

CALLAWAY GOLF CO
Form 10-K
February 26, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .

Commission file number 1-10962

Callaway Golf Company

(Exact name of registrant as specified in its charter)

Delaware

95-3797580

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(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

2180 Rutherford Road
Carlsbad, CA 92008
(760) 931-1771

(Address, including zip code, and telephone number, including area code, of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

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As of June 30, 2009, the aggregate market value of the Registrant's common stock held by nonaffiliates of the Registrant was \$319,548,817 based on the closing sales price of the Registrant's common stock as reported on the New York Stock Exchange. Such amount was calculated by excluding all shares held by directors and executive officers, shares held in treasury, and shares held by the Company's grantor stock trust without conceding that any of the excluded parties are affiliates of the Registrant for purposes of the federal securities laws.

As of January 31, 2010, the number of shares of the Registrant's common stock and preferred stock outstanding was 64,392,830 and 1,400,000, respectively.

Table of Contents**DOCUMENTS INCORPORATED BY REFERENCE**

Part III incorporates certain information by reference from the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission (Commission) pursuant to Regulation 14A in connection with the Registrant's 2010 Annual Meeting of Shareholders, which is scheduled to be held on May 18, 2010. Such Definitive Proxy Statement will be filed with the Commission not later than 120 days after the conclusion of the Registrant's fiscal year ended December 31, 2009.

Important Notice to Investors: *Statements made in this report that relate to future plans, events, liquidity, financial results or performance including statements relating to future cash flows and liquidity, the funding of future operations, as well as estimated unrecognized stock compensation expense, projected capital expenditures, future contractual obligations, improvements in future economic conditions, financial results and foreign currency rates, as well as the ability to manage costs or invest in future initiatives are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are based upon current information and expectations. Actual results may differ materially from those anticipated if the information on which those estimates was based ultimately proves to be incorrect or as a result of certain risks and uncertainties, including changes in foreign currency rates, consumer acceptance and demand for the Company's products, future consumer discretionary purchasing activity (which can be significantly adversely affected by unfavorable economic or market conditions), delays, difficulties, changed strategies, or unanticipated factors including those affecting the implementation of the Company's gross margin initiatives, as well as the general risks and uncertainties applicable to the Company and its business. For details concerning these and other risks and uncertainties, see Part I, Item 1A, "Risk Factors" contained in this report, as well as the Company's other reports on Forms 10-Q and 8-K subsequently filed with the Commission from time to time. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by law, the Company undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Investors should also be aware that while the Company from time to time does communicate with securities analysts, it is against the Company's policy to disclose to them any material non-public information or other confidential commercial information. Furthermore, the Company has a policy against distributing or confirming financial forecasts or projections issued by analysts and any reports issued by such analysts are not the responsibility of the Company. Investors should not assume that the Company agrees with any report issued by any analyst or with any statements, projections, forecasts or opinions contained in any such report.*

Callaway Golf Company Trademarks: *The following marks and phrases, among others, are trademarks of Callaway Golf Company: A Better Game By Design A Passion For Excellence Anypoint Apex Ben Hogan BH Big Bertha Big Bertha Diablo Black Series Black Series i-Callaway Callaway Collection Callaway Golf Callaway uPro GO C Grind-Chev Chev 18-Chevron Device Crimson Series Demonstrably Superior and Pleasingly Different Diablo Edge-Diablo Forged-Dimple-in-Dimple Divine Line Eagle-ERC Explosive Distance. Amazing Soft Feel Flying Lady FTi-brid FTiQ FTiZ FT Performance-FT Tour-FT-5 FT-9 Freak Fusion Game Series Gems Great Big Bertha Heavenwood Hogan HX H Hot Plus HX Hot Bite IMIX Legacy Legacy Aero Legend Marksman Never Lay Up Number One Putter in Golf Odyssey OptiFit-ORG.14 Rossie S2H2 Sabertooth SRT SenSert Solaire Squareway Steelhead Strata Stronomic Sure-Out Teron TF design Series Top-Flite Top-Flite D2 Top-Flite XL Tour Authentic Tour Deep Tour i Tour i(S) Tour iX Tour i(Z) Trade In! Trade Up! Tru Bore Tunite uPro VFT War Bird Warbird WarmSport White Hot White Hot Tour White Hot XG White Ice Windsport World's Friendliest X-20 Tour X-22 X-22 Tour XL5000 XJ Series XL Extreme X-Forged X Hot X Prototype X-Series X-Series Jaws-X-SPANN Xtra Traction Technology X-Tour XTT Xtra Width Technology XWT-2-Ball 2-Ball F7.*

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CALLAWAY GOLF COMPANY

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PART I

Item 1. Business

Callaway Golf Company (the Company or Callaway Golf) was incorporated in California in 1982 with the main purpose of designing, manufacturing and selling high quality golf equipment. The Company became a publicly traded corporation in 1992, and in 1997, the Company acquired substantially all of the assets of Odyssey Sports, Inc., which manufactured and marketed the Odyssey brand of putters and wedges. The Company reincorporated in Delaware on July 1, 1999 and in 2000, the Company entered the golf ball business with the release of its first golf ball product. In 2003, the Company acquired through a court-approved sale substantially all of the golf-related assets of the TFGC Estate Inc. (f/k/a The Top-Flite Golf Company, f/k/a Spalding Sports Worldwide, Inc.), which included golf ball manufacturing facilities, the Top-Flite and Ben Hogan brands, and all golf-related patents and trademarks (the Top-Flite Acquisition). In 2008, the Company acquired certain assets and liabilities of uPlay, LLC, a developer and marketer of global positioning system (GPS) range finders.

