



Callaway Equity Valuation and Analysis

Valued at 1 April, 2007



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Executive Summary



Investment Recommendation: Overvalued, Sell 04/1/2007

ELY – NYSE \$16.17
 52 week range \$11.49 - \$18.75
 Revenue (2006) \$1,017,907,000
 Market Capitalization \$1.32 Bil
 Shares Outstanding 73,150,000
 Dividend Yield 1.5%
 3-month Avg Daily Trade Volume 888,722
 Percent Institutional Ownership 82.1%
 Book Value Per Share (mrq) \$7.89
 ROE 3.97%
 ROA 3.27%
 Est 5 Year EPS Growth Rate

<u>Cost of Capital Est.</u>	<u>R2</u>	<u>Beta</u>	<u>Ke</u>
Ke estimated			12.03%
6-Months	.285	1.639	12.03%
5-Years	.282	1.628	11.98%
20-Years	.282	1.631	11.99
Published		2	

Kd BBY: 6.76%
 WACC BBY: 9.60%
Altman Z-Score
 ELY: 2.46

EPS Forecasts

FYE 12/31	2006(A)	2007(E)	2008(E)	2009(E)
EPS	.32	.56	.68	.74

Ratio Comparison

	<u>ELY</u>	<u>NKE</u>	<u>ADGO</u>
Trailing P/E	9.08	42.69	14.07
Forward P/E	17.79	139.48	NA
M/B	1.83	7.66	1.13

Valuation Estimates

Actual Price (as of 4/1/07) \$16.17

Ratio Based Valuations

P/E Trailing	\$75.84
P/E Forward	\$86.10
Enterprise Value	\$38.78
M/B	\$1.41

Intrinsic Valuations

Discount Dividends	\$2.70
Free Cash Flows	\$5.39
Residual Income	\$6.39
Long Run Residual Income	\$12.61
Abnormal Earnings Growth	\$6.67

Recommendation – Overvalued Firm

Company, Industry Overview and Analysis

Callaway Golf is a leading designer, manufacturer, and seller of high quality golf clubs, golf balls, and golf accessories. They were incorporated in California in 1982 and have since acquired several other companies throughout their existence. They have several competitors that are also highly established in the golf industry. These include, but are not limited to, Titleist, Ping, Taylor Made, Cobra, Nike, and Adams. Out of all of these Titleist, Cobra, Nike, and Adams are the only publicly traded companies. However Titleist and Cobra are owned by a conglomerate parent company named Fortune Brands Incorporated. These companies are in a highly competitive industry that is characterized by a high amount of research and development, innovation, and brand imaging. Competing on cost is a minimal factor compared to the previous in the golf industry, as quality is the highest emphasis. Creating a competitive advantage is achieved through customer retention by having a unique and favorable brand image, as well as having a highly qualified product. Callaway is seen as one of the leading organizations in the golf industry.

Accounting Analysis

The accounting analysis utilizes ratios and information disclosed in a firms 10-k, in order to asses the quality of a firms disclosure, as well as the quality of a firms actual information, and possible distortion. The main elements used from the 10-k are the income statement, balance sheet, statement of cash flows, and other disclosed information regarding key accounting policies. Callaway Golf's disclosure of information in their 10-kis moderate at best. Some of their actions in the past suggest aggressive policies with regards to accounting practices. For

example, in 2002 Callaway undertook a new policy that reduced warranty liability reserves by 17 million dollars. This led to the eventual separation of Callaway and KPMG as well as a 26% increase in earnings per share, rather than a 15% decline. The accounting analysis also screens a firm's 10-k for possible distortion, or red flags that may indicate distortion in a firm's numbers. We did not identify any apparent red flags for Callaway that could lead to possible distortion with regards to their financial information.

Financial Analysis

Financial Analysis consists of a set of ratios that evaluate a company's liquidity, profitability, and capital structure. These ratios are beneficial in determining a company's past performance, current performance, and possible trends for the future. By calculating these ratios for Callaway's competitors we also gain an understanding of their status in the industry.

The liquidity ratios evaluate a company's ability to convert assets into cash, which characterizes their ability to pay their debt. Callaway's ability to collect receivables and their inventory management are vital to their liquidity. These ratios include the current ratio, quick ratio, receivables turnover, days sales outstanding, inventory turnover, days supply of inventory, and working capital turnover. The profitability ratios determine a firm's ability to generate profits, these include gross profit margin, operating profit margin, net profit margin, asset turnover, return on assets, and return on equity. And finally a firm's capital structure determines a firm's financing structure. These ratios include debt to equity, times interest earned, debt service margin. Additionally the financial analysis includes a sustainable growth rate and an internal growth rate.

The core of the financial analysis is the forecasted balance sheet, income statement, and statement of cash flows. In addition to those there is also a common size for each of the statements. The common size breaks every item on the statement to a percentage amount. These forecasts are based on several

assumptions and can be assumed to be relatively accurate for the first proceeding years, with a declining accuracy as the years continue.

Intrinsic Valuation

The intrinsic valuation models determine the present value of all future cash flows generated by the firm; however each model has a different degree of explanatory power. This present value is theoretically the implied value of the firm per share of stock. Essential to these valuations is the firm's cost of equity, cost of debt, and the weighted average cost of capital (WACC). Callaway Golf has an after tax cost of debt of 4.39%, a cost of equity of 12.03%, and a WACC of 9.60%. The five valuation models we used are discounted dividends, free cash flows, residual income, long run residual income, and abnormal earnings growth. These models gave the following results: Discounted Dividends: \$2.70, Free Cash Flows: \$5.35, Residual Income: \$6.39, Long Run Residual Income: \$12.26, Abnormal Earnings Growth: \$5.19. As Callaway Golf's actual price per share on April 1st of 2007 was \$16.17, the valuation models would identify Callaway as overvalued. Another key component to the intrinsic valuation is the Altman Z-Score, which is used to determine the credit worthiness of the firm. A score of 1.8 or below indicates a firm that has bad credit and is in danger of bankruptcy, while a score of 2.67 or above indicates the opposite. Callaway Golf has a Z-Score of 2.46 which would indicate that they are not in immediate danger of bankruptcy, but they do not have highly favorable credit.

Business & Industry Analysis

Company overview

Callaway Golf was incorporated in California in 1982, and then reincorporated in Delaware on July 1, 1999. Since their foundation they have acquired several other brands such as Odyssey Sports and Top-Flite Golf. They are a sporting goods company that designs, manufactures, and sells high quality golf clubs, golf balls, and a wide range of golf accessories. They distribute their

product generally by selling to golf retailers, sporting goods retailers, mass merchants, and wholly owned subsidiaries. Their industry is characterized by several other highly recognized brand names, such as Titleist, TaylorMade, Nike, Adams Golf, etc. This leads to a high degree of competition and strong brand recognition. Callaway Golf is a seasonal business in which approximately two-thirds of its sales occur in the first half of its fiscal year, which ends December 31st, according to their annual 10-K.

