilities:						
Increase (Decrease) in trade receivables and other receivables	(1,384)	(2,417)	4,424	4,586	(373)	(651)
Decrease (Increase) in inventories	(5,890)	2,700	(1,716)	4,139	(1,587)	727
Decrease in long term receivables	-	350	-	209	-	94
Increase (Decrease) in payables and other current liabilities	1,559	(8,853)	183	1,512	420	(2,385)
Net cash from (used in) continuing operating activities	19,799	15,751	9,591	17,900	5,335	4,243
Net cash from (used in) discontinued operating activities	-	(22)	-	-	-	-

(*) Convenience translation into U.S. dollars.

G. WILLI-FOOD INTERNATIONAL LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine-months Ended September 30,		Three months		Nine-months Ended September 30,	
	2011	2010	2011	2010	2011	2010
	NIS (in thousands)				US dollars (*)	
CASH FLOWS - INVESTING ACTIVITIES						
Proceeds from purchase of marketable securities, net	(106,949)	(44,841)	(48,347)	(1,120)	(28,812)	(12,080)
Acquisition of property plant and equipment	(1,736)	(5,545)	(285)	(3,803)	(468)	(1,494)
Additions to prepaid expenses	(679)	(784)	(342)	(280)	(183)	(211)
Long term deposit, net	(47)	20	3	39	(13)	5
Proceeds from sale of property plant and Equipment	388	427	10	216	105	115
Net cash used in continuing investing activities	(109,023)	(50,723)	(48,961)	(4,948)	(29,371)	(13,665)
CASH FLOWS - FINANCING ACTIVITIES						

10.39	Indemnification Agreement, dated July 1, 1999, between the Company and Richard L. Rosenfield, incorporated herein by this reference to Exhibit 10.32 to the Company s Quarterly Report on Form 10-Q for the quarter ended June 30, 1999, as filed with the Commission on August 16, 1999 (file no. 1-10962).

	Other Contracts
10.40	Fourth Amendment to Amended and Restated Credit Agreement dated as of January 28, 2008 by and among Callaway Golf Company, Bank of America, N.A. (as Administrative Agent, Swing Line Lender and L/C Issuer) and certain other lenders named therein, incorporated herein by this reference to Exhibit 10.49 to the Company s Current Report on Form 8-K, as filed with the Commission on February 1, 2008 (file no. 1-10962).
10.41	Third Amendment to Amended and Restated Credit Agreement dated as of February 15, 2007 by and among Callaway Golf Company, Bank of America, N.A. (as Administrative Agent, Swing Line Lender and L/C Issuer), and certain other lenders named therein, incorporated herein by this reference to Exhibit 10.64 to the Company s Current Report on Form 8-K, dated as of February 15, 2007, as filed with the Commission on February 21, 2007 (file no. 1-10962).
10.42	

	Second Amendment to Amended and Restated Credit Agreement dated as of January 23, 2006 between the Company, Bank of America, N.A. as Administrative Agent, Swing Line Lender and L/C Issuer, and the other lenders party to the Amended and Restated Credit Agreement dated November 5, 2004, incorporated herein by this reference to Exhibit 10.60 to the Company s Current Report on Form 8-K, dated as of January 23, 2006, as filed with the Commission on January 27, 2006 (file no. 1-10962).
10.43	First Amendment to Amended and Restated Credit Agreement, dated as of March 31, 2005, between the Company, Bank of America, N.A. as Administrative Agent, Swing Line Lender and L/C Issuer, and the other lenders party to the Amended and Restated Credit Agreement dated November 5, 2004, incorporated herein by this reference to Exhibit 10.54 to the Company s Current Report on Form 8-K, dated as of March 31, 2005, as filed with the Commission on April 6, 2005 (file no. 1-10962).

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10.44	Amended and Restated Credit Agreement, dated as of November 5, 2004, between the Company and Bank of America, N.A. as Administrative Agent, Swing Line Lender and L/C Issuer, Banc of America Securities LLC, as Sole Lead Manager and Sole Book Manager, and the other lenders party to the Amended and Restated Credit Agreement, incorporated herein by this reference to Exhibit 10.48 to the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, as filed with the Commission on November 9, 2004 (file no. 1-10962).
10.45	Amendment No. 3 to Trust Agreement, effective as of November 1, 2005, by the Company with the consent of Union Bank of California, N.A., incorporated herein by this reference to Exhibit 10.47 to the Company s Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Commission on February 27, 2006 (file no. 1-10962).
10.46	Amendment No. 2 to Trust Agreement, effective as of October 21, 2004, by the Company with the consent of Arrowhead Trust Incorporated, incorporated herein by this reference to Exhibit 10.50 to the Company s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 10, 2005 (file no. 1-10962).
10.47	Amendment No. 1 to Trust Agreement, effective as of June 29, 2001, by the Company with the consent of Arrowhead Trust Incorporated, incorporated herein by this reference to Exhibit 10.46 to the Company s Annual Report on Form 10-K for the year ended December 31, 2001, as filed with the Commission on March 21, 2002 (file no. 1-10962).
10.48	Assignment and Assumption Agreement, effective as of January 1, 2006, among the Company, Arrowhead Trust Incorporated and Union Bank of California, N.A., incorporated herein by this reference to Exhibit 10.50 to the Company s Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Commission on February 27, 2006 (file no. 1-10962).
10.49	Assignment and Assumption Agreement, effective as of April 24, 2000, among the Company, Sanwa Bank California and Arrowhead Trust Incorporated, incorporated herein by reference to Exhibit 10.47 to the Company s Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Commission on March 30, 2001 (file no. 1-10962).
10.50	Trust Agreement, dated July 14, 1995, between the Company and Sanwa Bank California, as Trustee, for the benefit of participating employees, incorporated herein by this reference to Exhibit 10.45 to the corresponding exhibit to the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 1995, as filed with the Commission on November 14, 1995 (file no. 1-10962).
21.1	List of Subsidiaries.
23.1	Consent of Deloitte & Touche LLP.
24.1	Form of Limited Power of Attorney.
31.1	Certification of George Fellows pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Bradley J. Holiday pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of George Fellows and Bradley J. Holiday pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Included in this report

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CALLAWAY GOLF COMPANY

By: /s/ GEORGE FELLOWS
George Fellows

President and Chief Executive Officer

Date: February 26, 2009

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

Signature	Title	Dated as of
Principal Executive Officer:		
/s/ GEORGE FELLOWS **George Fellows**	President and Chief Executive Officer, Director	February 26, 2009
Principal Financial Officer and Principal Accounting Officer:		
/s/ BRADLEY J. HOLIDAY **Bradley J. Holiday**	Senior Executive Vice President and Chief Financial Officer	February 26, 2009
Directors:		
* **Samuel H. Armacost**	Director	February 26, 2009
* **Ronald S. Beard**	Chairman of the Board	February 26, 2009
* **John C. Cushman, III**	Director	February 26, 2009
* **Yotaro Kobayashi**	Director	February 26, 2009
* **Richard L. Rosenfield**	Director	February 26, 2009

*	Director	February 26, 2009
Anthony S. Thornley		

*By: /s/ BRADLEY J. HOLIDAY
Bradley J. Holiday

Attorney-in-fact

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Callaway Golf Company

Carlsbad, California

We have audited the accompanying consolidated balance sheets of Callaway Golf Company and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the basic consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, such basic consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note 14 to the consolidated financial statements, the Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* in 2007.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2009, expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Costa Mesa, California

February 26, 2009

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CALLAWAY GOLF COMPANY

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 38,337	$ 49,875
Accounts receivable, net	120,067	112,064
Inventories	257,191	253,001
Deferred taxes, net	27,046	42,219
Income taxes receivable	15,549	9,232
Other current assets	31,813	30,190
Total current assets	490,003	496,581
Property, plant and equipment, net	142,145	128,036
Intangible assets, net	146,945	140,985
Goodwill	29,744	32,060
Deferred taxes, net (Note 14)	6,299	
Other assets	40,202	40,416
	$ 855,338	$ 838,078
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 126,167	$ 130,410
Accrued employee compensation and benefits	25,630	44,245
Accrued warranty expense	11,614	12,386
Credit facilities	90,000	36,507
Total current liabilities	253,411	223,548
Long-term liabilities:		
Deferred taxes, net (Note 14)		2,367
Energy derivative valuation account (Note 15)		19,922
Income tax payable	14,993	13,833
Deferred compensation and other	6,566	8,200
Minority interest in consolidated subsidiary	2,213	1,978
Commitments and contingencies (Note 15)		
Shareholders equity:		
Preferred Stock, $.01 par value, 3,000,000 shares authorized, none issued and outstanding at December 31, 2008 and 2007		
Common Stock, $.01 par value, 240,000,000 shares authorized, 66,276,236 shares and 66,281,693 shares issued at December 31, 2008 and 2007, respectively	663	663
Additional paid-in capital	102,329	111,953
Unearned compensation	(279)	(2,158)
Retained earnings	518,851	470,469
Accumulated other comprehensive (loss) income	(6,376)	18,904
Less: Grantor Stock Trust held at market value, 1,440,570 shares and 1,813,010 shares at December 31, 2008 and 2007, respectively	(13,383)	(31,601)
Less: Common Stock held in treasury, at cost, 1,768,695 shares and 0 shares at December 31, 2008 and 2007, respectively	(23,650)	

Total shareholders equity	578,155	568,230
	$ 855,338	$ 838,078

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

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CALLAWAY GOLF COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31,					
	2008		2007		2006	
Net sales	$ 1,117,204	100%	$ 1,124,591	100%	$ 1,017,907	100%
Cost of sales	630,371	56%	631,368	56%	619,832	61%
Gross profit	486,833	44%	493,223	44%	398,075	39%
Selling expenses	287,802	26%	281,960	25%	254,526	25%
General and administrative expenses	85,473	8%	89,060	8%	79,709	8%
Research and development expenses	29,370	3%	32,020	3%	26,785	3%
Total operating expenses	402,645	36%	403,040	36%	361,020	35%
Income from operations	84,188	8%	90,183	8%	37,055	4%
Interest and other income, net	1,863		3,455		3,364	
Interest expense	(4,666)		(5,363)		(5,421)	
Change in energy derivative valuation account (Note 15)	19,922					
Income before income taxes	101,307	9%	88,275	8%	34,998	3%
Provision for income taxes	35,131		33,688		11,708	
Net income	$ 66,176	6%	$ 54,587	5%	$ 23,290	2%
Earnings per common share:						
Basic	$ 1.05		$ 0.82		$ 0.34	
Diluted	$ 1.04		$ 0.81		$ 0.34	
Common equivalent shares:						
Basic	63,055		66,371		67,732	
Diluted	63,798		67,484		68,503	

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

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CALLAWAY GOLF COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income	$ 66,176	$ 54,587	$ 23,290
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	37,963	35,326	32,274
Deferred taxes	13,977	9,047	673
Compensatory stock and stock options	6,375	10,851	11,921
Loss (gain) on disposal of long-lived assets	510	(4,731)	1,135
Non-cash change in energy derivative valuation account	(19,922)		
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts receivable, net	(18,133)	12,478	(12,128)
Inventories	(14,847)	17,292	(16,842)
Other assets	(13,795)	(7,410)	(4,475)
Accounts payable and accrued expenses	20,122	10,341	(4,525)
Accrued employee compensation and benefits	(17,925)	25,158	(6,376)
Accrued warranty expense	(772)	(978)	98
Income taxes receivable and payable	(10,234)	(10,573)	(6,936)
Other liabilities	(7,790)	594	(1,128)
Net cash provided by operating activities	41,705	151,982	16,981
Cash flows from investing activities:			
Capital expenditures	(51,005)	(32,930)	(32,453)
Acquisitions, net of cash acquired	(9,797)		374
Proceeds from sale of capital assets	45	11,460	469
Investment in golf-related ventures	(763)	(3,698)	(10,008)
Net cash used in investing activities	(61,520)	(25,168)	(41,618)
Cash flows from financing activities:			
Issuance of Common Stock	4,708	48,035	9,606
Acquisition of treasury stock	(23,650)	(114,795)	(52,872)
Dividends paid, net	(17,794)	(18,755)	(19,212)
Proceeds from (payments on) credit facilities, net	53,493	(43,493)	80,000
Excess tax benefit from exercise of stock options and compensatory stock	72	6,031	884
Other financing activities	235	(9)	1,971
Net cash provided by (used in) financing activities	17,064	(122,986)	20,377
Effect of exchange rate changes on cash and cash equivalents	(8,787)	(315)	1,141
Net (decrease) increase in cash and cash equivalents	(11,538)	3,513	(3,119)
Cash and cash equivalents at beginning of year	49,875	46,362	49,481
Cash and cash equivalents at end of year	$ 38,337	$ 49,875	$ 46,362