Today, the Company, together with its subsidiaries, designs, manufactures and sells high quality golf clubs (drivers, fairway woods, hybrids, irons, wedges and putters) and golf balls, and also sells golf accessories (such as GPS range finders, golf bags, gloves, footwear, apparel, headwear, eyewear, towels and umbrellas) under the Callaway, Odyssey, Top-Flite, Ben Hogan, and uPro brand names. The Company generally sells its products to retailers, directly and through its wholly-owned subsidiaries, and to third-party distributors. The Company sells pre-owned golf products through its website, www.callawaygolfpreowned.com. In addition, in November of 2006, the Company launched an online store, where consumers can place an order for Callaway Golf, Top-Flite, Ben Hogan and Odyssey products through its website Shop.CallawayGolf.com and have the order fulfilled by a local participating retailer or, in certain circumstances, by the Company. The Company also licenses its trademarks and service marks in exchange for a royalty fee to third parties for use on golf and lifestyle products, including apparel, watches, rangefinders, practice aids and travel gear. The Company's products are sold in the United States and in over 100 countries around the world.

Table of Contents**Financial Information about Segments and Geographic Areas**

Information regarding the Company's segments and geographic areas in which the Company operates is contained in Note 18 to the Company's Consolidated Financial Statements for the years ended December 31, 2009, 2008 and 2007 (Consolidated Financial Statements), which note is incorporated herein by this reference and is included as part of Item 8 Financial Statements and Supplementary Data.

Products

The Company designs, manufactures and sells high quality golf clubs and golf balls, and designs and sells golf accessories. The Company designs its products to be technologically advanced and in this regard invests a considerable amount in research and development each year. The Company's products are designed for golfers of all skill levels, both amateur and professional.

The following table sets forth the contribution to net sales attributable to the principal product groups for the periods indicated:

	2009		Year Ended December 31, 2008		2007	
	(Dollars in millions)					
Drivers and fairway woods	\$ 223.6	24%	\$ 268.3	24%	\$ 305.9	27%
Irons	234.0	25%	308.5	28%	309.6	27%
Putters	98.1	10%	101.7	9%	109.1	10%
Golf balls	180.9	19%	223.1	20%	213.1	19%
Accessories and other	214.2	22%	215.6	19%	186.9	17%
Net sales	\$ 950.8	100%	\$ 1,117.2	100%	\$ 1,124.6	100%

For a discussion regarding the changes in net sales for each product group from 2009 to 2008 and from 2008 to 2007, see below, Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations contained in Item 7.

The Company's current principal products by product group are described below:

Drivers and Fairway Woods. This product category includes sales of the Company's drivers, fairway woods and hybrid products, which are sold under the Callaway Golf, Top-Flite and Ben Hogan brands. These products are generally made of metal (either titanium or steel) or a combination of metal and a composite material. The Company's products compete at various price levels in the drivers and fairway woods category. In general, metal drivers, fairway woods and hybrids that incorporate composite materials sell at higher price points than titanium drivers and fairway woods, and titanium products sell at higher price points than steel products. The Company's drivers, fairway woods and hybrid products are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers. All of the Company's current drivers, fairway woods and hybrid products conform to the current rules of the United States Golf Association (the USGA) or the Royal and Ancient Golf Club of St. Andrews (the R&A), as applicable to the markets in which the products are intended to be sold.

Irons. This product category includes sales of the Company's irons and wedges, which are sold under the Callaway Golf, Top-Flite and Ben Hogan brands. The Company's irons are generally made of metal (either titanium, steel or special alloy) or a composite material (a combination of metal and polymer materials). The Company's products compete at various price levels in the irons category. In general, the Company's composite metal, titanium and special alloy irons sell at higher price points than its steel irons. The Company's irons are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers. All of the Company's current iron products conform to the current rules of the USGA and the R&A. The USGA and the R&A recently changed the Rules of Golf to gradually eliminate the use of certain groove

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designs that have been commonly used by the Company and other golf club manufacturers in irons and wedges. While models introduced prior to 2010 will still be deemed to conform to the Rules of Golf until at least 2024 so long as they are made and sold prior to 2011, models introduced in 2010 or thereafter will be required to meet the new groove standards. For further discussion on certain risks associated with product design and development, see below, *Certain Factors Affecting Callaway Golf Company* contained in Item 1A.

Putters. This product category includes sales of the Company's putters, which are sold under the Odyssey and Top-Flite brands. The Company's products compete at multiple price levels in the putters category. The Company's putters are available in a variety of styles, shafts and other specifications to accommodate the preferences and skill levels of all golfers. All of the Company's current putter products conform to the current rules of the USGA and the R&A.

Golf Balls. This product category includes sales of the Company's golf balls, which are primarily sold under the Callaway Golf and Top-Flite brands. The Company's golf balls are generally either a 2-piece golf ball (consisting of a core and cover) or a multilayer golf ball (consisting of two or more components in addition to the cover). The Company's golf ball products include covers that incorporate a traditional dimple pattern as well as covers that incorporate innovative designs, including the Company's proprietary HEX Aerodynamics (i.e., a lattice of tubes that form hexagons and pentagons), dimple-in-dimple, sub-hex and deep dimple technologies. The Company's products compete at all price levels in the golf ball category. In general, the Company's multilayer golf balls sell at higher price points than its 2-piece golf balls. All of the Company's current golf ball products conform to the current rules of the USGA and the R&A.

Accessories and Other. This product category includes sales of golf bags, golf gloves, golf footwear, GPS on-course range finders, golf and lifestyle apparel, recreational club sets, headwear, towels, umbrellas, eyewear and other accessories, as well as sales of pre-owned products through Callaway Golf Interactive, Inc. Additionally, this product category includes royalties from licensing of the Company's trademarks and service marks on products such as golf and lifestyle apparel, watches, travel gear, rangefinders and practice aids.