Although Callaway Golf distributes through over 100 countries, approximately 56% of their net sales are derived from distribution within the United States. The majority of Callaway's international sales come from Europe, Japan, Canada, Korea, and Australia, in which they have wholly-owned subsidiaries. The bulk of Callaway's net sales come from sales on golf clubs and golf balls. On a segment base, customers that distribute golf balls in the United States are much more concentrated than golf club customers. As stated in their 10-K in 2005, the top five customers of Callaway golf balls accounted for 24% of the total golf ball sales. The loss of one of these customers could have a significantly negative affect on the sale of golf balls.

Callaway has been experiencing a steady growth in Net sales. This can be partially attributed to international market opportunities, and favorable demographics of an aging population. However rounds of play had decreased in the United States from 2000 to 2003, and then rounds of play were flat from 2004 to 2005. This was primarily due to economic conditions, weather conditions, less golf-related travel, and lower corporate spending. Innovation, product quality, and successful marketing will be crucial for further success in this industry.

	2001	2002	2003	2004	2005
Assets	647,602	679,845	748,566	735,737	764,498
Sales	818.1	793.2	814.0	934.6	998.1
Stock Price	19.15	13.25	16.85	13.50	13.84

*Sales in millions

Five Forces Model

The five forces model compares five elements of an industry. A company within the industry needs stand out in or overcome these five different elements: rivalry among existing firms, threat of new entrants, threat of substitute products, bargaining power of buyers, and bargaining power of suppliers. The five forces model will outline the type of industry Callaway must compete in.

Rivalry Among Existing Firms

Rivalry among existing firms in an industry is a significant source of competition. Highly competitive industries are likely to drive prices down closer towards marginal cost. Firms may also rely upon innovation and brand image to distinguish themselves from competitors.

Industry Growth

Growth in an industry directly correlates to gaining market share. In an industry with strong growth, competitors are not forced to gain market share from other firms to grow. Golf sporting companies; however, are in an industry that has not seen substantial growth in several years. In the Industry, Callaway already has a sizeable share of worldwide golf club sales and golf ball products that rank second in market share, so in order to significantly gain more share in the industry they must gain market share from other firms or the industry itself must see more growth. As competition within the industry increases, firms are being forced to increase expenditures on tour and advertising support along with product development. These pressures and increased costs are negatively affecting the industry. For companies to avoid these adverse affects they must continue to compete on the basis of innovation, quality, performance, customer

service, and price. Though the majority of added market share must come from other firms, the industry is still growing at a slow rate.

Concentration and Balance of Competitors

The number and size of firms in an industry determines its concentration and balance, and the degree of concentration in an industry determines the amount of price competition between firms. The Golf industry is in a highly competitive industry with a number of well-established and well-financed companies with recognized brand names. Their main competitors include: TaylorMade, Titleist, and Ping. New product introductions, price reductions, consignment sales, extended payment terms, and increased spending on advertising and brand image continue to increase market competition. For a company to stand out, they must find a way to differentiate itself from competitors, while still providing price competitive products. The industry is moderately concentrated and increasingly competitive.

Degree of Differentiation and Switching Costs

The degree to which a firm is able to differentiate their products or services from competitors allows them to avoid less direct competition. If products are similar, customers will base decisions solely on price. The industry contains more differentiation and higher switching costs. A company must try to take pride in commitment to innovation. A company must revolutionized things, like Callaway did with their driver technology and the original Big Bertha Driver. In order for a company to compete they can try innovation in clubs, putters, balls and accessories with scientifically advanced products. A golf company must use their cutting-edge technology and respect for the game to make premium products for all types of golfers. The firms must focus on providing unique high-quality products along with good service to set them apart in their industry. This industry contains a higher degree of differentiation accompanied by higher switching costs.

Ratio of Fixed to Variable Costs

The ratio of fixed to variable costs is an important factor in determining price for a firm's products or services. A firm may conduct operations in both owned and leased properties. The golf companies do not have retail space, since they distribute their products to golf retailers, sporting good retailers, and mass merchants. This would reduce the fixed costs incurred by the golf manufacturing companies. The industry's size has made it a large consumer of certain materials, including steel, titanium alloys, carbon fiber and rubber. The industry does not make these materials themselves, and must rely on suppliers to supplement these variable costs.

Excess Capacity and Exit Barriers

If supply is greater than demand in an industry, excess capacity will exist. This will force firms to cut prices to fill capacity. Most companies in the industry plan their manufacturing capacity based upon the forecasted demand for its products. 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, excess inventories could result. In an industry whose product life cycle is estimated at two years, excess inventory must be minimal. Exit barriers in the industry are substantial due to the costs of property, plant, and equipment. This means a company in this industry must have a very efficient inventory system in order to minimize excess supply and building space due to the high costs.

Threat of New Entrants

The next five force factor is threat of new entrants. This is very important in a industry. This will explain how the degree of competition in an industry can increase and how easily.

Economies of Scale

When a industry has large economies of scale, a new entrant must invest a large amount and not see the returns for a long time. Economies of scale is a big determinant when it comes to a companies overall strategy. A leading competitor in the sporting goods industry gives it an advantage over new entrants. The size of the corporation entering the industry plays a big factor. In the sporting goods industry which has high economies of scale new entrants must enter with a large amount of capital to maintain market share. In order to compete in the sporting goods industry companies must be able to bargain with their buyers. While a firm can have higher prices than its competitors, it has an overall higher quality product which buyers are willing to spend. This gives companies like Callaway an advantage over new entrants into the sporting goods industry. Also, when entering, companies will not only have to compete on quality, performance and ease of use, but also brand recognition. If companies were able to compete on price and quality they will then have to compete and offer the same services. The industry has large economies of scale.

First Mover Advantage

In the sporting goods industry companies compete on quality, performance, and ease of use. Incorporate first mover advantage by selling sets of irons to compete with other manufactures. Overall Callaway offers drivers, woods, irons, wedges, and putters, but not a full complete set. To create a first mover advantage and compete with firms that are entering the industry Callaway will have to allow the sale of a complete set of golf clubs. Although quality and brand image of a product will increase the customers switching costs, the performance and ease of use will allow most of the growth of the industry.

When switching products in the golf industry you are paying a little more, but are receiving the higher quality product that a firm offers. Because of this first mover advantage is not a very high risk.