Supplemental disclosures:			
Cash paid for interest and fees	$ (4,346)	$ (5,633)	$ (4,502)
Cash paid for income taxes	$ (27,483)	$ (38,292)	$ (18,859)

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

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CALLAWAY GOLF COMPANY

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

AND COMPREHENSIVE INCOME

(In thousands)

	Common Stock		Additional Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Grantor Stock Trust	Treasury Stock		Total	Comprehensive Income
	Shares	Amount						Shares	Amount		
Balance, December 31, 2005	84,951	$ 850	$ 393,676	$ (9,014)	$ 430,996	$ 3,377	$ (82,414)	(8,501)	$ (141,423)	$ 596,048	
Adoption of SFAS No. 123R			(2,382)	2,382							
Exercise of stock options			(1,053)				7,134			6,081	
Excess tax benefit from exercise of stock options and compensatory stock			578							578	
Issuance of Restricted Common Stock	146	1	(1)								
Acquisition of Treasury Stock								(3,457)	(52,872)	(52,872)	
Compensatory stock and stock options			8,855	3,066						11,921	
Employee stock purchase plan			(533)				4,058			3,525	
Cash dividends					(19,212)					(19,212)	
Adjustment of Grantor Stock Trust shares to market value			3,488				(3,488)				
Equity adjustment from foreign currency translation						7,758				7,758	$ 7,758
Net income					23,290					23,290	23,290
Balance, December 31, 2006	85,097	$ 851	$ 402,628	$ (3,566)	$ 435,074	$ 11,135	$ (74,710)	(11,958)	$ (194,295)	$ 577,117	$ 31,048
Adoption of FIN 48					(437)					(437)	
Exercise of stock options	51		(6,370)				51,604			45,234	
Excess tax benefit from exercise of stock options and compensatory stock			3,858							3,858	
Acquisition of Treasury Stock								(6,883)	(114,795)	(114,795)	
Retirement of Treasury Stock	(18,841)	(188)	(308,902)					18,841	309,090		
Compensatory stock and stock options	(25)		9,443	1,408						10,851	
Employee stock purchase plan			(474)				3,275			2,801	
Cash dividends					(18,755)					(18,755)	

Adjustment of Grantor Stock Trust shares to market value			11,770				(11,770)				
Equity adjustment from foreign currency translation						7,769				7,769	$ 7,769
Net income					54,587					54,587	54,587
Balance, December 31, 2007	66,282	$ 663	$ 111,953	$ (2,158)	$ 470,469	$ 18,904	$ (31,601)		$	$ 568,230	$ 62,356
Exercise of stock options			(442)				1,901			1,459	
Tax deficit from exercise of stock options and compensatory stock			(610)							(610)	
Acquisition of Treasury Stock								(1,769)	(23,650)	(23,650)	
Compensatory stock and stock options	(6)		4,496	1,879						6,375	
Employee stock purchase plan			(382)				3,631			3,249	
Cash dividends					(17,794)					(17,794)	
Adjustment of Grantor Stock Trust shares to market value			(12,686)				12,686				
Equity adjustment from foreign currency translation						(25,280)				(25,280)	$ (25,280)
Net income					66,176					66,176	66,176
Balance, December 31, 2008	66,276	$ 663	$ 102,329	$ (279)	$ 518,851	$ (6,376)	$ (13,383)	(1,769)	$ (23,650)	$ 578,155	$ 40,896

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

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CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company

Callaway Golf Company (Callaway Golf or the Company), a Delaware corporation, together with its subsidiaries, designs, manufactures and sells high quality golf clubs (drivers, fairway woods, hybrids, irons, wedges and putters) and golf balls. The Company also sells golf accessories such as golf bags, golf gloves, golf footwear, golf and lifestyle apparel, golf headwear, eyewear, golf towels and golf umbrellas. The Company generally sells its products to golf retailers (including pro shops at golf courses and off-course retailers), sporting goods retailers and mass merchants, directly and through its wholly owned subsidiaries, to third-party distributors in the United States and in over 100 countries around the world. The Company also sells pre-owned Callaway Golf products through its website, www.callawaygolfpreowned.com and sells new Callaway Golf products through its website Shop.CallawayGolf.com as an alliance between the Company and its network of authorized U.S. retailers. In addition, the Company licenses its name for apparel, watches, travel gear and other golf accessories.

Note 2. Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its domestic and foreign subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Examples of such estimates include provisions for warranty, uncollectible accounts receivable, inventory obsolescence, sales returns, tax contingencies, estimates on the valuation of share-based awards and recoverability of long-lived assets. Actual results may materially differ from these estimates. On an ongoing basis, the Company reviews its estimates to ensure that these estimates appropriately reflect changes in its business or as new information becomes available.

Revenue Recognition

Sales are recognized in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements,* as products are shipped to customers, net of an allowance for sales returns and sales programs. The criteria for recognition of revenue is met when persuasive evidence that an arrangement exists and both title and risk of loss have passed to the customer, the price is fixed or determinable and collectability is reasonably assured. Sales returns are estimated based upon historical returns, current economic trends, changes in customer demands and sell-through of products. The Company also records estimated reductions to revenue for sales programs such as incentive offerings. Sales program accruals are estimated based upon the attributes of the sales program, management s forecast of future product demand, and historical customer participation in similar programs.

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

Royalty income is recorded as underlying product sales occur, subject to certain minimums, in accordance with the related licensing arrangements (see Note 18).

Warranty Policy

The Company has a stated two-year warranty policy for its golf clubs, although the Company s historical practice has been to honor warranty claims well after the two-year stated warranty period. The Company s policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company s stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty. The following table provides a reconciliation of the activity related to the Company s reserve for warranty expense:

	Year Ended December 31,		
	2008	2007	2006
		(In thousands)	
Beginning balance	$ 12,386	$ 13,364	$ 13,267
Provision	9,698	10,504	11,696
Claims paid/costs incurred	(10,470)	(11,482)	(11,599)
Ending balance	$ 11,614	$ 12,386	$ 13,364

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 (see Note 9) and its financing arrangements (see Note 8). The carrying amounts of these instruments approximate fair value because of their short-term maturities and variable interest rates. In addition, the Company has elected to purchase Company-owned life insurance in order to support a deferred compensation plan that is offered to certain employees (see Note 13). The cash surrender value of the Company-owned insurance policy approximates fair value because it represents the amount the Company would receive from the insurance company upon the surrender of the policies.

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 2008, 2007 and 2006 were $56,020,000, $52,203,000 and $47,599,000, respectively.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs for 2008, 2007 and 2006 were $29,370,000, $32,020,000 and $26,785,000, 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 using the current exchange rate at the balance sheet date for assets and liabilities and at the average exchange rate for the period for revenues and expenses. Cumulative translation gains or losses are recorded as accumulated other comprehensive (loss) income in shareholders equity. Gains or losses resulting from transactions that are made in a currency different from the functional currency are recognized in earnings as they occur or, for hedging contracts, when the underlying hedged transaction affects earnings. The Company recorded net foreign currency transaction gains of $519,000, $158,000 and $251,000 in 2008, 2007 and 2006, respectively.

Derivatives and Hedging

The Company from time to time uses derivative financial instruments to manage its exposure to foreign exchange rates. The derivative instruments are accounted for pursuant to Statement of Financial Accounting

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Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133), as amended by SFAS Nos. 138 and 149, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* and SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*. As amended, SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as an effective hedge that offsets certain exposures.

Cash and Cash Equivalents

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

Allowance for Doubtful Accounts

The Company maintains an allowance for estimated losses resulting from the failure of its customers to make required payments. An estimate of uncollectible amounts is made by management based upon historical bad debts, current customer receivable balances, age of customer receivable balances, the customer s financial condition and current economic trends, all of which are subject to change. Actual uncollected amounts have been consistent with the Company s expectations.

Inventories

Inventories are valued at the lower of cost or fair market value. Cost is determined using the first-in, first-out (FIFO) method. The inventory balance, which includes material, labor and manufacturing overhead costs, is recorded net of an estimated allowance for obsolete or unmarketable inventory. The estimated allowance for obsolete or unmarketable inventory is based upon current inventory levels, sales trends and historical experience as well as management s understanding of market conditions and forecasts of future product demand, all of which are subject to change. Actual inventory charges have been consistent with the Company s expectations.

Property, Plant and Equipment

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

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

Normal repairs and maintenance costs are expensed as incurred. Expenditures that materially increase values, change capacities or extend useful lives are capitalized. The related costs and accumulated depreciation of disposed assets are eliminated and any resulting gain or loss on disposition is included in net income. Construction in-process consists primarily of costs associated with the Company s building consolidation project, machinery and equipment that have not yet been placed into service, unfinished molds as well as in-process internally developed software.

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

Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* the Company assesses potential impairments of its long-lived assets whenever events or changes in circumstances indicate that the asset s carrying value may not be recoverable. An impairment loss would be recognized when the carrying amount of a long-lived asset or asset group is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset or asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group. Based on the Company s assessment of potential impairments during 2008, 2007 and 2006, there were no indicators identified that would warrant an impairment of its long-lived assets.

Goodwill and Intangible Assets

Goodwill and intangible assets consist of goodwill, trade names, trademarks, service marks, trade dress, patents and other intangible assets acquired during the acquisition of Odyssey Sports, Inc., the Top-Flite assets, FrogTrader, Inc., the Tour Golf Group assets, the uPlay, LLC assets and certain foreign distributors.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill and intangible assets with indefinite lives are not amortized but instead are measured for impairment at least annually, or when events indicate that an impairment exists. The Company calculates impairment as the excess of the carrying value of its indefinite-lived intangible assets over their estimated fair value. If the carrying value exceeds the estimate of fair value a write-down is recorded.

Intangible assets that are determined to have definite lives are amortized over their estimated useful lives and are measured for impairment only when events or circumstances indicate the carrying value may be impaired in accordance with SFAS No. 144 discussed above. See Note 7 for further discussion of the Company s goodwill and intangible assets.

Investments

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

The Company monitors investments for impairment in accordance with Accounting Principles Board (APB) Opinion No. 18 *The Equity Method of Accounting for Investments in Common Stock* and Emerging Issues Task Force No. 03-*1 The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments.* See Note 3 for further discussion of the Company s investments.

Share-Based Compensation

The Company accounts for its share-based compensation arrangements in accordance with the provisions of SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options at the date of grant. The Black-Scholes option valuation model requires the input of subjective assumptions to calculate the value of stock options. The Company uses historical data among other information to estimate the expected price volatility, option life, dividend yield and forfeiture rate. The risk-free rate is based

on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. The total compensation is recognized on a straight-line basis over the vesting period, reduced by an estimated forfeiture rate. Estimated forfeiture rates are trued up as actual cancellations occur.

In accordance with SFAS No. 123R, the Company records compensation expense for Restricted Stock Awards and Restricted Stock Units (collectively restricted stock) based on the estimated fair value of the award on the date of grant. The estimated fair value is determined based on the closing price of the Company s Common Stock on the award date multiplied by the number of shares underlying restricted stock awarded. Total compensation expense is recognized on a straight-line basis over the vesting period, reduced by an estimated forfeiture rate.

During 2006, the Company granted Performance Share Units to certain employees under the Company s 2004 Equity Incentive Plan. Performance Share Units are a form of share-based award in which the number of shares ultimately received depends on the Company s performance against specified performance targets over a three-year period from the date of grant. The estimated fair value of the Performance Share Units is determined based on the closing price of the Company s Common Stock on the award date multiplied by the estimated number of shares to be issued at the end of the performance period. Total compensation expense is recognized on a straight-line basis over the performance period, reduced by an estimated forfeiture rate. The Company uses forecasted performance metrics to estimate the number of Performance Share Units to be issued as well as approval from the Compensation and Management Succession Committee of the Board of Directors. The Company s performance against the specified performance targets is reviewed quarterly and expense is adjusted as the Company s actual and forecasted performance changes.

Income Taxes

Current income tax expense or benefit is the amount of income taxes expected to be payable or receivable for the current year. A deferred income tax asset or liability is established for the difference between the tax basis of an asset or liability computed pursuant to Financial Accounting Standards Board (FASB) Statement No. 109, *Accounting for Income Taxes* (SFAS No. 109), and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Deferred income tax expense or benefit is the net change during the year in the deferred income tax asset or liability.