Product Design and Development

Product design at the Company is a result of the integrated efforts of its brand management, research and development, manufacturing and sales departments, all of which work together to generate new ideas for golf equipment. The Company has not limited itself in its research efforts by trying to duplicate designs that are traditional or conventional and believes it has created a work environment in which new ideas are valued and explored. In 2009, 2008 and 2007, the Company invested \$32.2 million, \$29.4 million and \$32.0 million, respectively, in research and development. The Company intends to continue to invest substantial amounts in its research and development activities in connection with its development of new products.

The Company has the ability to create and modify product designs by using computer aided design (CAD) software, computer aided manufacturing (CAM) software and computer numerical control milling equipment. CAD software enables designers to develop computer models of new product designs. CAM software is then used by engineers to translate the digital output from CAD computer models so that physical prototypes can be produced. Further, the Company utilizes a variety of testing equipment and computer software, including golf robots, launch monitors, a proprietary virtual test center, a proprietary performance analysis system, an indoor test range and other methods to develop and test its products. Through the use of these technologies, the Company has been able to accelerate and make more efficient the design, development and testing of new golf clubs and golf balls.

For certain risks associated with product design and development, see below, *Certain Factors Affecting Callaway Golf Company* contained in Item 1A.

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Manufacturing

In connection with the Company's gross margin improvement initiatives, the Company has aggressively moved its production capabilities for both golf clubs and golf balls to other locations and to third parties outside the United States in order to meet regional demand and reduce costs. As a result, during 2009, more than half of the Company's golf club and golf ball production volume was generated at third-party sites outside the United States. The Company continues to produce a significant amount of its golf clubs and golf balls at its facilities in Carlsbad, California and Chicopee, Massachusetts, respectively.

In general, the Company's golf clubs are assembled using components obtained from suppliers both internationally and within the United States. Significant progress has been made in automating certain facets of the manufacturing process during the last few years and continued emphasis will be placed on automated manufacturing by the Company. However, the overall golf club assembly process remains fairly labor intensive, and requires extensive global supply chain coordination. With respect to golf balls, although a significant amount of labor is still used, the overall manufacturing process is much more automated than the golf club assembly process.

The Company purchases raw materials from numerous domestic and international suppliers in order to meet scheduled production needs. Raw materials include steel, titanium alloys and carbon fiber for the manufacturing of golf clubs, and rubber, plastic ionomers, zinc stearate, zinc oxide and lime stone for the manufacturing of golf balls. For certain risks associated with golf club and golf ball manufacturing, see below, "Certain Factors Affecting Callaway Golf Company" contained in Item 1A.

Sales and Marketing

Sales in the United States

Approximately 50% of the Company's net sales were derived from sales within the United States in both 2009 and 2008, and approximately 53% in 2007. The Company primarily sells to both on- and off-course golf retailers and sporting goods retailers who sell quality golf products and provide a level of customer service appropriate for the sale of such products. The Company also sells certain products to mass merchants. On a consolidated basis, no one customer that distributes golf clubs or golf balls in the United States accounted for more than 6% of the Company's consolidated revenues in 2009, 5% in 2008 and 3% in 2007. On a segment basis, the golf ball customer base is much more concentrated than the golf club customer base. In 2009, the top five golf ball customers accounted for approximately 22% of the Company's total consolidated golf ball sales. A loss of one or more of these customers could have a significant adverse effect upon the Company's golf ball sales.

Sales of the Company's products in the United States are made and supported by full-time regional field representatives and in-house sales and customer service representatives. Most of the Company's geographic territories are covered by both a field representative and a dedicated in-house sales representative who work together to initiate and maintain relationships with customers through frequent telephone calls and in-person visits. In addition to these sales representatives, the Company also has dedicated in-house customer service representatives.

In addition, other dedicated sales representatives provide service to corporate customers who want their corporate logo imprinted on the Company's golf balls, putters or golf bags. The Company imprints the logos on the majority of these corporate products, thereby retaining control over the quality of the process and final product. The Company also pays a commission to certain on- and off-course professionals and retailers with whom it has a relationship for corporate sales that originate through such professionals and retailers.

The Company also has a separate team of club fitting specialists who focus on the Company's custom club sales. Custom club sales are generated primarily from the utilization of the Company's club fitting programs such as performance centers, which utilize high speed cameras and precision software to capture relevant swing data.

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All performance centers are also equipped with the Optifit Fitting System, which is a custom fitting system that enables golfers to experiment with an extensive variety of clubhead and shaft combinations based on the golfers' individual swing in order to find the set of golf clubs that fits their personal specifications. The Optifit Fitting System is also utilized by participating on-and off-course retail stores. In addition, the Company utilizes iron and wood fitting carts as well as tour fitting vans with club fitting and building capabilities. Club fittings are performed by golf professionals who are specifically trained to fit golfers of all abilities into custom-fitted clubs. The Company believes that offering golfers the opportunity to increase performance with custom club specifications increases sales and promotes brand loyalty.

The Company maintains various sales programs including a Preferred Retailer Program. The Preferred Retailer Program offers longer payment terms during the initial sell-in period, as well as potential rebates and discounts, for participating retailers in exchange for providing certain benefits to the Company, including the maintenance of agreed upon inventory levels, prime product placement and retailer staff training.

Sales Outside of the United States

Approximately 50% of the Company's net sales were derived from sales for distribution outside of the United States in both 2009 and 2008, and approximately 47% in 2007. The Company does business (either directly or through its subsidiaries and distributors) in more than 100 countries around the world. The Company's management believes that controlling the distribution of its products in certain major markets in the world has been and will continue to be an important element in the future growth and success of the Company.

The majority of the Company's international sales are made through its wholly-owned subsidiaries located in Europe, Japan, Canada, Korea, Australia, China, Malaysia and Thailand. In addition to sales through its subsidiaries, the Company also sells through distributors in over 60 foreign countries, including Singapore, Taiwan, the Philippines, South Africa, Argentina and various countries in South America. Prices of golf clubs and balls for sales by distributors outside of the United States generally reflect an export pricing discount to compensate international distributors for selling and distribution costs. A change in the Company's relationship with significant distributors could negatively impact the volume of the Company's international sales.