Access to Channels of Distribution and Relationships

When there is limited space in the present distribution channels and too big of a cost to create a new one, this can create another barrier to entry. When entering the sporting goods industry, which has high costs to develop new channels, acts as powerful barriers to entry. Callaway has maintained good relationships with its existing supplier of metals and graphites to manufacture its golf clubs. While Callaway provides a higher quality product at a higher price it maintains good relationships with its buyers and suppliers to make it difficult for new firms to enter into the industry. Callaway is able to gain more channels by maintaining their high quality golf clubs and accessories. As the sporting goods industry grows Callaway will have to maintain and then gain more channels to be successful in the industry.

Legal Barriers

In the sporting goods industry there are no legal barriers that prevent any firm from entering the industry. The only legal barriers that Callaway must have are insurance for factories and facilities of products. In the sporting goods industry there are no patents or licensing regulations that exist. In the end, this creates a high risk of new entrants into the sporting goods industry, so quality and performance are a must when it comes to Callaway's industry.

It is expensive to enter this industry and the right capacity in order to compete with existing firms, and first mover advantage is not a risk. Existing firms have concrete channels of distribution and relationships. Although there are no legal barriers to enter the industry, the threat of new entrants is low to this industry. It would take too much money to invest to enter without enough return.

Threat of Substitute Products

The threat of substitute products in this industry is everywhere. There are different sports to play, other well established brand names, and many imitations to name a few. In order for a company to survive, they must differentiate themselves for other competition in the industry.

In this industry the majority of companies are well established, well financed and possessing recognizable and credible brand names. Therefore there is a threat of substitutes because several other companies provide very similar products at highly competitive prices. Callaway's strategy is to match price with top performance. Even though a company's products are often higher in price than their competitors, consumers are willing to sacrifice price in return, they receive some of the highest quality sporting good products offered on the market. A company can gain an advantage by having full time regional field representatives, and dedicated in house sales representatives that work together to initiate and maintain long lasting relationships with customers. Building a loyal customer base is one of should be a top priority. In addition, golfers usually purchase sporting products based on performance, ease of use, and appearance, not necessarily price.

Another way to battle the threat of substitutes through product differentiation by investing huge amounts of resources dedicated to innovation and improving upon existing technologies. One defining characteristic of a firm in the industry that sets them apart from their competitors is that they have the ability and resources to customize golf clubs to fit the specific needs of a particular consumer. A company can get an edge by having a separate team of manufacturing and club fitting specialists that can custom fit and manufacture clubs to their consumers. This elite team of club fitting specialists and manufacturers has vehicles with club fitting capacity enabling them to provide custom clubs to consumers anywhere, even on the golf course, further setting them apart from the competition.

Furthermore, a firm may devote a large part of their resources to advertising and marketing. The ability to advertise in national magazines, television, and sponsor many professional golfers and celebrities, can give a company even another way to differentiate themselves. The sports and golf apparel industry is difficult to predict and may be subject to rapid and unanticipated changes due to the highly competitive market.

Bargaining Power of Buyers

The bargaining power of buyers incorporates price sensitivity and relative bargaining power. The two factors make up the next five forces model and measure the strength of the buyers.

Although the industry is price sensitive, golf companies usually cater to an audience that isn't as concerned with price compared to other sports apparel consumer bases. Golf equipment is a leisure good therefore, a high percentage of the consumer base, isn't as sensitive to price compared to other sporting industries. To most customers, the percentage to the customers cost structure is relatively small when purchasing golf equipment. The buyer's power is strong when it comes to paying for quality. If a company were to fall short on quality then the customers bargaining power would come in to play and most likely lead to customers seeking other golf manufacturers, however if a firm is able to consistently produce some of the highest quality products on the market it will be able to maintain high levels of sales and a loyal customer base. There are many alternative products available to the buyer, however, when the level quality comes into play, consumers will find a pay for it.

Bargaining Power of Suppliers

In the golf industry, suppliers are primarily the manufacturers of raw materials. The materials in a golf club vary depending on the type of club. The overall quality also depends on the materials used. Customers of golf products are primarily concerned with performance, image, and brand recognition, rather

than the specifications of the materials used. There is concern however with the distinction of steel versus graphite shafts or aluminum versus titanium club heads. There are a limited number of suppliers for their club heads and shafts. Due to the company's size, it consumes large amounts of certain materials that it does not produce internally. They also require specific manufacturing techniques and processes which would make it difficult to use an alternative supplier quickly. United Parcel Service provides the primary shipping service for Callaway nationally and internationally. A disruption in shipping could also have negative effects on the company's supply chain. Maintaining a good relationship with suppliers and shippers is essential for a company to maintain consistent supplies. With these factors in consideration we conclude that the threat of bargaining power of suppliers is moderate.

Classifying the Industry

This is a highly competitive industry. In this industry, firms must rely upon innovation and brand image to distinguish themselves from competitors. Golf sporting companies are in an industry that has not seen substantial growth in several years, making it even more competitive. As competition within the industry increases, firms are being forced to increase expenditures on product development and placement. For a company to stand out, they must find a way to differentiate itself from competitors, while still providing price competitive products. This industry is also classified with a mixed cost structure, there are many ways that your costs will increase, but also many ways to decrease your costs. This means a company in this industry must be very efficient in everything they do. It is expensive to enter this industry and the right capacity in order to compete with existing firms, due to large economies of scale. Also, when entering, companies will not only have to compete on quality and performance, but also brand recognition.

Value Chain Industry Analysis

For a company to be successful in this industry it is vital that the consumer see them as the superior product. This leads to an extensive amount of research and development, product variety, and advertising. Therefore cost leadership competition between firms that are recognized as superior brands, is relatively low, making a differentiated product a key to success.

Research and Development

Expected performance of a golf club or golf ball is linked directly to quality. One way that golf companies improve quality is through research and development. Developers of golf balls and golf clubs have a wide variety of tools they use in this process, ranging from computer design software, to both destructive and non-destructive test methods. Research and development has also yielded a large variety of golf products. Every category of golf club has a variety of clubs to choose from. They are distinguished from one another by characteristics such as distance, accuracy, weight, feel, as well as many others. These characteristics, along with quality, are just one more area of differentiation that is achieved through current technology. And in a business where the estimated use of the product is 2 years, technology plays an important role.

Investment in Brand Image

Another method that golf companies use to achieve a strategic competitive advantage is heavy investment into the brand itself. Many organizations endorse a professional golfer, which establishes value to the customer by linking a prestigious golfer with a golf company's product. Brand images are also established through targeted printed advertisements in sport or golf related magazines, as well as television commercials on golf related telecasts.

Superior Product Quality

In order for a brand image to be maintained over time, a firm must continually offer the quality that is expected of it. This can only be achieved through retaining customers and continuous innovation. Whichever company is able to improve and revolutionize their product will gain a significant competitive edge. In such a fast paced industry where new products and models come regularly, strategic differentiation is what separates a company from success or failure.