Effective January 1, 2007, the Company was required to adopt and implement the provisions of Interpretation 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which requires the Company to accrue for the estimated additional amount of taxes for uncertain tax positions if it is more likely than not that the Company would be required to pay such additional taxes. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. As a result of the adoption of FIN 48 in 2007, the Company recognized an increase in the liability for its uncertain tax positions of $437,000, of which the entire charge was accounted for as a decrease to the beginning balance of retained earnings. The accrual for uncertain tax positions can result in a difference between the estimated benefit recorded in the Company s financial statements and the benefit taken or expected to be taken in the Company s income tax returns. This difference is generally referred to as an unrecognized tax benefit.

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 (see Note 14).

Interest and Other Income, Net

Interest and other income, net primarily includes gains and losses on foreign currency transactions, interest income and gains and losses on investments to fund the deferred compensation plan. The components of interest and other income, net are as follows:

	Year Ended December 31,		
	2008	2007	2006
	(In thousands)		
Foreign currency gains	$ 519	$ 158	$ 251
Interest income	2,312	2,202	1,329
(Loss) gains on deferred compensation plan assets	(1,925)	496	272
Other	957	599	1,512
	$ 1,863	$ 3,455	$ 3,364

Accumulated Other Comprehensive Income (Loss)

The components of comprehensive income for the Company include net income and foreign currency translation adjustments. Since the Company has met the indefinite reversal criteria, it does not accrue income taxes on foreign currency translation adjustments. The total equity adjustment from foreign currency translation included in accumulated other comprehensive income (loss) was ($6,376,000) and $18,904,000 as of December 31, 2008 and 2007, respectively.

Segment Information

The Company s operating segments are organized on the basis of products and consist of Golf Clubs and Golf Balls. The Golf Clubs segment consists primarily of Callaway Golf, Top-Flite and Ben Hogan woods, hybrids, irons, wedges and putters as well as Odyssey putters, pre-owned clubs, other golf-related accessories and royalty and other income. The Golf Balls segment consists primarily of Callaway Golf and Top-Flite golf balls that are designed, manufactured and sold by the Company. The Company also discloses information about geographic areas. This information is presented in Note 17.

Diversification of Credit Risk

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

The Company historically invests its excess cash in money market accounts and short-term 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 (including pro shops at golf courses and off-course retailers), sporting goods retailers and mass merchants, 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 estimated credit losses, which it considers adequate to cover any such losses. Managing customer-related credit risk is more difficult in regions outside of the United States. During 2008, 2007 and 2006, approximately 50%, 47% and 44%, respectively, of the Company s net sales were made in regions outside of the United States. Prolonged unfavorable economic conditions in the United States or in the Company s international markets could significantly increase the Company s credit risk.

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

Recent Accounting Pronouncements

In December 2008, the FASB issued FASB Staff Position (FSP) FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities.* This FSP requires additional disclosures by public companies about transfers of financial assets and interests in variable interest entities. The FSP amends both FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities , and FASB Interpretation No. 46 (Revised December 2003), Consolidation of Variable Interest Entities to require (i) additional disclosures about transferors continuing involvements with transferred financial assets; (ii) additional disclosures about a public entities (including sponsors) involvement with variable interest entities; (iii) disclosures by a public enterprise that is: (a) a sponsor of a qualifying special-purpose entity (SPE) that holds a variable interest in the qualifying SPE but was not the transferor of financial assets to the qualifying SPE; and (b) a servicer of a qualifying SPE that holds a significant variable interest in the qualifying SPE but was not the transferor of financial assets to the qualifying SPE. This FSP is effective for annual and interim reporting periods that end after December 15, 2008. Based on the Company s evaluation of this FSP, the adoption of this standard did not have a material impact on the Consolidated Financial Statements of the Company.

In October 2008, the FASB Issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP No. 157-3). FSP No. 157-3 clarifies the application of FASB Statement No. 157, *Fair Value Measurements,* in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP No. 157-3 is effective upon issuance. Based on the Company s evaluation of FSP No. 157-3, the adoption of this standard did not have a material impact on the Consolidated Financial Statements of the Company.

In September 2008, the FASB issued FSP No. 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161* (FSP No. 133-1 and FIN 45-4). FSP No. 133-1 and FIN 45-4 are intended to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. It amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* to require disclosures by sellers of credit derivatives, including credit derivatives embedded in hybrid instruments. FSP No. 133-1 and FIN 45-4 are effective for annual and interim reporting periods beginning after November 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of FSP No. 133-1 and FIN 45-4 will have on the Consolidated Financial Statements of the Company.

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* This FSP provides that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The FSP is effective for financial statements issued for interim periods and fiscal years beginning after December 15, 2008. Upon adoption, companies are required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. The Company is currently evaluating the impact, if any, that the adoption of this FSP will have on the Consolidated Financial Statements of the Company.

In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* . This FSP amends the factors that should be considered in developing renewal or extension assumptions

used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142, the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141R, and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for interim periods and fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of this FSP will have on the Consolidated Financial Statements of the Company.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires companies to provide enhanced disclosures regarding derivative instruments and hedging activities. It requires companies to better convey the purpose of derivative use in terms of the risks that such company is intending to manage. Disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect a company s financial position, financial performance, and cash flows are required. SFAS No. 161 retains the same scope as SFAS No. 133 and is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of SFAS No. 161 will have on the Consolidated Financial Statements of the Company.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin (ARB) No. 51* (SFAS No. 160). SFAS No. 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Additionally, SFAS No. 160 requires that consolidated net income include the amounts attributable to both the parent and the noncontrolling interest. SFAS No. 160 is effective for interim periods beginning on or after December 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of SFAS No. 160 will have on the Consolidated Financial Statements of the Company.

In December 2007, the FASB issued Statement No. 141R, *Business Combinations (a revision of Statement No. 141)* (SFAS No. 141R). SFAS No. 141R applies to all transactions or other events in which an entity obtains control of one or more businesses, including those combinations achieved without the transfer of consideration. SFAS No. 141R retains the fundamental requirements in Statement No. 141 that the acquisition method of accounting be used for all business combinations. SFAS No. 141R expands the scope to include all business combinations and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their fair values as of the acquisition date. Additionally, SFAS No. 141R changes the way entities account for business combinations achieved in stages by requiring the identifiable assets and liabilities to be measured at their full fair values. Additionally, contractual contingencies and contingent consideration shall be measured at fair value at the acquisition date. SFAS No. 141R is effective on a prospective basis to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will apply the provisions of SFAS No. 141R for all acquisitions completed after December 31, 2008.

Note 3. Investments

Investment in Golf Entertainment International Limited Company

The Company has a $10,000,000 investment in the Preferred Shares of Golf Entertainment International Limited (GEI), the owner and operator of TopGolf entertainment centers. The Company accounts for this investment under the cost method in accordance with the provisions of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* and reflected the balance in other long-term assets in the accompanying consolidated balance sheet as of December 31, 2008 and 2007.

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In addition, the Company and GEI entered into a Preferred Partner Agreement under which the Company is granted preferred signage rights, rights as the preferred supplier of golf products used or offered for use at TopGolf facilities at prices no less than those paid by the Company s customers, preferred retail positioning in the TopGolf retail stores, access to consumer information obtained by TopGolf, and other rights incidental to those listed.

In August 2007, the Company and other GEI shareholders entered into a loan agreement with GEI to provide funding to GEI for certain capital projects as well as operational needs. In December 2007, the Company and other GEI shareholders entered into a second loan agreement with GEI to supplement GEI s cash flows from operations as a result of the seasonal fluctuations of the business. Both loan agreements extend to all shareholders of GEI, whereby each shareholder may participate by funding up to an amount agreed upon by GEI. As of December 31, 2008, the Company funded a combined total of $4,997,000 under both loan agreements, which includes accrued interest of $992,000. The loan agreements provide for the option, at the Company s discretion, to convert up to 100 percent of the amount drawn by GEI, including accrued interest, into convertible preferred shares. In connection with the loans, the Company has received underwriting fees and will receive annual interest at market rates on the loaned amounts.

In February 2008, the Company and another GEI shareholder entered into an arrangement to provide collateral in the form of a letter of credit in the amount of $8,000,000 for a loan that was issued to a subsidiary of GEI. In January 2009, the Company and another GEI shareholder extended this agreement for an additional year through February 2010. The Company is currently responsible for $5,500,000 of the total guaranteed amount. In connection with the letter of credit, the Company received underwriting fees and warrants to purchase GEI s preferred stock at a future date. The fees were included as additional principle under the second loan agreement.

Investment in Qingdao Suntech Sporting Goods Limited Company

In October 2006, the Company entered into a Golf Ball Manufacturing and Supply Agreement with Qingdao Suntech Sporting Goods Limited Company (Suntech), where Suntech manufactures and supplies certain golf balls solely for and to the Company. In connection with the agreement, the Company provides Suntech with golf ball raw materials, packing materials, molds, tooling, as well as manufacturing equipment in order to carry out the manufacturing and supply obligations set forth in the agreement. Suntech provides the personnel as well as the facilities to effectively perform these manufacturing and supply obligations. Due to the nature of the arrangement, as well as the controlling influence the Company has in the Suntech operations, the Company is required to consolidate the financial results of Suntech in its consolidated financial statements for the years ended December 31, 2008, 2007 and 2006, in accordance with the provisions of FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*.

Suntech is a wholly-owned subsidiary of Suntech Mauritius Limited Company (Mauritius). The Company has entered into a loan agreement with Mauritius in order to provide working capital for Suntech. In connection with this loan agreement, the Company loaned Mauritius a total of $3,200,000 as of December 31, 2008.

Note 4. Business Acquisitions

uPlay Asset Acquisition

On December 31, 2008, the Company acquired certain assets and liabilities of uPlay, LLC (uPlay), a developer and marketer of GPS devices that provide accurate on-course measurements utilizing aerial imagery of each golf hole. The Company acquired uPlay in order to form synergies from co-branding these products with the Callaway Golf brand, promote the global distribution of these products through the Company s existing sales force and create incremental new business opportunities.

The uPlay acquisition was accounted for as a purchase in accordance with SFAS No. 141, *Business Combinations.* Under SFAS No. 141, the estimated aggregate cost of the acquired assets was $11,186,000, which includes cash paid of $9,780,000, transaction costs of approximately $225,000, and assumed liabilities of approximately $1,181,000. The aggregate acquisition costs exceeded the estimated fair value of the net assets

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acquired. As a result, the Company has preliminarily recorded goodwill of $361,000, none of which is deductible for tax purposes. In accordance with applicable accounting rules, a final determination of the allocation of the aggregate acquisition costs will be made upon a final assessment of the estimated fair value of the acquired net assets. It is anticipated that the final assessment will be completed during the first half of 2009 and that the final allocation will not differ materially from the preliminary allocation. The Company has preliminarily recorded the fair values of uPlay s database and technology, trademarks and trade names, and non-compete agreements using an income valuation approach. This valuation technique provides an estimate of the fair value of an asset based on the cash flows that the asset can be expected to generate over its remaining useful life.

In connection with this purchase, the Company could be required to pay an additional purchase price not to exceed $10,000,000 based on a percentage of earnings generated from the sale of uPlay products over a period of three years ending on December 31, 2011. Any such additional purchase price paid at the end of the three year period will be recorded as goodwill. The preliminary allocation of the aggregate acquisition costs is as follows (in thousands):

Assets Acquired:	
Cash	$ 208
Accounts receivable	948
Inventory	228
Property, plant and equipment	254
Database and technology	7,800
Trademarks and trade names	540
Non-compete agreements	760
Other	87
Goodwill (Note 7)	361
Liabilities:	
Current liabilities	(1,181)
Total net assets acquired	$ 10,005

The pro-forma effects of the uPlay, LLC asset acquisition would not have been material to the Company s results of operations for fiscal years 2008, 2007 or 2006 and, therefore, are not presented.

Note 5. Restructuring and Integration Initiatives

In connection with the Company s gross margin improvement initiatives and its actions to improve the profitability of its golf ball business, the Company has taken actions to consolidate its golf ball operations into other existing locations. As a result of these initiatives, in May 2008, the Company announced the closure of its golf ball manufacturing facility in Gloversville, New York. This closure resulted in the recognition of non-cash charges for the acceleration of depreciation on certain golf ball manufacturing equipment and cash charges related to severance benefits and facility costs. During the twelve months ended December 31, 2008, the Company recorded pre-tax charges of $4,254,000 in connection with the closure of this facility. In addition, the Company expects to incur additional charges of approximately $300,000 in 2009, primarily related to the costs associated with the closure of the manufacturing facility. The remaining liability as of December 31, 2008, represents estimated costs for certain ongoing facility costs and severance benefits.