The Company's sales programs in foreign countries are specifically designed based upon local laws and competitive conditions. Some of the sales programs utilized include the custom club fitting experiences and the Preferred Retailer Program or variations of those programs employed in the United States as described above.

Conducting business outside of the United States subjects the Company to increased risks inherent in international business. These risks include but are not limited to foreign currency risks, increased difficulty in protecting the Company's intellectual property rights and trade secrets, unexpected government action or changes in legal or regulatory requirements, and social, economic or political instability. For a complete discussion of these risk factors, see "Certain Factors Affecting Callaway Golf Company" contained in Item 1A below.

Sales of Pre-Owned and Outlet Golf Clubs

The Company sells certified pre-owned Callaway Golf products in addition to golf and lifestyle apparel and golf-related accessories through its websites, www.callawaygolfpreowned.com and www.callawaygolfoutlet.com. The Company generally acquires the pre-owned products through the Company's Trade In! Trade Up! program, which gives golfers the opportunity to trade in their used Callaway Golf clubs and certain competitor golf clubs at authorized Callaway Golf retailers or through the Callaway Golf Pre-Owned website for credit toward the purchase of new or pre-owned Callaway Golf equipment. The website for this program is www.tradeintradeup.com.

Online Store

The Company has a relationship with its network of authorized U.S. retailers in which consumers are linked to golf retailers through the Company's website, Shop.CallawayGolf.com. The website allows consumers to

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place an order and have it fulfilled by a local participating retailer, or in certain circumstances by the Company itself. The website offers the full line of Callaway Golf, Top-Flite and Odyssey products, including drivers, fairway woods, hybrids, irons, golf balls, footwear, eyewear, golf and lifestyle apparel and golf-related accessories, including uPro GPS on-course range finders.

Advertising and Promotion

Within the United States, the Company has focused its advertising efforts mainly on a combination of printed advertisements in national magazines, such as *Golf Magazine*, *Sports Illustrated* and *Golf Digest*, and television commercials, primarily on The Golf Channel, ESPN and on network television during golf telecasts, as well as web-based advertising. Advertising of the Company's products outside of the United States is generally handled by the Company's subsidiaries, and while it is based on the Company's global brand principles, the local execution is tailored by each region based on their unique consumer market and lifestyles.

In addition, the Company establishes relationships with professional golfers in order to promote the Company's products. The Company has entered into endorsement arrangements with members of the various professional golf tours to promote the Company's golf club and golf ball products. For certain risks associated with such endorsements, see below, Certain Factors Affecting Callaway Golf Company contained in Item 1A.

Competition

The golf club markets in which the Company competes are highly competitive and are served by a number of well-established and well-financed companies with recognized brand names. With respect to drivers, fairway woods and irons, the Company's major competitors are TaylorMade, Ping, Acushnet (Titleist and Cobra brands), SRI Sports Limited (Cleveland and Srixon brands), Mizuno, Bridgestone and Nike. For putters, the Company's major competitors are Titleist, Ping and TaylorMade. In addition, the Company also competes with SRI Sports Limited (Dunlop brand) and Yamaha among others in Japan and throughout Asia. The Company believes that it is the leader, or one of the leaders, in every golf club market in which it competes.

The golf ball business is also highly competitive. There are a number of well-established and well-financed competitors, including Acushnet (Titleist and Pinnacle brands), SRI Sports Limited (Dunlop and Srixon brands), Bridgestone (Bridgestone and Precept brands), Nike, TaylorMade and others. These competitors compete for market share in the golf ball business, with Acushnet having a market share of over 50% of the golf ball business in the United States and a leading position in other regions outside the United States. The Company's golf ball products continue to be well received by both professional and amateur golfers alike, and continue to receive a significant degree of usage on the major professional golf tours and maintained the number two position on the PGA Tour in 2009. In addition, the Company's golf ball products remained number two in U.S. revenue market share in 2009.

For both golf clubs and golf balls, the Company generally competes on the basis of technology, quality, performance, customer service and price. In order to gauge the effectiveness of the Company's response to such factors, its management receives and evaluates Company-generated market research for U.S. and foreign markets, as well as periodic public and customized market research for U.S. markets from *Golf Datatech*.

For risks relating to competition, see below, Certain Factors Affecting Callaway Golf Company contained in Item 1A.

Environmental Matters

The Company's operations are subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the environment and establish standards for the handling,

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generation, emission, release, discharge, treatment, storage and disposal of certain materials, substances and wastes and the remediation of environmental contaminants (Environmental Laws). In the ordinary course of its manufacturing processes, the Company uses paints, chemical solvents and other materials, and generates waste by-products, that are subject to these Environmental Laws. In addition, in connection with the Top-Flite Acquisition, the Company assumed certain monitoring and remediation obligations at its manufacturing facility in Chicopee, Massachusetts.

The Company adheres to all applicable Environmental Laws and takes action as necessary to comply with these laws. The Company maintains an environmental and safety program and employs two full-time senior environmental engineers at its Carlsbad, California facility and a director of environmental, health and safety matters at its Chicopee, Massachusetts facility to manage the program. The environmental and safety program includes obtaining environmental permits as required, capturing and appropriately disposing of any waste by-products, tracking hazardous waste generation and disposal, air emissions, safety situations, material safety data sheet management, storm water management and recycling, and auditing and reporting on its compliance.

Historically, the costs of environmental compliance have not had a material adverse effect upon the Company's business. Furthermore, the Company believes that the monitoring and remedial obligations it assumed in connection with the Top-Flite Acquisition did not have and are not expected to have a material adverse effect upon the Company's business. The Company believes that its operations are in substantial compliance with all applicable Environmental Laws.