Competitive Strategy Analysis

In the golf apparel industry, most manufacturers lower the prices of their products accordingly in order to stay competitive with all other manufacturers. Callaway's approach to staying on top of the Golf apparel industry has always been to provide top quality golf products with cutting edge technology, at the lowest price possible. Callaway products are in high demand because of their outstanding quality and top performance, not because they are offered at a lower price.

Research and Development

"Golfers generally purchase [Callaway] products on the basis of performance, ease of use and appearance" (Thompson One). Therefore Callaway concentrates on product differentiation. Callaway spends invests millions of dollars annually in research and development as well as production efficiency. Callaway has both CAD software (computer aided design) and CAM software (computer aided manufacturing), as they point out very clearly in their 10-K, in order to improve manufacturing efficiency as well as to ensure their products are provided to the consumer at the lowest price possible.

Superior Product Quality

Callaway has been on the forefront of a quality for many years. In the past, this was achieved by Callaway's introduction of the Big Bertha club line, which through a process of stretching titanium over the face of the club head, gave superior control and quality. This is an example of how differentiating a product had led to a competitive advantage.

Investment in Brand Image

Callaway also likes to keep their brand recognizable, by spending money in advertising their image in the proper place. Callaway advertises only through mediums that cater specifically to their key demographics. Most of their printed advertisements are found in Golf Magazine, Golf World and Golf Digest, all of which are national publications.

One of Callaway's most defining attributes, described in its 10-K, is their unparalleled customer service. Callaway has a mobile club fitting and manufacturing division that can customize clubs to consumers anywhere in the country. Club fitting customers and professionals help promote sales and brand loyalty.

In order for Callaway to sustain the competitive advantage they have now, they will continue their innovative approach partnered with the highest quality, top performing golf products available on the market today.

Accounting Analysis

In accounting analysis we will be using Callaway's 10-k to assess the quality of accounting. The most essential portions of the 10-k will be the balance sheet, the income statement, and the statement of cash flows. Also, management's discussion of key accounting policies will be an integral part of our valuation. The following will be broken into 5 parts. First we will identify and evaluate Callaway's key accounting policies, accounting flexibility, actual accounting strategy, quantitative and qualitative analysis, and potential red flags.

Key Accounting Policies

Callaway Golf's competitive strategy is based largely on product differentiation. Because of this, Callaway uses accounting policies that best reflect their identified key success factors. Some of the more prominent of these accounting policies include research and development, warranty expense and reserves, inventory management, and goodwill and intangibles.

In order for Callaway to be successful in their industry, they must always be on the leading edge of technology. This is achieved through extensive research and development. GAAP requires research and development to be expensed to the cost of goods sold account (COGS). This restricts management's flexibility and makes the benefits to the firm from R&D difficult to capitalize. Some of the most direct benefits from investments in R&D include an increase in intangible assets such as patents and improved product quality. Technological advancements such as computer aided design and manufacturing software are also directly related to R&D expenditures. "Through the use of this technology, the Company has been able to accelerate the design, development and testing of new golf clubs and golf balls" (Callaway 10-K 2005).

Since Callaway differentiates itself from competitors based on factors such as customer service and superior product quality, it is their policy to honor warranties past the stated 2 years. Warranties are estimated by historical frequency claims, as well as the cost of satisfying warranty claims. Callaway also keeps warranty reserves to ensure coverage of claims. They adjust these reserves to maintain the percentage of warranty reserves to sales fairly constant as indicated in the table. This shows that management has been able to successfully predict and account for any significant changes in warranty

expenses, and has a good idea of how much to expect warrant expenses to amount to

	2003	2004	2005	2006
Warranty Reserve/Sales	1.6%	1.3%	1.3%	1.3%

Inventory management allows firm's to choose the best-suited method of valuating their inventory. Callaway's inventories are valued at the lower of cost or market. Cost of inventory is determined by the first-in, first-out (FIFO) method. This method assumes the first products produced are the first to be sold. This allows Callaway to lower their expenses assuming that new products carry a higher product cost. This in turn, has a positive effect on net income. Due to the high degree of differentiation and innovation in the golf industry, Callaway's inventory has the risk of becoming impaired or even possibly obsolete due to new introductions and advancements in the market. Thus, "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 management's understanding of market conditions and forecasts of future product demand, all of which are subject to change" (Callaway 10-K 2005).

Goodwill and intangible assets are another key success factor Callaway must consider. Together they comprised a total of \$175 million on Callaway's 2006 consolidated balance sheet. Intangible assets include patents and trademarks. It can be somewhat difficult to give a direct dollar value to the intangibles. Callaway uses a method of estimating fair value based on earnings and depreciation. Any impairments are then adjusted to fair value. Intangible assets have accounted for a large percentage of total assets for Callaway in the past and will continue into the future.

	2001	2002	2003	2004	2005

Intangible Assets	104,467	\$103,115	\$149,635	\$149,168	\$146,123
Total Assets	\$647,602	\$679,845	\$748,566	\$735,737	\$764,498
% of Assets in Intangibles	16.1%	15.2%	20%	20.3%	19.1%

*Numbers in millions

Accounting Flexibility

The amount of accounting flexibility given to managers can directly influence how informative the firm's financial reports will be to outsiders. The determining factor, however, is not necessarily the amount of flexibility given but how the managers decide to use that flexibility.

Callaway's success highly depends on their ability to differentiate their products; therefore, they must invest large amounts of money in research and development. There is no flexibility given to managers in the reporting of R&D; it must be expensed as incurred. This lack of flexibility is detrimental to managers because even though expensed R&D provides unrecognized future benefits to the company in the form of advancements and introductions of new golf clubs and golf balls.

Managers have the option of choosing their method of calculating inventory; the LIFO, FIFO, and Average Cost are the methods that are available. Callaway, along with other competitors in the industry, chooses to value their inventory through FIFO. This flexibility given to managers allows them to either boost their net income and lower expenses (FIFO), or lower their expenses to decrease the amount of taxes they must pay (LIFO) depending upon what is needed to best represent their firm. In the case of Callaway, the FIFO method allows them to decrease the risk of impaired or obsolete inventory. The possibility of impairment along with the higher amount contributed to cost of goods sold could lead to an overstatement of Callaway's assets.

Goodwill and intangible assets are a large and vital part of Callaway's success. Intangible assets with an infinite life cannot be amortized; their fair value is measured annually and impairments are assessed accordingly. Callaway

uses its best judgment based on the most current facts and circumstances surrounding its business when applying these impairment rules. These estimates do contain error and provide management with flexibility through possible manipulation of fair values.