The activity and liability balances recorded as part of the Company s golf ball manufacturing consolidation were as follows (in thousands):

	Workforce Reductions	Facility and Other	Total
Charges to cost and expense	$ 1,295	$ 2,959	$ 4,254
Non-cash items		(1,798)	(1,798)
Cash payments	(1,162)	(890)	(2,052)
Restructuring payable balance, December 31, 2008	$ 133	$ 271	$ 404

In September 2005, the Company began the implementation of several company-wide restructuring initiatives designed to improve the Company s business processes and reduce the Company s overall expenses (the 2005 Restructuring Initiatives). The 2005 Restructuring Initiatives include, among other things, the consolidation of the Callaway Golf, Odyssey, Top-Flite and Ben Hogan selling functions, as well as the elimination or reduction of other operating expenses.

In connection with the 2005 Restructuring Initiatives, the Company committed to staff reductions that involved the elimination of approximately 500 positions worldwide, including full-time and part-time employees, temporary staffing and open positions. In the aggregate, the Company recorded charges to pre-tax earnings of $11,994,000 in connection with the 2005 Restructuring Initiatives. Of this amount, approximately $896,000 and $3,023,000 were incurred in 2007 and 2006, respectively. There were no charges incurred during 2008.

Note 6. Selected Financial Statement Information

	December 31, 2008	December 31, 2007
	(In thousands)	
Accounts receivable, net:		
Trade accounts receivable	$ 128,686	$ 120,054
Allowance for doubtful accounts	(8,619)	(7,990)
	$ 120,067	$ 112,064
Inventories, net:		
Raw materials	$ 79,132	$ 82,185
Work-in-process	38	1,932
Finished goods	178,021	168,884
	$ 257,191	$ 253,001
Property, plant and equipment, net:		
Land	$ 11,407	$ 11,609
Buildings and improvements	89,223	85,245
Machinery and equipment	146,431	143,994
Furniture, computers and equipment	110,838	112,079
Production molds	35,859	41,511
Construction-in-process	21,465	10,368
	415,223	404,806
Accumulated depreciation	(273,078)	(276,770)
	$ 142,145	$ 128,036
Accounts payable and accrued expenses:		
Accounts payable	$ 42,020	$ 33,019
Accrued expenses	84,147	97,391
	$ 126,167	$ 130,410
Accrued employee compensation and benefits:		
Accrued payroll and taxes	$ 14,207	$ 31,882
Accrued vacation and sick pay	10,598	10,752
Accrued commissions	825	1,611
	$ 25,630	$ 44,245

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Note 7. Goodwill and Intangible Assets

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* the Company s goodwill and certain intangible assets are not amortized, but are subject to an annual impairment test. The following sets forth the intangible assets by major asset class:

	Useful Life (Years)	December 31, 2008			December 31, 2007		
		Gross	Accumulated Amortization (In thousands)	Net Book Value	Gross	Accumulated Amortization (In thousands)	Net Book Value
Non-Amortizing:							
Trade name, trademark and trade dress and other	NA	$ 121,794	$	$ 121,794	$ 121,794	$	$ 121,794
Amortizing:							
Patents	2-16	36,459	21,106	15,353	36,459	18,288	18,171
Developed technology and other	1-9	12,016	2,218	9,798	2,853	1,833	1,020
Total intangible assets		$ 170,269	$ 23,324	$ 146,945	$ 161,106	$ 20,121	$ 140,985

The increase in other amortizing intangibles is related to the uPlay acquisition, consummated in December 2008 (see Note 4). Aggregate amortization expense on intangible assets was approximately $3,203,000, $3,341,000 and $3,301,000 for the years ended December 31, 2008, 2007 and 2006, respectively. Amortization expense related to intangible assets at December 31, 2008 in each of the next five fiscal years and beyond is expected to be incurred as follows (in thousands):

2009	$ 4,772
2010	4,632
2011	4,381
2012	3,952
2013	2,998
Thereafter	4,416
	$ 25,151

In accordance with SFAS No. 142, the Company has completed its annual impairment tests and fair value analysis for goodwill and other non-amortizing intangible assets held throughout the year. There were no impairments and no loss was recorded during the year ended December 31, 2008. Goodwill additions during the year ended December 31, 2008 consisted of approximately $361,000 in connection with the uPlay acquisition. There were no additions to goodwill during the year ended December 31, 2007. In addition, the goodwill balances held in foreign currencies as of December 31, 2008 and 2007 include an unfavorable foreign currency translation adjustment of $2,677,000 and favorable foreign currency translation adjustment of $1,227,000, respectively.

Note 8. Financing Arrangements

The Company s primary credit facility is a $250,000,000 Line of Credit with a syndicate of eight banks under the terms of the November 5, 2004 Amended and Restated Credit Agreement (as amended, the Line of Credit). The Line of Credit is not scheduled to expire until February 15, 2012.

The lenders in the syndicate are Bank of America, N.A., Union Bank of California, N.A., Barclays Bank, PLC, JPMorgan Chase Bank, N.A., US Bank, N.A., Comerica West Incorporation, Fifth Third Bank, and Citibank, N.A. To date, all of the banks in the syndicate have continued to meet their commitments under the Line of Credit despite the turmoil in the financial markets. If any of the banks in the syndicate were unable to

perform on their commitments to fund the Line of Credit, the Company s liquidity would be impaired, unless the Company were to find a replacement source of funding under the Line of Credit or from other sources.

The Line of Credit provides for revolving loans of up to $250,000,000, although actual borrowing availability can be effectively limited by the financial covenants contained therein. As of December 31, 2008, the maximum amount that could be borrowed under the Line of Credit was $250,000,000, of which $90,000,000 was outstanding at December 31, 2008.

Under the Line of Credit, the Company is required to pay certain fees, including an unused commitment fee of between 10.0 to 25.0 basis points per annum of the unused commitment amount, with the exact amount determined based upon the Company s consolidated leverage ratio and trailing four quarters earnings before interest, income taxes, depreciation and amortization, as well as other non-cash expense and income items (adjusted EBITDA) (each as defined in the agreement governing the Line of Credit). Outstanding borrowings under the Line of Credit accrue interest, at the Company s election, based upon the Company s consolidated leverage ratio and trailing four quarters adjusted EBITDA of (i) the higher of (a) the Federal Funds Rate plus 50.0 basis points or (b) Bank of America s prime rate, or (ii) the Eurodollar Rate (as defined in the agreement governing the Line of Credit) plus a margin of 50.0 to 125.0 basis points.

The Line of Credit requires the Company to meet certain financial covenants, including a maximum consolidated leverage ratio and minimum interest coverage ratio, and includes certain other restrictions, including restrictions limiting dividends, stock repurchases, capital expenditures and asset sales. As of December 31, 2008, the Company was in compliance with the covenants and other terms of the Line of Credit, as then applicable.

The total origination fees incurred in connection with the Line of Credit, including fees incurred in connection with the amendments, were $2,170,000 and are being amortized into interest expense over the remaining term of the Line of Credit agreement. Unamortized origination fees were $902,000 as of December 31, 2008, of which $282,000 was included in other current assets and $620,000 in other long-term assets in the accompanying consolidated balance sheet.

Note 9. Derivatives and Hedging

The Company from time to time uses derivative financial instruments to manage its exposure to foreign exchange rates. The derivative instruments are accounted for pursuant to SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS Nos. 138 and 149, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* and SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*. As amended, SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change, unless the derivative qualifies as an effective hedge that offsets certain exposures.

Foreign Currency Exchange Contracts

The Company from time to time enters into foreign exchange contracts to hedge against exposure to changes in foreign currency exchange rates from the time inventory is shipped to foreign subsidiaries to the time when they pay the liability for these inventories. Such contracts are designated at inception to the related foreign currency exposures being hedged, which may include anticipated intercompany sales of inventory denominated in foreign currencies, payments due on intercompany transactions from certain wholly owned foreign subsidiaries, and anticipated sales by the Company s wholly owned European subsidiary for certain Euro-denominated transactions. Hedged transactions are denominated primarily in British Pounds, Euros, Japanese Yen, Korean Won, Canadian Dollars and Australian Dollars. Pursuant to its foreign exchange hedging policy, the Company may hedge anticipated transactions and the related receivables and payables denominated in foreign currencies using forward foreign currency exchange rate contracts and put or call options. Foreign currency derivatives are used only to meet the Company s objectives of minimizing variability in the Company s

operating results arising from foreign exchange rate movements, which may include derivatives that do not meet the criteria for hedge accounting. The Company does not enter into foreign exchange contracts for speculative purposes. Hedging contracts mature within twelve months from their inception.

At December 31, 2008, 2007 and 2006, the notional amounts of the Company s foreign exchange contracts used to hedge outstanding balance sheet exposures were approximately $23,742,000, $31,095,000 and $32,470,000, respectively. The Company estimates the fair values of derivatives based on quoted market prices or pricing models using current market rates, and records all derivatives on the balance sheet at fair value with changes in fair value recorded in the statement of operations. At December 31, 2008 and 2007, the fair values of foreign currency-related derivatives were recorded as current liabilities of $2,007,000 and $421,000, respectively. The gains and losses on foreign currency contracts used to manage balance sheet exposures are recognized as a component of other income (expense) in the same year as the remeasurement gain and loss of the related foreign currency denominated assets and liabilities and thus generally offset these gains and losses. During the years ended December 31, 2008, 2007 and 2006, the Company recorded net losses of $3,251,000, $5,979,000 and $2,064,000, respectively, due to net realized and unrealized losses on contracts used to manage balance sheet exposures that do not qualify for hedge accounting. These net realized and unrealized contractual losses are used by the Company to offset actual foreign currency transactional net gains of $3,770,000, $6,137,000 and $2,315,000 as of December 31, 2008, 2007 and 2006, respectively. At December 31, 2008, 2007 and 2006, there were no foreign exchange contracts designated as cash flow hedges.

Note 10. 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 sum of the weighted-average number of common shares outstanding during the period, plus the number of potentially dilutive common shares (dilutive securities) that were outstanding during the period. Dilutive securities include options granted pursuant to the Company s stock option plans, potential shares related to the Employee Stock Purchase Plan and restricted stock grants, restricted stock units and performance share units to employees and non-employees (see Note 12). Dilutive securities related to 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 market value at the end of the period.

The schedule below summarizes the elements included in the calculation of basic and diluted earnings per common share for the years ended December 31, 2008, 2007 and 2006.

	Year Ended December 31,		
	2008	**2007**	**2006**
	(In thousands, except per share data)		
Net income	$ 66,176	$ 54,587	$ 23,290
Weighted-average shares outstanding:			
Weighted-average shares outstanding Basic	63,055	66,371	67,732
Dilutive securities	743	1,113	771
Weighted-average shares outstanding Diluted	63,798	67,484	68,503
Earnings per common share:			
Basic	$ 1.05	$ 0.82	$ 0.34
Diluted	$ 1.04	$ 0.81	$ 0.34

Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue Common Stock were exercised or converted into Common Stock. Options with an exercise price in excess of the average market value of the Company s Common Stock during the period have been excluded from the calculation as their effect would be antidilutive. Additionally, potentially dilutive securities are excluded from the

computation of earnings per share in periods in which a net loss is reported as their effect would be antidilutive. Thus, weighted-average shares outstanding Diluted is the same as weighted-average shares outstanding Basic in periods when a net loss is reported. For the years ended December 31, 2008, 2007 and 2006, options outstanding totaling approximately 5,702,000, 2,856,000 and 6,447,000 shares, respectively, were excluded from the calculations of earnings per common share, as their effect would have been antidilutive.

Note 11. Capital Stock

Common Stock and Preferred Stock

The Company has an authorized capital of 243,000,000 shares, $0.01 par value, of which 240,000,000 shares are designated Common Stock, and 3,000,000 shares are designated Preferred Stock. Of the Preferred Stock, 240,000 shares are designated Series A Junior Participating Preferred Stock. The remaining shares of Preferred Stock are undesignated as to series, rights, preferences, privileges or restrictions.

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

Treasury Stock and Stock Repurchases

In November 2007, the Board of Directors authorized the retirement of all Common Stock held in treasury, which resulted in the retirement of approximately 18,841,000 shares at a total cost of $309,090,000. The retirement also reduced additional paid in capital and Common Stock by $308,902,000 and $188,000, respectively. There was no Common Stock held in treasury as of December 31, 2007.