Sustainability

The Company believes it is important for the Company to conduct its business in an environmentally, economically, and socially sustainable manner. In this regard, the Company has implemented an environmental sustainability initiative which focuses on reductions of volatile organic compound (VOC) emissions, reductions of hazardous waste, reductions in water usage, improved recycling and expansion of its Green Chemistry initiative which involves the elimination or reduction of undesirable chemicals and solvents in favor of chemically similar functional alternatives. These efforts cross divisional lines and are visible in our facilities department through its Cool Planet Project (a partnership with our local utility company designed to encourage large industrial customers to install energy efficiency projects in return for cost effective, user-friendly assistance to measure and further reduce greenhouse gas emissions), in our manufacturing processes through automation and waste minimization, in our product development processes through design efficiency and specification of environmentally preferred substances, and in logistics improvements and packaging minimization. These programs are routinely monitored through metrics reporting and reviewed by senior management.

The Company also has two existing programs focusing on the community, the Callaway Golf Company Foundation and the Callaway Golf Company Employee Community Giving Department. Through these programs the Company and its employees are able to give back to the community through monetary donations and by providing community services. Information on both of these programs is available on the Company's website at www.callawaygolf.com. By being active and visible in the community and by embracing the tenets of environmental stewardship, the Company believes it is acting in an economically sustainable manner.

Intellectual Property

The Company is the owner of approximately 3,000 U.S. and foreign trademark registrations and over 2,500 U.S. and foreign patents relating to the Company's products, product designs, manufacturing processes and research and development concepts. Other patent and trademark applications are pending and await registration. In addition, the Company owns various other protectable rights under copyright, trade dress and other statutory and common laws. The Company's intellectual property rights are very important to the Company and the Company seeks to protect such rights through the registration of trademarks and utility and design patents, the maintenance of trade secrets and the creation of trade dress. When necessary and appropriate, the Company

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enforces its rights through litigation. Information regarding current litigation matters in connection with intellectual property is contained in Item 3 Legal Proceedings below and in Note 16 to the Company's Consolidated Financial Statements, Commitments and Contingencies Legal Matters.

The Company's patents are generally in effect for up to 20 years from the date of the filing of the patent application. The Company's trademarks are generally valid as long as they are in use and their registrations are properly maintained and have not been found to become generic. See below, Certain Factors Affecting Callaway Golf Company contained in Item 1A.

Licensing

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 and lifestyle apparel, watches, travel gear, rangefinders and practice aids. With respect to its line of golf and lifestyle apparel, the Company has current licensing arrangements with 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 Perry Ellis International for a complete line of men's and women's apparel for distribution in the United States.

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. In addition, the Company designs and sells its own line of footwear and eyewear, and has entered into buying service agreements with Advanced Manufacturing Group Ltd. for footwear and MicroVision Optical Inc. for eyewear.

Employees

As of December 31, 2009, the Company and its subsidiaries had approximately 2,300 full-time and part-time employees. This number was reduced from 2,700 full-time and part-time employees as of December 31, 2008 in order to reduce costs to mitigate the negative impacts of the economy on the Company's results of operations. The Company employs temporary workers as the business requires.

Historically, Callaway Golf employees have not been represented by unions. The golf ball manufacturing employees in Chicopee, Massachusetts, however, are unionized and are covered under a collective bargaining agreement, which is scheduled to expire on September 30, 2011. In addition, certain of the Company's production employees in Canada and Australia are also unionized. The Company considers its employee relations to be good.

Access to SEC Filings through Company Website

Interested readers can access the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) through the Investor Relations section of the Company's website at www.callawaygolf.com. These reports can be accessed free of charge from the Company's website as soon as reasonably practicable after the Company electronically files such materials with, or furnishes them to, the Commission. In addition, the Company's Corporate Governance Guidelines, Code of Conduct and the written charters of the committees of the Board of Directors are available in the Corporate Governance portion of the Investor Relations section of the Company's website and are available in print to any shareholder who requests a copy. The information contained on the Company's website shall not be deemed to be incorporated into this report.

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Item 1A. Risk Factors

Certain Factors Affecting Callaway Golf Company

The financial statements contained in this report and the related discussions describe and analyze the Company's financial performance and condition for the periods presented. For the most part, this information is historical. The Company's prior results, however, are not necessarily indicative of the Company's future performance or financial condition. The Company has also included certain forward-looking statements concerning the Company's future performance or financial condition. These forward-looking statements are based upon current information and expectations and actual results could differ materially. The Company therefore has included the following discussion of certain factors that could cause the Company's future performance or financial condition to differ materially from its prior performance or financial condition or from management's expectations or estimates of the Company's future performance or financial condition. These factors, among others, should be considered in assessing the Company's future prospects and prior to making an investment decision with respect to the Company's stock.

Successfully managing the frequent introduction of new products that satisfy changing consumer preferences is very important to the Company's success.

The Company's main products, like those of its competitors, generally have life cycles of two years or less, with sales occurring at a much higher rate in the first year than in the second. Factors driving these short product life cycles include the rapid introduction of competitive products and quickly changing consumer preferences. In this marketplace, a substantial portion of the Company's annual revenues is generated each year by products that are in their first year of life.

These marketplace conditions raise a number of issues that the Company must successfully manage. For example, the Company must properly anticipate consumer preferences and design products that meet those preferences while also complying with significant restrictions imposed by the Rules of Golf (see further discussion of the Rules of Golf below) or its new products will not achieve sufficient market success to compensate for the usual decline in sales experienced by products already in the market. Second, the Company's R&D and supply chain groups face constant pressures to design, develop, source and supply new products that perform better than their predecessors—many of which incorporate new or otherwise untested technology, suppliers or inputs. Third, for new products to generate equivalent or greater revenues than their predecessors, they must either maintain the same or higher sales levels with the same or higher pricing, or exceed the performance of their predecessors in one or both of those areas. Fourth, the relatively short window of opportunity for launching and selling new products requires great precision in forecasting demand and assuring that supplies are ready and delivered during the critical selling periods. Finally, the rapid changeover in products creates a need to monitor and manage the closeout of older products both at retail and in the Company's own inventory.