Callaway's ability to determine whether they classify leases as operating leases or capital leases provides a substantial amount of flexibility. Choosing to use operating leases lowers you liabilities and increases expenses, because it is an off-balance sheet account and listed under expenses. Callaway has taken this approach and lists its facilities under operating leases. Because Callaway is not a retailer and only holds operating leases in its warehouses, distribution and office facilities this is not a large concern as rent expense for 2005 was only \$7.7 million. The flexibility is still given and Callaway uses it to their benefit.

Callaway's key accounting policies grant them some flexibility in their reporting of financial numbers. GAAP provides no flexibility in reporting R&D, but they have been given flexibility in other areas. This flexibility will allow Callaway to accurately disclose meaningful information to outsiders.

Actual Accounting Strategy

Callaway has been a publicly traded company since 1982; therefore they prepare their financial statements in accordance with accounting principles generally accepted in the United States. This means they must follow the guidelines that GAAP provides for their accounting disclosure. Callaway currently uses the accounting firm Deloitte & Touché to audit their financial reports, after switching from the KPMG firm in 2002.

An accounting issue between management of the company and KPMG sprung up over a warranty issue in 2002. After Callaway overestimated their warranty reserve for two years, they decided it could be dramatically reduced. They changed the way they estimated warranty costs due to better product engineering and manufacturing systems combined with accurate record keeping and lowered costs associated with resolving warranty claims according to

WarrantyWeek.com. They came to the conclusion that the warranty reserve should be reduced by 17 million dollars. KPMG agreed with this number but disagreed with the way Callaway wanted to reduce the warranty fund. Callaway wanted to, and eventually did, account for the reduction of warranties for the quarter at which the new estimate occurred, which meant a 10.5 million dollar gross profit increase in the third quarter of 2002. KPMG disagreed and wanted go back and allocate the reduced costs to prior years. Callaway aggressively put pressure on KPMG to agree with the company. After the matter was not resolved, Callaway chose to fire the company over restating years of earnings. They hired Deloitte & Touché and reported a 26% increase in earnings per share rather than a 15% decline in 2002. This also made gross profit margins remain steady at 50%, instead of falling to 48% due to the warranty adjustment. This accounting strategy worked. After Callaway explained the accounting disagreement in its annual report, investors took the news well and the stock price in 2003 started to increase (warrantyweek). While this change in accounting policy is easily justified by Callaway, it is still a very aggressive and spontaneous step that was taken, and it had a significant impact on the firms displayed earnings. Earnings per share took a 41% increase from what would have been a 15% decline to a 26% increase. Aggressive actions with such large impacts such as this leads us to question management's actions.

The company has two operating segments divided into golf clubs and golf balls; they also break down geographic segments. This gives Callaway the opportunity to look at each aspect of their operations, which helps them narrow down problems within the company more efficiently. When looking closer at Callaway's operations, one finds that the company uses operating leases for warehouses, distribution and office facilities, vehicles and office equipment. This gives Callaway more expenses for the cost of the operating lease. This lowers their liabilities and also lowers their taxes due to heavier expenses. To account for inventories Callaway uses the first in, first out method when determining cost

of inventories. This method will give Callaway's net income an increase, because expenses will decrease.

Callaway has done well with their accounting since the estimation error in 2002. Callaway used aggressive accounting for that situation and in other in other parts of accounting, such as using operating leases and the FIFO inventory method. They use industry standard accounting practices by estimating based on historical data and market fluctuations, depreciate assets using common life spans, check for impairments periodically or when an event takes place, and always disclose information in entirety. This part accounting shows some conservatism in their financial statements. When they use aggressive accounting in some practices, they fully explain their decision and why they choose it. This gives them a fair position in the market place and also confidence with stakeholders.

Quantitative and Qualitative Analysis

To fully assess whether or not Callaway distorts any of their accounting numbers we have to take a look at the sporting goods industry as a whole. To evaluate the degree of accounting in the industry we must run diagnostics ratios. To do this we will combine ratios and fully complete a qualitative and quantitative analysis of Callaway. Many companies decide to beef up their assets by disclosing information on their financial statements. It has been known by many corporations to manipulate their financials to beef up their sales and reduce expenses to show a greater profit and revenue during a bad quarter or year. So to understand if Callaway and the industry have done this we will run sales and expense diagnostics. The sales diagnostics table can be seen below.

Callaway (Sales)	2002	2003	2004	2005	2006
Net Sales/Cash from Sales	1.02	1.05	1.08	.97	1.02
Net Sales/Net A/R	12.4	8.1	8.9	10.2	8.6

Net Sales/Warranty Liabilities	58.9	74	77.6	75.2	76.2
Net Sales/Inventory	5.2	4.4	5.2	4.1	3.8

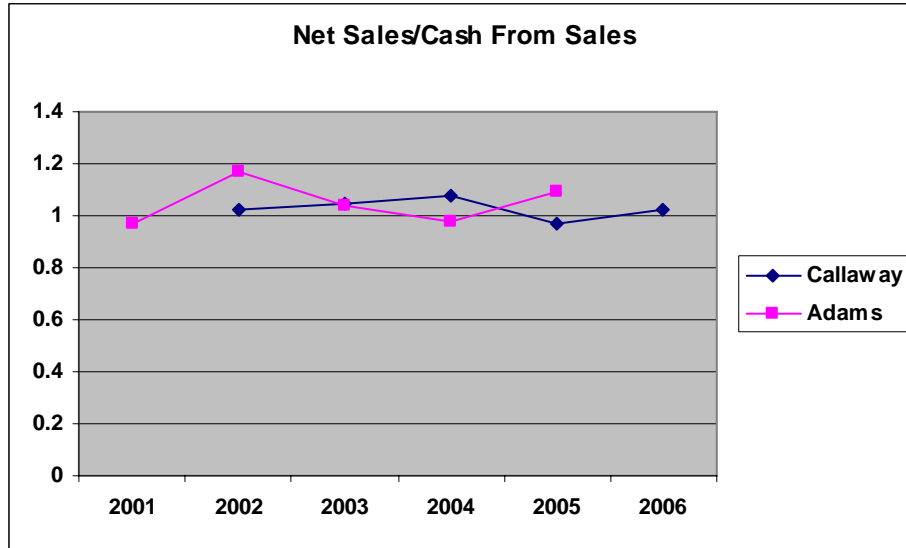
As the table shows, Callaway's numbers tend to stay pretty much average throughout the five years that we can see. This means that there are no identifiable great favorable fluctuations which may indicate manipulation.

Net sales over cash from sales were most unfavorable in 2005 at 1.08. This means that in 2004 Callaway was receiving less cash than for products sold, however afterwards in 2005, the ratio dropped below one, which means that Callaway rebounded and collected additional cash from the previous period.