In November 2007, the Company announced that its Board of Directors authorized it to repurchase shares of its Common Stock in the open market or in private transactions, subject to the Company s assessment of market conditions and buying opportunities, up to a maximum cost to the Company of $100,000,000, which would remain in effect until completed or otherwise terminated by the Board of Directors (the November 2007 repurchase program). The November 2007 repurchase program supersedes all prior stock repurchase authorizations and will remain in effect until completed or otherwise terminated by the Board of Directors.

During 2008, the Company repurchased 1,769,000 shares of its Common Stock under the November 2007 repurchase program at an average cost per share of $13.37 for a total cost of $23,650,000. The Company s repurchases of shares of Common Stock are recorded at the average cost of the Common Stock held in treasury and result in a reduction of shareholders equity. As of December 31, 2008, the Company remained authorized to repurchase up to an additional $76,350,000 of its Common Stock under this program.

Grantor Stock Trust

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

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

For financial reporting purposes, the GST is consolidated with the Company. The value of shares owned by the GST are accounted for as a reduction to shareholders equity until the shares are used. Each period, the shares owned by the GST are valued at the closing market price, with corresponding changes in the GST balance reflected in additional paid-in capital. The issuance of shares by the GST is accounted for by reducing the GST and additional paid-in capital accounts proportionately as the shares are released. The GST does not impact the determination or amount of compensation expense for the benefit plans being settled. The GST shares do not have any impact on the Company s earnings per share until they are issued in connection with the settlement of restricted stock units, stock option exercises, employee stock plan purchases or other awards.

The following table presents shares released from the GST for the settlement of employee stock option exercises and employee stock plan purchases for the years ended December 31, 2008, 2007 and 2006:

	Year Ended December 31,		
	2008	2007	2006
	(In thousands)		
Employee stock option exercises	113	3,170	468
Employee stock plan purchases	260	201	303
Total shares released from the GST	373	3,371	771

Note 12. Share-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R, *Share-Based Payment,* which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. The Company adopted SFAS No. 123R using the modified prospective transition method. Under this transition method, compensation expense for all share-based awards outstanding as of the adoption date is based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. The valuation provisions of SFAS No. 123R apply to new share-based awards granted on or after January 1, 2006. As part of the adoption of SFAS No. 123R, $2,382,000 of unrecognized compensation expense was reclassified as a component of additional paid-in capital as of January 1, 2006.

The Company uses the alternative transition method provided in the FASB Staff Position No. FAS 123R-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards* for calculating the tax effects of share-based compensation pursuant to SFAS No. 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC Pool) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC Pool and consolidated statements of cash flows of the tax effects of employee and director share-based awards that were outstanding upon adoption of SFAS No. 123R.

Stock Plans

As of December 31, 2008, the Company had the following two shareholder approved stock plans under which shares were available for equity-based awards: the Callaway Golf Company Amended and Restated 2004 Incentive Plan (the 2004 Plan) and the 2001 Non-Employee Directors Stock Incentive Plan (the 2001

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Directors Plan). The 2004 Plan permits the granting of stock options, stock appreciation rights, restricted stock/ units, performance share units and other equity-based awards to the Company s officers, employees, consultants and certain other non-employees who provide services to the Company. All grants under the 2004 Plan are discretionary, although no participant may receive awards in any one year in excess of 1,000,000 shares. The 2001 Directors Plan permits the granting of stock options, restricted stock and restricted stock units. Directors receive an initial equity award grant not to exceed 20,000 shares upon their initial appointment to the Board and thereafter an annual grant not to exceed 10,000 shares upon being re-elected at each annual meeting of shareholders. The maximum number of shares issuable over the term of the 2004 Plan and the 2001 Directors Plan is 12,250,000 and 500,000 shares, respectively.

The following table presents shares authorized, available for future grant and outstanding under each of the Company s plans as of December 31, 2008:

	Authorized	Available (In thousands)	Outstanding[1]
1991 Stock Incentive Plan	10,000		75
Promotion, Marketing and Endorsement Stock Incentive Plan	3,560		510
1995 Employee Stock Incentive Plan	10,800		1,944
1996 Stock Option Plan	9,000		422
2001 Directors Plan	500	231	257
2004 Plan	12,250	2,578	4,048
Employee Stock Purchase Plan	6,000	2,900	
Non-Employee Directors Stock Option Plan	840		16
Total	52,950	5,709	7,272

(1) Outstanding shares do not include issued Restricted Stock awards that are subject to forfeitures.

Stock Options

All stock option grants made under the 2004 Plan and the 2001 Directors Plan are made at exercise prices no less than the Company s closing stock price on the date of grant. Outstanding stock options generally vest over a three-year period from the grant date and generally expire up to 10 years after the grant date. The Company recorded $3,351,000, $4,241,000 and $6,122,000 of compensation expense relating to outstanding stock options for the years ended December 31, 2008, 2007 and 2006, respectively.

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. The model uses various assumptions, including a risk-free interest rate, the expected term of the options, the expected stock price volatility over the expected term of the options, and the expected dividend yield. Compensation expense for employee stock options is recognized ratably over the vesting term and is reduced by an estimate for pre-vesting forfeitures, which is based on the Company s historical forfeitures of unvested options and awards. For the years ended December 31, 2008, 2007 and 2006, the average estimated pre-vesting forfeiture rate used was 4.8%, 3.9% and 5.6%, respectively. The table below summarizes the average fair value assumptions used in the valuation of stock options granted during the years ended December 31, 2008, 2007 and 2006.

	2008	2007	2006
Dividend yield	1.9%	2.0%	2.0%
Expected volatility	35.6%	37.4%	39.5%
Risk-free interest rate	2.7%	4.7%	4.7%
Expected life	4.1 years	3.1 years	3.2 years

The dividend yield is based upon a three-year historical average. The expected volatility is based on the historical volatility, among other factors, of the Company s stock. The risk-free interest rate is based on the U.S.

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Treasury yield curve at the date of grant with maturity dates approximately equal to the expected term of the options at the date of the grant. The expected life of the Company s options is based on evaluations of historical and expected future employee exercise behavior, forfeitures, cancellations and other factors. The valuation model applied in this calculation utilizes highly subjective assumptions that could potentially change over time. Changes in the subjective input assumptions can materially affect the fair value estimates of an option. Furthermore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by the employee holding the option.

The following table summarizes the Company s stock option activities for the year ended December 31, 2008 (in thousands, except price per share and contractual term):

Options	Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2008	6,186	$ 16.51		
Granted	1,125	$ 14.68		
Exercised	(113)	$ 12.96		
Forfeited	(44)	$ 14.52		
Expired	(674)	$ 21.47		
Outstanding at December 31, 2008	6,480	$ 15.75	5.56	$
Vested and expected to vest in the future at December 31, 2008	6,401	$ 15.77	5.52	$
Exercisable at December 31, 2008	4,677	$ 16.18	4.35	$

The weighted-average grant-date fair value of options granted during the years ended December 31, 2008, 2007 and 2006 was $3.95, $3.93 and $4.54 per share, respectively. The total intrinsic value for options exercised during the years ended December 31, 2008, 2007 and 2006 was $372,000, $11,248,000 and $1,344,000, respectively.

Cash received from the exercise of stock options for the years ended December 31, 2008, 2007 and 2006 was approximately $1,459,000, $45,234,000 and $6,081,000, respectively. The Company settles the exercise of stock options through the Callaway Golf Company Grantor Stock Trust (see Note 11 Capital Stock). The tax effect related to option exercises for the years ended December 31, 2008, 2007 and 2006 totaled approximately $(610,000), $3,858,000 and $578,000, respectively.

Restricted Stock, Restricted Stock Units and Performance Units

All Restricted Stock, Restricted Stock Units and Performance Share Units awarded under the 2004 Plan and the 2001 Directors Plan are recorded at the Company s closing stock price on the date of grant. Restricted Stock awards and Restricted Stock Units generally cliff-vest over a period of three years. Performance Share Units generally cliff-vest at the end of a three-year performance period. Performance Share Units are a form of stock-based award in which the number of shares ultimately received depends on the Company s performance against specified financial performance metrics over a three-year period. At the end of the performance period, the number of shares of stock issued will be determined based upon the Company s performance against those metrics.

The Company recorded $1,346,000, $1,327,000, and $1,448,000 of compensation expense relating to Restricted Stock awards for the years ended December 31, 2008, 2007 and 2006, respectively. The Company recorded $2,350,000, $1,241,000, and $156,000 of compensation expense in connection with shares underlying Restricted Stock Units for the years ended December 31, 2008, 2007 and 2006, respectively. In connection with shares underlying Performance Share Units, the Company recorded $326,000 and $333,000, respectively, as of December 31, 2007 and 2006. The Company continuously evaluates the specified financial performance metrics

associated with the Performance Share Units that were granted in 2006. In 2008, based on this evaluation, the Company reversed $737,000 of compensation expense related to these awards as it was not anticipated that its performance metrics would be achieved for the payout of any portion of these awards.

The table below summarizes the total number of Restricted Stock shares and shares underlying Restricted Stock Units and Performance Share Units granted to certain employee participants and directors during the years ended December 31, 2008, 2007 and 2006, as well as the related weighted average grant date fair value for each type of award (number of shares are in thousands).

	# of Shares Granted			Weighted Average Grant-Date Fair Value		
	2008	2007	2006	2008	2007	2006
Restricted Stock Awards			166	$	$	$ 14.91
Restricted Stock Units	324	260	52	$ 14.57	$ 14.76	$ 14.37
Performance Share Units			154	$	$	$ 14.90

The fair value of nonvested Restricted Stock awards, Restricted Stock Units and Performance Share Units (collectively nonvested shares) is determined based on the closing trading price of the Company s Common Stock on the grant date. A summary of the Company s nonvested share activity for the year ended December 31, 2008 is as follows (in thousands, except fair value amounts):

Restricted Stock, Restricted Stock Units and Performance Share Units	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2008	1,103	$ 13.22
Granted	324	$ 14.57
Vested	(371)	$ 12.52
Forfeited	(33)	$ 14.67
Nonvested at December 31, 2008[(1)]	1,023	$ 13.89

(1) Total unvested shares as of December 31, 2008 include 306,000 Restricted Stock shares, 111,000 shares underlying Performance Share Units and 606,000 shares underlying Restricted Stock Units.

At December 31, 2008, there was $6,260,000 of total unrecognized compensation expense related to nonvested shares granted to both employees and non-employees under the Company s share-based payment plans. That cost is expected to be recognized over a weighted-average period of 1.2 years. The amount of unrecognized compensation expense noted above does not necessarily represent the amount that will ultimately be realized by the Company in its Statement of Operations.

Employee Stock Purchase Plan

On February 1, 2006, the Company amended and restated the Callaway Golf Company Employee Stock Purchase Plan (the Plan) to eliminate the look-back provision. Under the amended and restated plan, participating employees authorize the Company to withhold compensation and to use the withheld amounts to purchase shares of the Company s Common Stock at 85% of the closing price on the last day of each six-month offering period. During 2008, 2007 and 2006 approximately 260,000, 201,000 and 303,000 shares, respectively, of the Company s Common Stock were purchased under the Plan on behalf of participating employees. As of December 31, 2008, there were 2,900,000 shares reserved for future issuance under the Plan. In connection with the Plan, the Company recorded $537,000, $496,000 and $597,000 of compensation expense for the years ended December 31, 2008, 2007 and 2006, respectively.

Share-Based Compensation Expense

The table below summarizes the amounts recognized in the financial statements for the years ended December 31, 2008, 2007 and 2006 for share-based compensation related to employees and directors. Amounts are in thousands, except for per share data.

	2008	2007	2006
Cost of sales	$ 553	$ 490	$ 484
Operating expenses	7,059	7,141	8,172
Total cost of employee share-based compensation included in income, before income tax	7,612	7,631	8,656
Amount of income tax recognized in earnings	(2,014)	(2,320)	(2,813)
Amount charged against net income	$ 5,598	$ 5,311	$ 5,843
Impact on net income per common share:			
Basic	$ (0.09)	$ (0.08)	$ (0.08)
Diluted	$ (0.09)	$ (0.08)	$ (0.08)

From time to time, the Company accelerates the vesting of certain share-based awards as a result of employee terminations. In connection with the accelerations, the Company recognized pre-tax expense in the amount of $149,000 and $1,330,000 for the years ended December 31, 2008 and 2006, respectively. There was no accelerated vesting in 2007. In addition, the Company recorded expense of $3,221,000 and $3,261,000 for Restricted Stock awards granted to certain non-employees for the years ended December 31, 2007 and 2006, respectively, and reversed expense of $705,000 for the year ended December 31, 2008 to revalue shares of Restricted Stock at market value.