Should the Company not successfully manage all of the risk factors associated with this rapidly moving marketplace, the Company's results of operations, financial condition and cash flows could be significantly adversely affected.

Unfavorable economic conditions could have a negative impact on consumer discretionary spending and therefore reduce sales of the Company's products.

The Company sells golf clubs, golf balls and golf accessories. These products are recreational in nature and are therefore discretionary purchases for consumers. Consumers are generally more willing to make discretionary purchases of golf products during favorable economic conditions and when consumers are feeling confident and prosperous. Discretionary spending is also affected by many other factors, including general business conditions, interest rates, the availability of consumer credit, taxes, and consumer confidence in future economic conditions. Purchases of the Company's products could decline during periods when disposable income is lower, or during

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periods of actual or perceived unfavorable economic conditions. Any significant decline in general economic conditions or uncertainties regarding future economic prospects that adversely affect consumer discretionary spending, whether in the United States or in the Company's international markets, could result in reduced sales of the Company's products, which could have a negative impact on the Company's results of operations, financial condition and cash flows.

A severe or prolonged economic downturn could adversely affect our customers' financial condition, their levels of business activity and their ability to pay trade obligations.

The Company primarily sells its products to golf equipment retailers directly and through wholly-owned domestic and foreign subsidiaries, and to foreign distributors. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral from these customers. Historically, the Company's bad debt expense has been low. However, a prolonged downturn in the general economy could adversely affect the retail golf equipment market which in turn, would negatively impact the liquidity and cash flows of our customers, including the ability of our customers to obtain credit to finance purchases of our products and to pay their trade obligations. This could result in increased delinquent or uncollectible accounts for some of the Company's significant customers. A failure by the Company's customers to pay on a timely basis a significant portion of outstanding account receivable balances would adversely impact the Company's results of operations, financial condition and cash flows.

The Company has significant international sales and purchases, and is exposed to currency exchange rate fluctuations.

A significant portion of the Company's purchases and sales are international purchases and sales, and the Company conducts transactions in approximately 14 currencies worldwide. Conducting business in such various currencies exposes the Company to fluctuations in foreign currency exchange rates relative to the U.S. dollar.

The Company's financial results are reported in U.S. dollars. As a result, transactions conducted in foreign currencies must be translated into U.S. dollars for reporting purposes based upon the applicable foreign currency exchange rates. Fluctuations in these foreign currency exchange rates therefore may positively or negatively affect the Company's reported financial results and can significantly affect period-over-period comparisons.

The effect of the translation of foreign currencies on the Company's financial results can be significant. The Company therefore from time to time engages in certain hedging activities to mitigate over time the impact of the translation of foreign currencies on the Company's financial results. The Company's hedging activities can reduce, but will not eliminate, the effects of foreign currency fluctuations. The extent to which the Company's hedging activities mitigate the effects of foreign currency translation varies based upon many factors, including the amount of transactions being hedged. The Company generally only hedges a limited portion of its international transactions. Other factors that could affect the effectiveness of the Company's hedging activities include accuracy of sales forecasts, volatility of currency markets and the availability of hedging instruments. Since the hedging activities are designed to reduce volatility, they not only reduce the negative impact of a stronger U.S. dollar but also reduce the positive impact of a weaker U.S. dollar. The Company's future financial results could be significantly affected by the value of the U.S. dollar in relation to the foreign currencies in which the Company conducts business.

Foreign currency fluctuations can also affect the prices at which products are sold in the Company's international markets. The Company therefore adjusts its pricing based in part upon fluctuations in foreign currency exchange rates. Significant unanticipated changes in foreign currency exchange rates make it more difficult for the Company to manage pricing in its international markets. If the Company is unable to adjust its pricing in a timely manner to counteract the effects of foreign currency fluctuations, the Company's pricing may not be competitive in the marketplace and the Company's financial results in its international markets could be adversely affected.

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The Company's obligations and certain financial covenants contained under the existing Line of Credit expose it to risks that could adversely affect its business, operating results and financial condition.

The Company's primary credit facility is comprised of 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. The Line of Credit is scheduled to expire on February 15, 2012 and provides for revolving loans of up to \$250,000,000, although actual borrowing availability can be effectively limited by the financial covenants contained therein, including a maximum consolidated leverage ratio and a minimum interest coverage ratio. Both the maximum consolidated leverage ratio and minimum interest coverage ratio are based in part upon the Company's trailing four quarters' earnings before interest, income taxes, depreciation and amortization, as well as other non-cash expense and income items as defined in the agreement governing the Line of Credit (adjusted EBITDA).

If the Company experiences a decline in revenues or adjusted EBITDA, the Company may have difficulty paying interest and principal amounts due on our Line of Credit or other indebtedness and meeting certain of the financial covenants contained in the Line of Credit. If the Company is unable to make required payments under the Line of Credit, or if the Company fails to comply with the various covenants and other requirements of the Line of Credit or other indebtedness, the Company would be in default thereunder, which would permit the holders of the indebtedness to accelerate the maturity thereof and increase the interest rate thereon. Any default under the Line of Credit or other indebtedness could have a significant adverse effect on the Company's liquidity, business, operating results and financial condition and ability to make any dividend or other payments on the Company's capital stock.

A reduction in the number of rounds of golf played or in the number of golf participants could adversely affect the Company's sales.