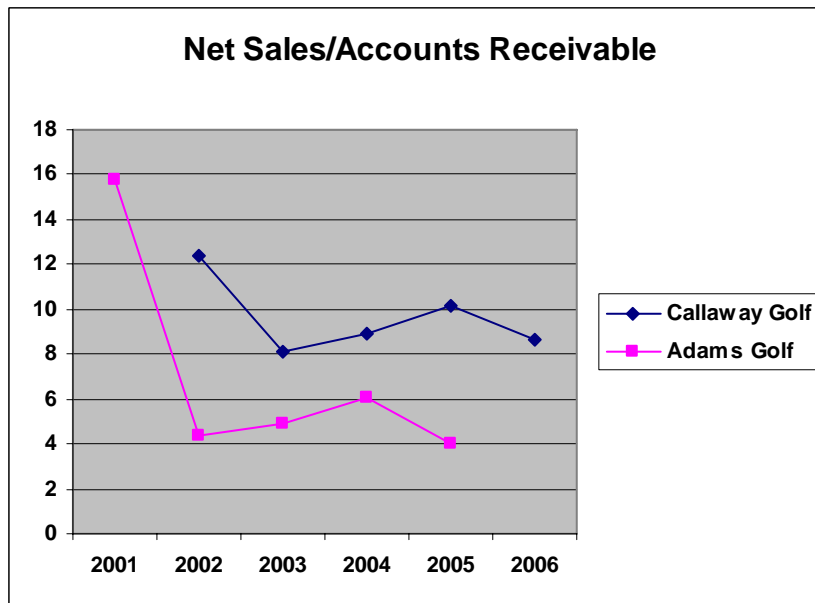
With regards to sales divided by accounts receivable the numbers have been pretty consistent around 9 with 12 in the earlier year. Net sales over net accounts receivable, are very closely related to net sales over cash from sales. These numbers can be expected to fluctuate in a related manner and have so in our chart, which leads us to believe that manipulation is unlikely.

Warranty liabilities have remained about the same throughout the years with 75. The only great variation was in 2002 with net sales over warrant liabilities of 58.9. This change can largely be explained by Callaway's large change in warranty liabilities policy in 2002.

Lastly, Sales divided by inventory has been consistent around 4 to 5 showing they have kept sales constant leaving inventory low. This indicates that Callaway has a mediocre ability to manage their inventory stocks.

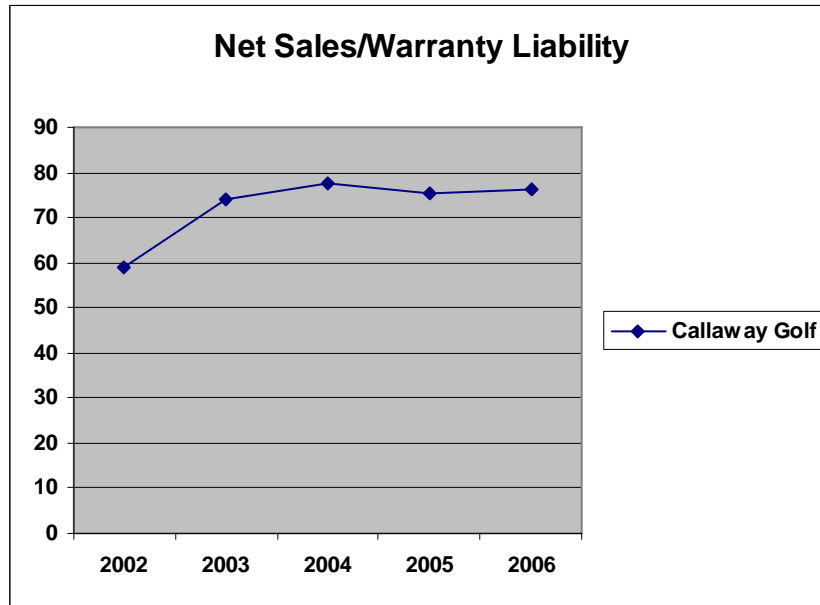


As the graph above shows Callaway and one of its main publicly traded competitors, Adams Golf, show a somewhat consistent net sale over cash from sales. It would seem that the industry is performing rather consistently, however overall, Callaway stays closer to 1 than Adams, who had a sharp increase in 2002 and 2005.

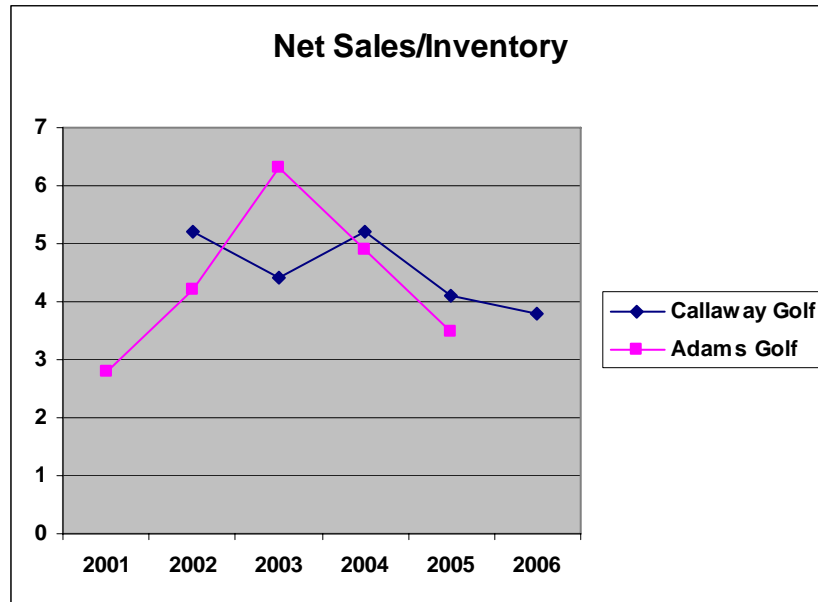


Again, this graph shows that the golf industry is following the same trend with this ratio, which would indicate that manipulation is unlikely. A higher net sales over accounts receivable is favorable as it indicates a smaller amount of receivables to sales, and a smaller risk of uncollectible accounts being written off.

In the golf industry, manufactures sell in bulk to distributors, so it is understood why accounts receivables is so high in relations to sales. Callaway has successfull7 outperformed Adams with this ratio after Adams took a sharp drop in 2002. Ideally this ratio would be improved in the future through good management of accounts receivables.



In the ratio of net sales over warranty liability, one can see a significant increase from 2002 to 2003 and then continue to remain steady to the latest ratio. This change in 2002 is due to a new estimation system of warranty liabilities, because Callaway had been overestimating the expense for years. They changed the way they estimated warranty costs due to better product engineering and manufacturing systems combined with accurate record keeping and lowered costs associated with resolving warranty claims. Plus, in 2002 they wrote off 17 million dollars of warranty expense which gave them a greater profit and revenue for the year. While the actions they took may be GAAP and not qualified as manipulating any accounts, they were still considered to be moderately aggressive. Adams Golf does not disclose their information regarding warranty liability.