Note 13. 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 25% of annual compensation, up to the maximum permitted under federal law, and during the periods presented herein, the Company was obligated to contribute annually an amount equal to 100% of the participant s contribution up to 6% of that participant s annual compensation. The portion of the participant s account attributable to elective deferral contributions and rollover contributions are 100% vested and nonforfeitable. Participants vest in employer matching and profit sharing contributions at a rate of 25% per year, becoming fully vested after the completion of four years of service. Employees contributed $10,019,000, $9,200,000 and $9,235,000 to the 401(k) Plan in 2008, 2007 and 2006, respectively. In accordance with the provisions of the 401(k) Plan, the Company matched employee contributions in the amount of $7,098,000, $6,379,000 and $6,307,000 during 2008, 2007 and 2006, respectively. Additionally, the Company can make discretionary contributions based on the profitability of the Company. For the years ended December 31, 2008, 2007 and 2006 there were no discretionary contributions. Effective February 1, 2009, in light of the unfavorable economic conditions, the 401(k) Plan was amended to suspend the Company s obligation to match employee contributions for 2009.

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. To support the deferred compensation plan, the Company has elected to purchase Company-owned life insurance. The cash surrender value of the Company-owned insurance related to deferred compensation is included in other long-term assets and was $7,178,000 and $9,103,000 at December 31, 2008 and 2007, respectively. The liability for the deferred compensation is included in long-term liabilities and was $6,438,000 and $7,790,000 at December 31, 2008, and 2007, respectively. For the years ended December 31, 2008 and 2007, the total participant deferrals were $1,346,000 and $1,609,000, respectively.

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Note 14. Income Taxes

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

	Year Ended December 31,		
	2008	2007	2006
United States	$ 76,255	$ 69,481	$ 18,455
Foreign	25,052	18,794	16,543
	$ 101,307	$ 88,275	$ 34,998

The provision for income taxes is as follows (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Current tax provision:			
Federal	$ 18,534	$ 25,127	$ 2,986
State	1,720	4,061	1,085
Foreign	8,370	2,790	6,050
	28,624	31,978	10,121
Deferred tax expense (benefit):			
Federal	4,216	(2,288)	645
State	1,297	(675)	289
Foreign	994	4,673	653
	6,507	1,710	1,587
Income tax provision	$ 35,131	$ 33,688	$ 11,708

During 2008, 2007 and 2006, tax benefits related to the exercise or vesting of stock-based awards were $1,379,000, $6,031,000 and $884,000, respectively. Such benefits were recorded as a reduction of income taxes payable with a corresponding increase in additional paid-in capital or a decrease to deferred tax assets in connection with compensation cost previously recognized in income.

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Deferred tax assets and liabilities are classified as current or noncurrent according to the classification of the related asset or liability. Significant components of the Company s deferred tax assets and liabilities as of December 31, 2008 and 2007 are as follows (in thousands):

	December 31,	
	2008	2007
Deferred tax assets:		
Reserves and allowances	$ 18,924	$ 18,476
Depreciation	20,666	9,575
Compensation and benefits	8,031	16,060
Effect of inventory overhead adjustment	4,675	4,398
Compensatory stock options and rights	5,619	5,836
Deferred revenue and other	1,804	2,080
Operating loss carryforwards	1,410	1,705
Tax credit carryforwards	2,780	3,633
Energy derivative		8,305
Other	239	44
Total deferred tax assets	64,148	70,112
Valuation allowance for deferred tax assets	(2,277)	(4,702)
Deferred tax assets, net of valuation allowance	61,871	65,410
Deferred tax liabilities:		
State taxes, net of federal income tax benefit	(1,846)	(3,094)
Prepaid expenses	(2,390)	(1,707)
Amortization	(24,290)	(20,757)
Net deferred tax assets	$ 33,345	$ 39,852

The Company identified a misclassification in the presentation of its long-term deferred taxes in 2007. The Company had reported in its consolidated balance sheet long-term deferred tax assets and long-term deferred tax liabilities as separate line items. In accordance with paragraph 42 of SFAS No. 109, *Accounting for Income Taxes* , deferred tax assets and deferred tax liabilities should be offset and presented as a single amount when they relate to a particular tax-paying component of an enterprise within the same tax jurisdiction. As such, the Company s 2007 consolidated balance sheet has been corrected to be consistent with the requirements of SFAS No. 109 and the current presentation to report only the net amount of current and long-term deferred tax assets and deferred tax liabilities when they relate to the same tax jurisdiction. This correction resulted in an $18,885,000 decline in long-term deferred tax assets from $18,885,000 to zero as well as a corresponding decline in long-term deferred tax liabilities from $21,252,000 to $2,367,000. Additionally, total assets decreased from $856,963,000 to $838,078,000 as of December 31, 2007. This correction has no effect on the previously reported shareholders equity, statement of cash flows or net income.

The current year change in net deferred taxes of $6,507,000 is comprised of a net deferred benefit of $510,000 related to FIN 48 reserves offset by a net deferred expense of $7,017,000 recorded through current income tax expense for the year ended December 31, 2008.

Of the total tax credit carryforwards of $2,780,000 at December 31, 2008, the Company has state investment tax credits of $646,000, which expire in 2009 and $1,527,000 that generally do not expire and state research and development credit carryforwards of $607,000 that generally do not expire. Of the $1,410,000 of operating loss carryforwards, $845,000 relates to state loss carryforwards that expire in 2010, $346,000 relates to foreign loss carryforwards that will expire in 2013 and $219,000 relates to loss carryforwards that do not expire.

The Company maintains a valuation allowance to reduce certain deferred tax assets to amounts that are not, in management s estimation, more likely than not to be realized. This allowance primarily relates to the uncertainty of realizing certain state tax credit carryforwards and state operating loss carryforwards. Of the $2,277,000 valuation allowance at December 31, 2008, $660,000 is related to certain Top-Flite deferred tax

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assets existing at the time of the acquisition. In the future, if the Company determines that the realization of these Top-Flite deferred tax assets is more likely than not, the reversal of the related valuation allowance will reduce goodwill instead of the provision for income taxes. The change in the valuation allowance during 2008 resulted primarily from the reversal of the allowance related to the energy derivative valuation liability. Based on management s assessment, it is more likely than not that the net deferred tax assets will be realized through future earnings.

A reconciliation of the effective tax rate is as follows:

	Year Ended December 31,		
	2008	2007	2006
Statutory U.S. tax rate	35.0%	35.0%	35.0%
State income taxes, net of U.S. tax benefit	3.6%	3.7%	3.5%
Federal and State tax credits, net of U.S. tax benefit	(0.9)%	(1.4)%	(1.1)%
Expenses with no tax benefit	1.4%	1.4%	5.3%
Domestic manufacturing tax benefits	(0.3)%	(0.8)%	(0.5)%
Extra-territorial income exclusion benefit			(0.8)%
Effect of foreign rate changes		0.2%	
Change in deferred tax valuation allowance	(2.4)%	0.7%	0.3%
Reversal of previously accrued taxes	(1.7)%	(1.8)%	(8.5)%
Accrual for interest and income taxes related to uncertain tax positions		1.1%	
Other		0.1%	0.2%
Effective tax rate	34.7%	38.2%	33.4%

In 2008, 2007 and 2006, the tax rate benefited from net favorable adjustments to previously estimated tax liabilities in the amount of $1,716,000, $1,620,000 and $2,983,000, respectively. The most significant favorable adjustments in each year related to adjustments resulting from the finalization of the Company s prior year U.S. and state income tax returns as well as agreements reached with the Internal Revenue Service (IRS) and other major jurisdictions on certain issues necessitating a reassessment of the Company s tax exposures for all open tax years, with no individual year being significantly affected.

Effective January 1, 2007, the Company was required to adopt and implement the provisions of FIN 48, which requires the Company to accrue for the estimated additional amount of taxes for uncertain tax positions if it is more likely than not that the Company would be required to pay such additional taxes. An uncertain income tax position will not be recognized if it has less than 50% likelihood of being sustained. As a result of the adoption of FIN 48 in 2007, the Company recognized an increase in the liability for its uncertain tax positions of $437,000, of which the entire charge was accounted for as a decrease to the beginning balance of retained earnings. The accrual for uncertain tax positions can result in a difference between the estimated benefit recorded in the Company s financial statements and the benefit taken or expected to be taken in the Company s income tax returns. This difference is generally referred to as an unrecognized tax benefit.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	2008	2007
Balance at January 1	$ 16,850	$ 23,632
Additions based on tax positions related to the current year	2,441	2,122
Additions for tax positions of prior years	1,588	666
Reductions for tax positions of prior years Other	(156)	(1,063)
Reductions for tax positions of prior years Bilateral Advanced Pricing Agreement between U.S. and Japan		(8,239)
Settlements	(2,327)	(258)
Reductions due to lapsed statute of limitations	(1,871)	(10)
Balance at December 31	$ 16,525	$ 16,850

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As of December 31, 2008, the liability for income taxes associated with uncertain tax benefits was $16,525,000 and can be reduced by $6,160,000 of offsetting tax benefits associated with the correlative effects of potential transfer pricing adjustments which was recorded as a long-term income tax receivable, as well as $2,475,000 of tax benefits associated with state income taxes and other timing adjustments which are recorded as deferred income taxes pursuant to FIN 48. The net amount of $7,890,000, if recognized, would affect the Company s financial statements and favorably affect the Company s effective income tax rate.

The Company does expect changes in the amount of unrecognized tax benefits in the next twelve months; however, the Company does not expect the change to have a material impact on its results of operations or its financial position.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. For the year ended December 31, 2008 the Company recognized a benefit of approximately $195,000 related to interest and penalties in the provision for income taxes. This benefit resulted from the reversal of interest previously accrued on issues that were either settled or for which the statute of limitations lapsed during the year. As of December 31, 2008 and 2007, the Company had accrued $1,329,000 and $1,524,000, respectively, (before income tax benefit) for the payment of interest and penalties.

All issues that were pending before IRS Appeals on December 31, 2007 related to tax years 2001 through 2003 were settled during 2008. Resolution of the issues pending before Appeals resulted in a minor increase to net earnings in 2008. The Company is currently under audit by the IRS for tax years 2005 through 2007 and the examination is not expected to be concluded within the next twelve months.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is generally no longer subject to income tax examinations by tax authorities in its major jurisdictions as follows:

Tax Jurisdiction	**Years No Longer Subject to Audit**
U.S. federal	2004 and prior
California (U.S.)	2000 and prior
Massachusetts (U.S.)	2003 and prior
Australia	2003 and prior
Canada	2003 and prior
Japan	2003 and prior
Korea	2002 and prior
United Kingdom	2002 and prior

As of December 31, 2008, the Company did not provide for United States income taxes or foreign withholding taxes on a cumulative total of $77,300,000 of undistributed earnings from certain non-U.S. subsidiaries that will be permanently reinvested outside the United States. Upon remittance, certain foreign countries impose withholding taxes that are then available, subject to certain limitations, for use as credits against the Company s U.S. tax liability, if any. It is not practicable to estimate the amount of the deferred tax liability on such unremitted earnings. Should the Company repatriate foreign earnings, the Company would have to adjust the income tax provision in the period management determined that the Company would repatriate earnings.

Note 15. Commitments and Contingencies

Legal Matters

In conjunction with the Company s program of enforcing its proprietary rights, the Company has initiated or may initiate actions against alleged infringers under the intellectual property laws of various countries, including, for example, the U.S. Lanham Act, the U.S. Patent Act, and other pertinent laws. The Company is also active internationally. For example, it has worked with other golf equipment manufacturers to encourage Chinese and

other foreign government officials to conduct raids of identified counterfeiters, resulting in the seizure and destruction of counterfeit golf clubs and, in some cases, criminal prosecution of the counterfeiters. Defendants in these actions may, among other things, contest the validity and/or the enforceability of some of the Company s patents and/or trademarks. Others may assert counterclaims against the Company. Historically, these matters individually and in the aggregate have not had a material adverse effect upon the financial position or results of operations of the Company. It is possible, however, that in the future one or more defenses or claims asserted by defendants in one or more of those actions may succeed, resulting in the loss of all or part of the rights under one or more patents, loss of a trademark, a monetary award against the Company or some other material loss to the Company. One or more of these results could adversely affect the Company s overall ability to protect its product designs and ultimately limit its future success in the marketplace.