The Company generates substantially all of its revenues from the sale of golf-related products, including golf clubs, golf balls and golf accessories. The demand for golf-related products in general and golf balls in particular, is directly related to the number of golf participants and the number of rounds of golf being played by these participants. If golf participation or the number of rounds of golf played decreases, sales of the Company's products may be adversely affected. In the future, the overall dollar volume of the market for golf-related products may not grow or may decline.

In addition, the demand for golf products is also directly related to the popularity of magazines, cable channels and other media dedicated to golf, television coverage of golf tournaments and attendance at golf events. The Company depends on the exposure of its products through advertising and the media or at golf tournaments and events. Any significant reduction in television coverage of, or attendance at, golf tournaments and events or any significant reduction in the popularity of golf magazines or golf channels, could reduce the visibility of the Company's brand and could adversely affect the Company's sales.

The Company may have limited opportunities for future growth in sales of golf clubs and golf balls.

In order for the Company to significantly grow its sales of golf clubs or golf balls, the Company must either increase its share of the market for golf clubs or balls, or the market for golf clubs or balls must grow. The Company already has a significant share of worldwide sales of golf clubs and golf balls. Therefore, opportunities for additional market share may be limited. The Company also believes that overall dollar volume of the worldwide market for golf equipment sales has not experienced substantial growth in the past several years. In the future, the overall dollar volume of worldwide sales of golf clubs or golf balls may not grow or may decline.

If the Company inaccurately forecasts demand for its products, it may manufacture either insufficient or excess quantities, which, in either case, could adversely affect its financial performance.

The Company plans its manufacturing capacity based upon the forecasted demand for its products. The nature of the Company's business makes it difficult to quickly adjust its manufacturing capacity if actual demand

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for its products exceeds or is less than forecasted demand. If actual demand for its products exceeds the forecasted demand, the Company may not be able to produce sufficient quantities of new products in time to fulfill actual demand, which could limit the Company's sales and adversely affect its financial performance. On the other hand, if actual demand is less than the forecasted demand for its products, the Company could produce excess quantities, resulting in excess inventories and related obsolescence charges that could adversely affect the Company's financial performance.

The Company depends on single source or a limited number of suppliers for some of its products, and the loss of any of these suppliers could harm its business.

The Company is dependent on a limited number of suppliers for its clubheads and shafts, some of which are single sourced. Furthermore, some of the Company's products require specially developed manufacturing techniques and processes which make it difficult to identify and utilize alternative suppliers quickly. In addition, many of the Company's suppliers are not well capitalized and prolonged unfavorable economic conditions could increase the risk that they will go out of business. If current suppliers are unable to deliver clubheads, shafts or other components, or if the Company is required to transition to other suppliers, the Company could experience significant production delays or disruption to its business. The Company also depends on a single or a limited number of suppliers for the materials it uses to make its golf balls. Many of these materials are customized for the Company. Any delay or interruption in such supplies could have a material adverse impact upon the Company's golf ball business. If the Company did experience any such delays or interruptions, the Company may not be able to find adequate alternative suppliers at a reasonable cost or without significant disruption to its business.

A significant disruption in the operations of the Company's golf club assembly facilities in Carlsbad, California or its golf ball manufacturing facilities in Chicopee, Massachusetts could have a material adverse effect on the Company's sales, profitability and results of operations.

A significant amount of the Company's golf club products are assembled at and shipped from its facilities in Carlsbad, California and a significant amount of the Company's golf ball products are manufactured at and shipped from its facilities in Chicopee, Massachusetts. Any natural disaster or other significant disruption to the operation of these facilities could substantially disrupt the Company's global supply chain coordination for the relevant golf club or golf ball business segment, including damage to inventory at the respective facilities. In addition, the Company could incur significantly higher costs and longer delivery times associated with fulfilling orders and distributing product. As a result, a significant disruption at either of the Carlsbad, California or Chicopee, Massachusetts, facilities could adversely affect the Company's sales, profitability and results of operations.

If the Company is unable to obtain at reasonable costs materials or electricity necessary for the manufacture of its products, its business could be adversely affected.

The Company's size has made it a large consumer of certain materials, including steel, titanium alloys, carbon fiber and rubber. The Company does not produce these materials itself, and must rely on its ability to obtain adequate supplies in the world marketplace in competition with other users of such materials. In the future, the Company may not be able to obtain its requirements for such materials at a reasonable price or at all. An interruption in the supply of the materials used by the Company or a significant change in costs could have a material adverse effect on the Company's business.

The Company's golf club and golf ball manufacturing facilities use, among other resources, significant quantities of electricity to operate. An interruption in the supply of electricity or a significant increase in the cost of electricity could have a significant adverse effect upon the Company's results of operations.

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A disruption in the service or a significant increase in the cost of the Company's primary delivery and shipping services for its products and component parts could have a material adverse effect on the Company's business.

The Company uses United Parcel Service (UPS) for substantially all ground shipments of products to its U.S. customers. The Company uses air carriers and ship services for most of its international shipments of products. Furthermore, many of the components the Company uses to build its golf clubs, including clubheads and shafts, are shipped to the Company via air carrier and ship services. The Company's inbound and outbound shipments are particularly dependent upon air carrier facilities at Los Angeles International Airport and ship service facilities at the Port of Los Angeles (Long Beach). If there is any significant interruption in service by such providers or at other significant airports or shipping ports, the Company may be unable to engage alternative suppliers or to receive or ship goods through alternate sites in order to deliver its products or components in a timely and cost-efficient manner. As a result, the Company could experience manufacturing delays, increased manufacturing and shipping costs, and lost sales as a result of missed delivery deadlines and product demand cycles. Any significant interruption in UPS services, air carrier services or ship services could have a material adverse effect upon the Company's business. Furthermore, if the cost of delivery or shipping services were to increase significantly and the additional costs could not be covered by product pricing, the Company's operating results could be significantly adversely affected.