Net sales over inventory indicates a firm's ability to generate sales with a given amount of inventory in assets. Ideally in the golf industry, which is characterized by innovation and research, this ratio would be as high as reasonably possible. While the results for Adams and Callaway are similar, they do not seem to follow the same trend, except from 2004 to 2005. It would seem that this ratio would be difficult to predict, however that Callaway's ratio is on the decline, meaning they could be managing their inventory stocks more efficiently. It would be difficult to determine whether there is or isn't inventory manipulation as there is no apparent trend between the firms.

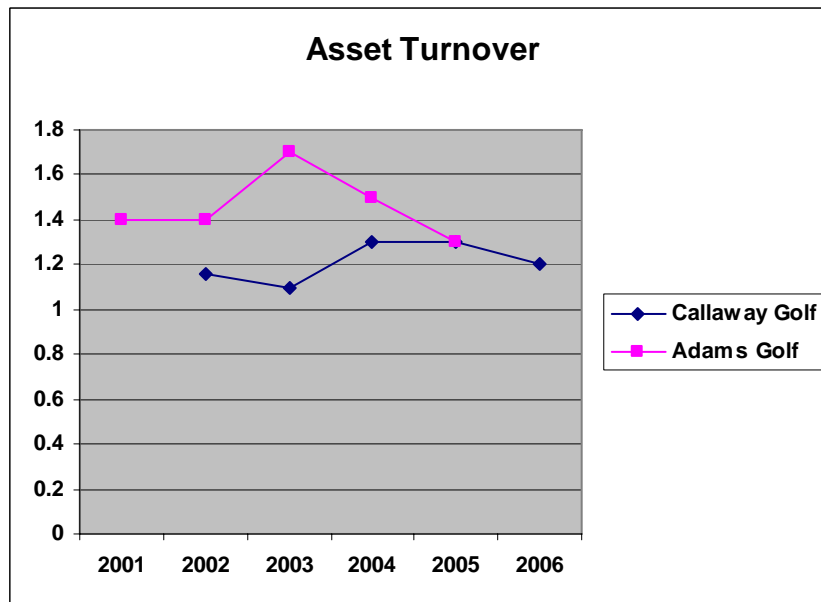
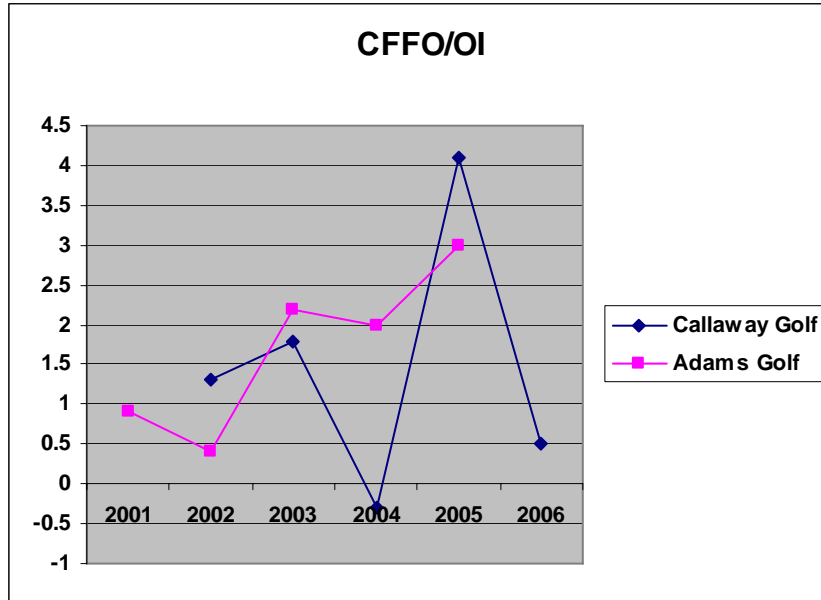
Adams Golf (Sales)	2001	2002	2003	2004	2005
Net Sales/Cash from Sales	.97	1.17	1.04	.98	1.02
Net Sales/Net A/R	15.8	4.4	4.9	6.1	4
Net Sales/Inventory	2.8	4.2	6.3	4.9	3.5

To get the full picture we had to analyze one of Callaway's competitors and run diagnostics ratios. When comparing the relation of net sales over cash from sales, both firms are fairly consistent with slight fluctuations. In addition,

when you factor in net sales over net accounts receivables, both firms follow a similar trend. When you combine these two ratios, we conclude that the two firms have a relevant reflection of the current trends in the golf industry. This leads us to believe that Callaway has not been manipulating their sales or revenues diagnostics, as it does to stray too far away from the industry, however it would seem that Callaway outperforms Adams Golf on these levels. Both firms experienced a large amount of fluctuation with regards to their net sales over inventory. This makes it difficult to set a standard for what the industry should experience. Callaway's change in this ratio has not been a favorable one, which would lead us to believe that they have not been trying to distort their inventory in order to obtain a better ratio.

Callaway (Expense)	2002	2003	2004	2005	2006
Asset Turnover	1.16	1.1	1.3	1.3	1.2
CFFO/OI	1.3	1.8	-0.3	4.1	0.5

Callaway's asset turnover has remained fairly constant with the largest shift between 2003 and 2004. This means Callaway's assets have increased at about the same rate that their sales have been increasing, although it appears that assets are slowly increasing faster than sales. The golf industry is characterized by a large amount of assets, and one can assume the larger the firm, the lower this ratio would be. Thus we find the asset turnover ratio for Callaway and Adams not to be surprising. Cash flows from operations over operating income have fluctuated greatly. The largest shift occurs after 2003. This can be explained by Callaway's acquisition of Top-Flite golf. This caused them to have a negative operating income for that period. If Adams Golf reflects the golf industry it could be assumed that Callaway should rebound from the costs of the acquisition with an increase in the ratio. However the sharp increase in 2005 followed by a sharp decrease is questionable.



Adams Golf (Expense)	2001	2002	2003	2004	2005
Declining Asset Turnover	1.4	1.4	1.7	1.5	1.3
CFFO/OI	0.9	.4	2.2	2	3

As stated above, Adams and Callaway's sales over asset ratio seems to be converging to an industry standard which would not lead us to question the numbers. With regards to cash flows from operations, the acquisition of Top-Flite makes it difficult to explain the behavior of the ratio post year 2003. We can only expect that operating income will increase for the following years. With this being said we cannot explain the sharp rebound from the increase in 2005.