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

On February 9, 2006, the Company filed a complaint in the United States District Court for the District of Delaware, Case No. C.A. 06-91, asserting claims against Acushnet Company for patent infringement. Specifically, Callaway Golf asserted that Acushnet s sale of the Titleist Pro V1 family of golf balls infringes four golf ball patents that Callaway Golf acquired when it acquired the assets of Top-Flite. Callaway Golf is seeking damages and an injunction to prevent future infringement by Acushnet. In its answer to the Complaint, Acushnet responded that the patents at issue are invalid and not infringed by the Pro V1 family of golf balls. On November 20, 2007, the District Court rejected various legal challenges by Acushnet as to the validity of the patents, permitting Callaway Golf s claims against Acushnet to proceed to trial, and ruled that the issues of damages and willfulness would be decided in a second trial between the parties at a later date. On the eve of trial, Acushnet stipulated that its Pro V1 family of golf balls collectively infringe the nine claims in the four patents asserted by Callaway Golf. As a result of the Court s rulings, and Acushnet s concession as to infringement, only the validity of the patents was tried before a jury commencing on December 5, 2007. On December 14, 2007, after a six-day trial, a unanimous jury decided that eight of the nine patent claims asserted by Callaway Golf against Acushnet are valid. The Court entered judgment in favor of Callaway Golf and against Acushnet on December 20, 2007. On November 10, 2008, the District Court entered an order effective January 1, 2009 permanently enjoining Acushnet from infringing these valid patents. The District Court also denied Acushnet s motions for a new trial and for judgment as a matter of law, while granting a motion to dismiss a pendant state law breach of contract for lack of subject matter jurisdiction. On November 11, 2008, Acushnet announced that it had changed the formulation of its golf balls in September 2008 to avoid the patents in suit and would begin shipping new versions of the golf balls prior to the effective date of the permanent injunction. Acushnet filed its notice of appeal of the District Court s judgment with the Court of Appeals for the Federal Circuit on November 24, 2008 (Case No. 1:06-CV-91), and immediately moved for an order staying the permanent injunction. On December 23, 2008, a three judge panel of the Federal Circuit denied Acushnet s motion for a stay of the permanent injunction. On December 29, 2008, Acushnet announced a Retail Exchange Program offering to take back infringing Pro V1 golf balls and to replace them with the converted versions of those golf balls.

Acushnet has filed petitions for reexamination with the United States Patent and Trademark Office (PTO) challenging the validity of the patents asserted by Callaway Golf in the litigation described above. The PTO has issued multiple administrative decisions rejecting the claims of all four of the patents, and issued a right of appeal notice as to one of the patents. To the extent claims previously approved are no longer allowed upon the conclusion of the reexamination process, the Company will appeal such actions to the Board of Patent Appeals and Interferences (BPAI). The Company expects that some of the prior claims or newly framed claims submitted as part of the reexamination proceeding will eventually be affirmed by the PTO s BPAI. The Company expects to appeal any adverse decision of the BPAI to the United States Court of Appeals for the Federal Circuit, the same court that is hearing the appeal on the merits of the District Court s judgment in the litigation described above. In the meantime, interim rulings by the PTO do not void the District Court s judgment.

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On February 27, 2007, the Company and Dailey & Associates (an advertising agency) filed a complaint in the United States District Court for the Southern District of California, Case No. 07CV0373, asserting claims against the Screen Actors Guild (SAG) and the Trustees of SAG s Pension and Health Plans (Plans) seeking declaratory and injunctive relief. Specifically, the Plans contend that Callaway Golf is required to treat a significant portion of the sums paid to professional golfers who endorse the Company s products as compensation for acting services, and to make contributions to the Plans based upon a percentage of that total amount. The Company is seeking a declaration that it is not required to contribute beyond the contributions already made, or alternatively, is obligated to pay nothing and is entitled to restitution for all contributions previously made to the Plans. The Plans filed a counterclaim to compel an audit and to recover unpaid Plan contributions, as well as liquidated damages, interest, and reasonable audit and attorneys fees. The Company recently agreed to dismiss its claims against SAG in return for SAG s agreement to be bound by the result of the Company s litigation with the Plans. A pretrial conference is set for March 16, 2009. No trial date has been set.

On January 16, 2008, the Company issued a notice of default to Ashworth Inc. under the parties May 14, 2001 License Agreement, as amended from time to time (Ashworth License). Under the Ashworth License, Ashworth had thirty (30) days from the date of notice in which to cure a default. Ashworth denied that any breach has occurred, and did not take the steps requested by the Company to cure. Accordingly, it was the Company s belief that it had the right to terminate the Agreement and Ashworth s assertion that the Ashworth License was not subject to termination. The parties were prepared to arbitrate that dispute when TaylorMade-adidas Golf announced that it was acquiring Ashworth, providing another basis for termination of the Ashworth License. Callaway Golf thereafter negotiated a transition and termination of the Ashworth License with TaylorMade-adidas Golf, calling for a termination of the Ashworth License in 2009. As a result of the transition and termination agreement, the parties resolved and dismissed the arbitration with prejudice. Callaway Golf is negotiating a new apparel license with a new licensee.

On February 13, 2008, Ogio International Inc. filed a complaint for patent infringement against Callaway Golf in the United States District Court, for the District of Utah, Case No. 08CV116. Specifically, Ogio alleges that Callaway Golf s sales of Warbird XTT, Warbird Hot, Terra Firma X, Terra Firma XI, CX Cart, Euro Stand, and Matrix and Hyper-X golf bags infringe one or more claims of United States Patents numbered 6,877,604 and 7,213,705. The complaint seeks compensatory damages and an injunction. The Company has answered the complaint denying that it infringes the patents. Discovery has not yet commenced and no trial date has been set.

On May 8, 2008, Kenji Inaba filed a suit against Callaway Golf Japan in the Osaka District Court in Japan. Inaba has alleged that certain golf balls sold by Callaway Golf Japan with a hex aerodynamic pattern infringe his Japanese utility design patent No. 3,478,303 and his Japanese design patent No. 1,300,582. Inaba is seeking damages pursuant to a royalty based on sales. The Court has conducted hearings to consider the respective positions of the parties on infringement, non-infringement and invalidity. A decision is expected on the matter sometime during 2010. Callaway Golf Japan has also filed a proceeding with the Japan Patent and Trademark Office seeking to invalidate the patents in suit.

On May 13, 2008, Clear with Computers, LLC (CWC) filed a patent infringement suit against Callaway Golf Company, Callaway Golf Interactive, Inc., and forty-five other defendants in the Eastern District of Texas. CWC alleges that Callaway Golf s websites (www.callawaygolf.com, www.odysseygolf.com, www.benhogan.com, and www.topflite.com) infringe U.S. Pat. Nos. 5,615,342 and 5,367,627, relating to computer-assisted proposal generation and part sales methods. On November 17, 2008, the Company resolved the case pursuant to a confidential settlement agreement. The complaint was dismissed with prejudice on December 2, 2008.

On July 11, 2008, the Company was sued in the Eastern District of Texas by Nicholas Colucci, dba EZ Line Putters, pursuant to a complaint asserting that the Odyssey White Hot XG No. 7, White Hot XG (Long) No. 7, Black Series i No. 7, and White Hot XG Sabertooth putters infringe U.S. Patent No. 4,962,927 and infringe the

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alleged trade dress of plaintiff s EZ Line putters. The Company responded to the complaint on September 5, 2008, denying that it infringes the patent or the trade dress. Pursuant to a scheduling conference held on October 6, 2008, the Court set various pretrial deadlines and a trial date of March 1, 2010.

On January 19, 2009, the Company filed suit in the Superior Court for the County of San Diego, case no. 37-2009-00050363-CU-BC-NC, against Corporate Trade International, Inc. (CTI) seeking damages for breach of contract and for declaratory relief based on the asserted use and transfer of corporate trade credits to the Company in connection with assets from Top-Flite in 2003. On January 26, 2009, CTI filed its own suit in the United States District Court for the Southern District of New York, case no. 09CV0698, asserting claims for breach of contract, account stated and unjust enrichment, and seeking damages of approximately $8,900,000.

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

Supply of Electricity and Energy Contracts

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

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

Because the Enron Contract provided for the Company to purchase an amount of energy in excess of what it expected to be able to use in its operations, the Company accounted for the Enron Contract as a derivative instrument in accordance with SFAS No. 133. *Accounting for Derivative Instruments and Hedging Activities.* The Enron Contract did not qualify for hedge accounting under SFAS No. 133. Therefore, the Company recognized changes in the estimated fair value of the Enron Contract currently in earnings. The estimated fair value of the Enron Contract was based upon present value determination of the net differential between the contract price for electricity and the estimated future market prices for electricity as applied to the remaining amount of unpurchased electricity under the Enron Contract. Through September 30, 2001, the Company had recorded unrealized pre-tax losses of $19,922,000.

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

On November 30, 2001, EESI notified the Company that it disagreed that it was in default of the Enron Contract and that it was prepared to deliver energy pursuant to the Enron Contract. On December 2, 2001, EESI,

along with Enron Corporation and numerous other related entities, filed for bankruptcy. Since November 30, 2001, the parties have not been operating under the Enron Contract and Pilot Power has been providing energy to the Company from alternate suppliers.

As a result of the Company s notice of termination to EESI, and certain other automatic termination provisions under the Enron Contract, the Company believes that the Enron Contract has been terminated. As a result, the Company adjusted the estimated value of the Enron Contract through the date of termination, at which time the terminated Enron Contract ceased to represent a derivative instrument in accordance with SFAS No. 133. Because the Enron Contract was terminated and neither party to the contract was performing pursuant to the terms of the contract, no valuation adjustments for changes in electricity rates were recorded subsequent to November 29, 2001.

The Company continued to reflect on its balance sheet the derivative valuation account of $19,922,000, subject to quarterly review in accordance with applicable law and accounting regulations, including SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125.* During the fourth quarter of 2008, the Company, in consultation with its outside advisors, determined that the Company had met the criteria under SFAS No. 140 and therefore reversed the energy derivative valuation account. As a result, the Company recorded in income in the fourth quarter of 2008 a $19,922,000 non-cash, non-operational benefit. No provision has been made for any contingencies or obligations under the Enron Contract.

Lease Commitments

The Company leases certain warehouse, distribution and office facilities, vehicles as well as office equipment under operating leases and certain computer and telecommunication equipment under capital leases. Lease terms range from 1 to 9 years expiring at various dates through November 2017, with options to renew at varying terms. Commitments for minimum lease payments under non-cancelable operating leases as of December 31, 2008 are as follows (in thousands):

2009	$ 10,679
2010	6,668
2011	4,422
2012	3,049
2013	1,512
Thereafter	5,411
	$ 31,741

Rent expense for the years ended December 31, 2008, 2007 and 2006 was $12,985,000, $9,818,000 and $7,807,000, respectively.

Unconditional Purchase Obligations

During the normal course of its business, the Company enters into agreements to purchase goods and services, including purchase commitments for production materials, endorsement agreements with professional golfers and other endorsers, employment and consulting agreements, and intellectual property licensing agreements pursuant to which the Company is required to pay royalty fees. It is not possible to determine the amounts the Company will ultimately be required to pay under these agreements as they are subject to many variables including performance-based bonuses, reductions in payment obligations if designated minimum performance criteria are not achieved, and severance arrangements. As of December 31, 2008, the Company has entered into many of these contractual agreements with terms ranging from one to five years. The minimum obligation that the Company is required to pay under these agreements is $92,114,000 over the next five years. In

addition, the Company also enters into unconditional purchase obligations with various vendors and suppliers of goods and services in the normal course of operations through purchase orders or other documentation or that are undocumented except for an invoice. Such unconditional purchase obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in this total. Future purchase commitments as of December 31, 2008 are as follows (in thousands):

2009	$ 50,641
2010	24,033
2011	11,601
2012	3,964
2013	1,875
Thereafter	
	$ 92,114

Other Contingent Contractual Obligations

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company s customers and licensees in connection with the use, sale and/or license of Company products, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct of the Company and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has made contractual commitments to each of its officers and certain other employees providing for severance payments upon the termination of employment. The Company also has consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued guarantees in the form of two standby letters of credit as security for contingent liabilities under certain workers compensation insurance policies and as collateral for a loan issued to GEI. In addition, in connection with the uPlay acquisition (see Note 4), the Company could be required to pay an additional purchase price, not to exceed $10,000,000, based on a percentage of earnings generated from the sale of uPlay products over a period of three years ending on December 31, 2011.