The Company faces intense competition in each of its markets.

Golf Clubs. The golf club business is highly competitive, and is served by a number of well-established and well-financed companies with recognized brand names. New product introductions, price reductions, consignment sales, extended payment terms, closeouts, including closeouts of products that were recently commercially successful, and significant tour and advertising spending by competitors continue to generate intense market competition. Furthermore, continued downward pressure on pricing in the market for new clubs could have a significant adverse effect on the Company's pre-owned club business as the gap narrows between the cost of a new club and a pre-owned club. Successful marketing activities, discounted pricing, consignment sales, extended payment terms or new product introductions by competitors could negatively impact the Company's future sales.

Golf Balls. The golf ball business is also highly competitive. There are a number of well-established and well-financed competitors, including one competitor with an estimated U.S. market share of approximately 50%. As the Company's competitors continue to incur significant costs in the areas of advertising, tour and other promotional support, the Company will continue to incur significant expenses in both tour and advertising support and product development. Unless there is a change in competitive conditions, these competitive pressures and increased costs will continue to adversely affect the profitability of the Company's golf ball business.

Accessories. The Company's accessories include golf bags, golf gloves, golf footwear, golf and lifestyle apparel and other items. The Company faces significant competition in every region with respect to each of these product categories. In most cases, the Company is not the market leader with respect to its accessory markets.

The Company's golf ball business has a concentrated customer base. The loss of one or more of the Company's top customers could have a significant negative impact on this business.

On a consolidated basis, no one customer that distributes golf clubs or golf balls in the United States accounted for more than 6% of the Company's consolidated revenues in 2009, 5% in 2008 and 3% in 2007. On a segment basis, the golf ball customer base is much more concentrated than the golf club customer base. In 2009, the top five golf ball customers accounted for approximately 22% of the Company's total consolidated golf ball sales. A loss of one or more of these customers could have a significant adverse effect upon the Company's golf ball sales.

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International political instability and terrorist activities may decrease demand for the Company's products and disrupt its business.

Terrorist activities and armed conflicts could have an adverse effect upon the United States or worldwide economy and could cause decreased demand for the Company's products as consumers' attention and interest are diverted from golf and become focused on issues relating to these events. If such events disrupt domestic or international air, ground or sea shipments, the Company's ability to obtain the materials necessary to produce and sell its products and to deliver customer orders would be harmed. Furthermore, such events can negatively impact tourism, which could adversely affect the Company's sales to retailers at resorts and other vacation destinations.

The Company's business could be harmed by the occurrence of natural disasters or pandemic diseases.

The occurrence of a natural disaster, such as an earthquake, fire, flood or hurricane, or the outbreak of a pandemic disease, such as the H1N1 virus (Swine Flu), could significantly adversely affect the Company's business. A natural disaster or a pandemic disease could significantly adversely affect both the demand for the Company's products as well as the supply of the components used to make the Company's products. Demand for golf products also could be negatively affected as consumers in the affected regions restrict their recreational activities and as tourism to those areas declines. If the Company's suppliers experienced a significant disruption in their business as a result of a natural disaster or pandemic disease, the Company's ability to obtain the necessary components to make its products could be significantly adversely affected. In addition, the occurrence of a natural disaster or the outbreak of a pandemic disease generally restricts the travel to and from the affected areas, making it more difficult in general to manage the Company's international operations.

The Company's business and operating results are subject to seasonal fluctuations.

The Company's business is subject to seasonal fluctuations. The Company's first quarter sales generally represent the Company's sell-in to the golf retail channel of its golf club products for the new golf season. Orders for many of these sales are received during the fourth quarter of the prior year. The Company's second and third quarter sales generally represent reorder business for golf clubs. Sales of golf clubs during the second and third quarters are significantly affected not only by the sell-through of the Company's products that were sold into the channel during the first quarter but also by the sell-through of products by the Company's competitors. Retailers are sometimes reluctant to reorder the Company's products in significant quantity when they already have excess inventory of products of the Company or its competitors. The Company's sales of golf balls are generally associated with the level of rounds played in the areas where the Company's products are sold. Therefore, golf ball sales tend to be greater in the second and third quarters, when the weather is good in most of the Company's key markets and rounds played are up. Golf ball sales are also stimulated by product introductions as the retail channel takes on initial supplies. Like golf clubs, reorders of golf balls depend on the rate of sell-through. The Company's sales during the fourth quarter are generally significantly less than the other quarters because in many of the Company's principal markets fewer people are playing golf during that time of year due to cold weather. Furthermore, the Company generally announces its new product line in the fourth quarter to allow retailers to plan for the new golf season. Such early announcements of new products could cause golfers, and therefore the Company's customers, to defer purchasing additional golf equipment until the Company's new products are available. Such deferrals could have a material adverse effect upon sales of the Company's current products or result in closeout sales at reduced prices.

The seasonality of the Company's business could exacerbate the adverse effects of unusual or severe weather conditions on the Company's business.

Because of the seasonality of the Company's business, the Company's business can be significantly adversely affected by unusual or severe weather conditions. Unfavorable weather conditions generally result in fewer golf rounds played, which generally results in reduced demand for all golf products, and in particular, golf

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balls. Furthermore, catastrophic storms can negatively affect golf rounds played both during the storms and afterward, as storm damaged golf courses are repaired and golfers focus on repairing the damage to their homes, businesses and communities. Consequently, sustained adverse weather conditions, especially during the warm weather months, could materially affect the Company's sales.

Goodwill and intangible assets represent a significant portion of our total assets and any impairment of these assets could negatively impact our results of operations and shareholders' equity.

The Company's goodwill and intangible assets consist of goodwill from acquisitions, trade names, trademarks, service marks, trade dress, patents, and other intangible assets.