The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company s financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that material payments will be required under the indemnities, commitments and guarantees described above. The fair value of indemnities, commitments and guarantees that the Company issued during the twelve months ended December 31, 2008 was not material to the Company s financial position, results of operations or cash flows.

Employment Contracts

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

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Note 16. Fair Value of Financial Instruments

The Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157) as of January 1, 2008. SFAS No. 157 applies to certain assets and liabilities that are being measured and reported on a fair value basis. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosure about fair value measurements. SFAS No. 157 enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. SFAS No. 157 requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The following table summarizes the valuation of the Company s derivative instruments by the above SFAS No. 157 pricing levels as of the valuation dates listed (in thousands):

	December 31, 2008		December 31, 2007	
	Carrying Value	Observable market based inputs (Level 2)	Carrying Value	Observable market based inputs (Level 2)
Derivative instruments liability position	$ 2,007	$ 2,007	$ 421	$ 421

The fair value of the Company s foreign currency exchange contracts is determined based on observable inputs that are corroborated by market data. All derivatives on the balance sheet are recorded at fair value with changes in fair value recorded in the statement of operations.

Note 17. Segment Information

The Company s operating segments are organized on the basis of products and include golf clubs and golf balls. The golf clubs segment consists primarily of Callaway Golf, Top-Flite and Ben Hogan woods, hybrids, irons, wedges and putters as well as Odyssey putters, other golf-related accessories and royalties from licensing of the Company s trademarks and service marks. The golf balls segment consists primarily of Callaway Golf and Top-Flite golf balls that are designed, manufactured and sold by the Company. There are no significant intersegment transactions.

The table below contains information utilized by management to evaluate its operating segments.

	2008	2007[3]	2006[3]
		(In thousands)	
Net sales			
Golf Clubs	$ 894,129	$ 911,527	$ 803,124
Golf Balls	223,075	213,064	214,783
	$ 1,117,204	$ 1,124,591	$ 1,017,907
Income (loss) before tax			
Golf Clubs	$ 134,018	$ 151,759	$ 101,837
Golf Balls	6,903	902	(6,396)
Reconciling items[1]	(39,614)	(64,386)	(60,443)
	$ 101,307	$ 88,275	$ 34,998
Identifiable assets[2]			
Golf Clubs	$ 429,170	$ 413,352	$ 419,212
Golf Balls	146,855	140,730	152,282
Reconciling items[2]	279,313	283,996	258,197
	$ 855,338	$ 838,078	$ 829,691
Goodwill			
Golf Clubs	$ 29,744	$ 32,060	$ 30,833
Golf Balls			
	$ 29,744	$ 32,060	$ 30,833
Depreciation and amortization			
Golf Clubs	$ 23,863	$ 23,975	$ 21,045
Golf Balls	14,100	11,351	11,229
	$ 37,963	$ 35,326	$ 32,274

(1) Represents corporate general and administrative expenses and other income (expense) not utilized by management in determining segment profitability. In 2008, the reconciling items include a one-time reversal of $19,922,000 in connection with the Company s termination of a long-term energy supply contract (see Note 15).

(2) Identifiable assets are comprised of net inventory, certain property, plant and equipment, intangible assets and goodwill. Reconciling items represent unallocated corporate assets not segregated between the two segments.

(3) The Company identified a misclassification in the presentation of its long-term deferred taxes in 2007 and 2006. The Company had reported in its consolidated balance sheet deferred tax assets and deferred tax liabilities as separate line items. In accordance with paragraph 42 of SFAS No. 109, Accounting for Income Taxes (SFAS No.109), deferred tax assets and deferred tax liabilities should be offset and presented as a single amount when they relate to a particular tax-paying component of an enterprise within the same tax jurisdiction. As such, the Company s 2007 and 2006 consolidated balance sheets have been corrected to be consistent with the requirements of FASB No. 109 and the current presentation to report only the net amount of current and long-term deferred tax assets and deferred tax liabilities when they relate to the same tax jurisdiction. For further discussion see Note 14 Income Taxes .

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The Company s net sales by product category are as follows:

	Year Ended December 31, 2008	2007 (In thousands)	2006
Net sales			
Drivers and Fairway Woods	$ 268,286	$ 305,880	$ 266,478
Irons	308,556	309,594	287,960
Putters	101,676	109,068	102,714
Golf Balls	223,075	213,064	214,783
Accessories and Other	215,611	186,985	145,972
	$ 1,117,204	$ 1,124,591	$ 1,017,907

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

	Sales	Long-Lived Assets[1]
	(In thousands)	
2008		
United States	$ 554,029	$ 320,594
Europe	191,089	7,354
Japan	166,476	8,180
Rest of Asia	80,011	3,171
Other foreign countries	125,599	13,750
	$ 1,117,204	$ 353,049
2007		
United States	$ 597,569	$ 302,941
Europe	193,336	10,353
Japan	120,148	3,216
Rest of Asia	86,133	1,271
Other foreign countries	127,405	15,574
	$ 1,124,591	$ 333,355
2006		
United States	$ 566,600	$ 305,305
Europe	159,886	9,457
Japan	105,705	2,829
Rest of Asia	75,569	2,374
Other foreign countries	110,147	13,962
	$ 1,017,907	$ 333,927

(1)

Prior year amounts were reclassified to conform with the current year presentation, which includes other long term assets by geographic region.

Note 18. Licensing Arrangements

The Company from time to time, in exchange for a royalty fee, licenses its trademarks and service marks to third parties for use on products such as golf apparel, watches, travel gear, rangefinders and practice aids. The Company has current licensing arrangements with (i) Sanei International Co., Ltd. for a complete line of men s and women s apparel for distribution in Japan, Korea, China and other Asian Pacific countries, and (ii) Playcorp Pty. Ltd. for a complete line of men s and women s apparel for distribution in Australia and New Zealand. From 2001

through 2008, the Company had a licensing arrangement with Ashworth, Inc. for a complete line of men s and women s apparel for distribution in the United States, Canada, Europe and South Africa. In the fourth quarter of 2008 Ashworth, Inc. was acquired by the Taylor-Made-adidas Golf business. As a result, the Company elected to terminate its arrangement with Ashworth, Inc. and is actively working to transition the golf apparel licensing business to a new licensee.

In addition to apparel, the Company has also licensed its trademarks to, among others, (i) IZZO Golf for practice aids, (ii) TRG Accessories, LLC for a collection primarily consisting of travel gear, (iii) Fossil, Inc. for a line of Callaway Golf watches and clocks, (iv) Nikon Vision Co., Ltd. for rangefinders and (v) Global Wireless Entertainment, Inc. for the creation of golf-related software and applications for wireless handheld devices and platforms. Prior to April 2006, the Company had a licensing arrangement with Tour Golf Group, Inc. (TGG) for a line of Callaway Golf footwear. In April 2006, the Company terminated the licensing arrangement and acquired certain assets of TGG. The Company currently designs and sells its own Callaway Golf footwear line. Additionally, prior to June 2008, the Company had a licensing arrangement with Microvision Optical (MVO) for a line of Callaway Golf eyewear. In June 2008, the Company terminated the licensing arrangement and entered into a buying services agreement with MVO. The Company currently sells its full line of Callaway Golf eyewear. The Company recognized royalty income under its various licensing agreements of $8,847,000, $8,672,000 and $8,292,000 during 2008, 2007 and 2006, respectively.

Note 19. Transactions with Related Parties

In December 2006, the Company purchased the primary residence from one of its recently hired officers at a cost of $545,000. The purchase was pursuant to the Company s home purchase procedures as referenced in the officer s Employment Agreement. The purchase price was determined based upon two independent appraisals. During December 2006, the Company was marketing the home and accounted for the home as a long-lived asset held for sale classified as other assets. In January 2007, this residence was sold and the Company recorded a net loss of $22,500.

The Callaway Golf Company Foundation (the Foundation) oversees and administers charitable giving for the Company and makes grants to carefully selected organizations. Officers of the Company also serve as directors of the Foundation and the Company s employees provide accounting and administrative services for the Foundation. During 2008, 2007 and 2006, the Company did not contribute to the Foundation.

Note 20. Summarized Quarterly Data (Unaudited)

	Fiscal Year 2008 Quarters				
	1st	2nd	3rd	4th[2]	Total
	(In thousands, except per share data)				
Net sales	$ 366,452	$ 366,029	$ 213,451	$ 171,272	$ 1,117,204
Gross profit	$ 175,534	$ 171,080	$ 80,131	$ 60,088	$ 486,833
Net income (loss)	$ 39,666	$ 37,107	$ (7,443)	$ (3,154)	$ 66,176
Earnings (loss) per common share[1]					
Basic	$ 0.62	$ 0.59	$ (0.12)	$ (0.05)	$ 1.05
Diluted	$ 0.61	$ 0.58	$ (0.12)	$ (0.05)	$ 1.04

	Fiscal Year 2007 Quarters				
	1st	2nd	3rd	4th	Total
Net sales	$ 334,607	$ 380,017	$ 235,549	$ 174,418	$ 1,124,591
Gross profit	$ 160,721	$ 175,125	$ 94,006	$ 63,371	$ 493,223
Net income (loss)	$ 32,836	$ 36,639	$ 1,269	$ (16,157)	$ 54,587
Earnings (loss) per common share[1]					
Basic	$ 0.49	$ 0.54	$ 0.02	$ (0.25)	$ 0.82
Diluted	$ 0.48	$ 0.53	$ 0.02	$ (0.25)	$ 0.81

(1) Earnings per share is computed individually for each of the quarters presented; therefore, the sum of the quarterly earnings per share may not necessarily equal the total for the year.

(2) In the fourth quarter of 2008, net income and earnings per share were favorably affected by the reversal of a $19,922,000 energy derivative valuation account, which resulted in an after-tax benefit of $14,058,000 ($0.22 per share) (see Note 15).

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SCHEDULE II

CALLAWAY GOLF COMPANY

CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS

For the Years Ended December 31, 2008, 2007 and 2006

Date	Allowance for Sales Returns	Warranty Reserves	Allowance for Doubtful Accounts	Reserve for Obsolete Inventory
		(In thousands)		
Balance, December 31, 2005	$ 6,467	$ 13,267	$ 8,404	$ 16,678
Provision	19,124	11,696	1,823	9,015
Write-off, disposals, costs and other, net	(19,682)	(11,599)	(1,688)	(8,378)
Balance, December 31, 2006	5,909	13,364	8,539	17,315
Provision	22,457	10,504	1,519	12,182
Write-off, disposals, costs and other, net	(22,670)	(11,482)	(2,068)	(9,368)
Balance, December 31, 2007	5,696	12,386	7,990	20,129
Provision	26,233	9,698	3,349	11,702
Write-off, disposals, costs and other, net	(25,505)	(10,470)	(2,720)	(12,870)
Balance, December 31, 2008	$ 6,424	$ 11,614	$ 8,619	$ 18,961

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EXHIBIT INDEX

Exhibit	Description
10.2	Callaway Golf Company First Amendment to the First Amended and Restated Chief Executive Officer Employment Agreement, effective as of January 26, 2009, by and between Callaway Golf Company and George Fellows.
10.4	Callaway Golf Company First Amendment to the Officer Employment Agreement, effective as of January 26, 2009, by and between the Company and Steven C. McCracken.
10.6	Callaway Golf Company First Amendment to the Officer Employment Agreement, effective as of January 26, 2009, by and between the Company and Bradley J. Holiday.
10.8	Callaway Golf Company First Amendment to the Officer Employment Agreement, effective as of January 26, 2009, by and between the Company and David A. Laverty.
10.10	Callaway Golf Company First Amendment to the Officer Employment Agreement, effective as of January 26, 2009, by and between the Company and Thomas Yang.
10.19	Notice of Grant and Agreement for Contingent Stock Option/SAR, effective as of January 29, 2009, between the Company and George Fellows.
10.20	Notice of Restricted Stock Unit Grant, effective as of January 29, 2009, between the Company and George Fellows.
10.21	Notice of Grant of Stock Option and Option Agreement, effective as of January 29, 2009, between the Company and George Fellows.
21.1	List of Subsidiaries.
23.1	Consent of Deloitte & Touche LLP.
24.1	Form of Limited Power of Attorney.
31.1	Certification of George Fellows pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Bradley J. Holiday pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of George Fellows and Bradley J. Holiday pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.