Potential Red Flags

During the course of our accounting analysis of Callaway Golf we did not detect any potential Red Flags. Research & Development is expensed as incurred allowing little flexibility, which minimizes concern. Their aggressive warranty policy in past years has raised concern; however, they have explained the reasons for their course of action and had proven to be the appropriate course of action. Callaway uses the FIFO inventory method, which is commonly used and accepted by GAAP. This leads us to believe that there has not been any significant distortion concerning inventory. Callaway's goodwill and intangibles are adjusted annually to account for possible impairments; therefore, no red flags are raised. After evaluating Callaway's key accounting policies we feel there are no potential threats in their financial statements.

Overall Conclusion

As we stated, there are no apparent red flags that would call for the need to attempt to revise any of Callaway's financial statements. Their most aggressive actions taken over the past 5 years, was the alteration of the warranty liabilities policy. It may be possible to go back and adjust Callaway's warranty liability to reflect how their financial statement would appear without the alteration, however since it has occurred; the adjustment has been seen as acceptable by shareholders and analysts alike. The transparency of Callaway's 10-k can be seen as moderate. They do note a large amount of their key

accounting policies, as well as external threats. They did not note their warranty liabilities policy change in their 10-k. All of the information found regarding this was found in an article from "warranty week". We have found no apparent reasons to doubt the quality of the information disclosed in the financial statements. Excluding cash flows from operations over operating income, there were no major ratio fluctuations, that did not follow the industry, which may lead us to suspect sales or expense manipulation.

Financial Analysis

According to Palepu, Healy, and Bernard "the goal of financial analysis is to use financial data to evaluate the current and past performance of a firm and to assess its sustainability." A financial analysis using a series of ratios and forecasted financial statements are the methods used to bring meaning to financial data.

Ratio Analysis and Forecasted Financials

Completing a company valuation report involves solving numerous financial ratios and using forecasting methodology to see where the company stands now and in the future. Financial ratios and forecasts are used to provide managers with a company's performance and planning measures as well. They are also very useful for analysts in providing information to investors, bankers, and debt collectors. Next, the ratios will help give a comparison within the industry about how they match up to its competitors. Financial forecasting is the next step after financial ratios which are estimates of how the company will perform in the future. The methodology to completing this is by providing future income statements, balance sheets, and statement of cash flows. While doing so forecasts will be divided into liquidity, profitability, and capital structure analysis. These three ratio sections will help us complete an industry comparison to Callaway and see how they match up to the competition.

Ratio Analysis

In this section we will be performing analysis of the important ratios that measure the liquidity, profitability, and the capital structure of Callaway and the rest of the industry. The financial statement ratio analysis can provide valuable information that can tell many things about a company. The first set of ratios we will measure have to do with liquidity; This will tell us the firm's ability to meet its cash obligations in a timely manner. Profitability ratios will tell us the principle objectives of profit, and capital structure ratios refer to the source of a company's financing. We will interpret these ratios and find their significance. In addition growth rates for Callaway will be figured. We will perform a trend analysis of Callaway and cross sectional analysis including both individual competitors and the entire industry.

Trend (Time Series) Analysis

The first group of ratios we will be evaluating are liquidity ratios. These ratios help to determine how easily a firm can convert its assets into cash, as well as how a firm generates cash flows. These ratios are vital to determining a firm's ability to successfully complete the money merry-go-round. The first of these ratios we will evaluate is the current ratio.

Current Ratio

	2002	2003	2004	2005	2006
Callaway	3.38	2.95	3.26	3.13	2.21

The current ratio can literally be translated as a dollar amount of current assets for every one dollar of current liabilities. At a glance, Callaway's current ratio has fluctuated, however it has been on an overall decline. A decline in current ratio is beneficial to a company such as Callaway with a number around 3. This means that more assets are being utilized and invested rather than sitting

in the current assets. Inventory for Callaway is the largest portion of current assets, followed by accounts receivable. It currently accounts for roughly 53 percent of current assets, which helps to explain the high ratio.

Quick Asset Ratio

	2002	2003	2004	2005	2006
Callaway	1.58	1.14	1.13	1.05	.74

Callaway golf has not held any marketable securities for the past five years, thus their quick assets only include cash and accounts receivables. Similar to the current ratio, the quick ratio has also been on a decline, with two major drops between 2002 to 2003 and 2005 to 2006. The drop from 2005 to 2006 can be explained by a significant increase in current liabilities which was caused by the opening of an 80,000 dollar bank line of credit. This decline is no cause for concern as Callaway has substantial assets to cover their current liabilities.

Receivables Turnover

	2002	2003	2004	2005	2006
Callaway	12.42	8.09	8.89	10.18	8.62

Days Sales Outstanding

	2002	2003	2004	2005	2006
Callaway	29.4	45.14	41.07	35.86	42.36

Receivables turnover and days sales outstanding indicate how long it takes a firm to collect accounts receivables. Days sales outstanding puts this into the perspective of an annual basis. Callaway's receivables turnover is relatively low, which inversely causes days sales outstanding to be high and to be fluctuated. Callaway Golf is a high priced golf product manufacturer which does

not distribute their product directly to the consumer. They distribute through golf retailers and sporting goods retailers. These sales involve wholesales at a high purchasing price. Therefore it is not surprising that Callaway's days sales outstanding for the past five years surpasses the time of a month, with 2002 as the exception. Callaway's ability to collect their accounts receivables depends on their customer, which can help to explain the fluctuations across time. It is also important to note, as with any large days sales outstanding, there is a higher risk of incurring bad debts expenses.

Inventory Turnover

	2002	2003	2004	2005	2006
Callaway	2.59	2.40	3.18	2.42	2.34

Days Supply of Inventory

	2002	2003	2004	2005	2006
Callaway	140.93	151.96	114.92	151.08	156.11

The golf industry is a seasonal industry in which the manufacturing firms produce a limited variety of products and a limited number of models, which are constantly improved. This means that a majority of sales for a golf company are in late spring and summer, while the rest of the season, in comparison, has relatively less sales. In a company such as Callaway where inventory accounts for roughly one third of assets, inventory turnover will be relatively low. In 2004 Callaway experienced a substantial increase in sales, thus cost of goods sold also took a sharp rise which caused inventory to flow out from the company faster. Afterwards cost of goods sold related to inventory leveled back out and resumed the previous trend. Overall Callaway's inventory turnover has taken a steady decrease, which would suggest that Callaway is steadily producing more inventory than they sell. This left over inventory becomes obsolete as new models and golf products are produced.

Working Capital Turnover

	2002	2003	2004	2005	2006
Callaway	3.05	3.21	3.42	3.34	3.77

Working Capital Turnover shows the ability of the amount of current assets over current liabilities, to create sales. These numbers would imply that Callaway requires a large amount of current assets in order to generate sales. The steady increase in working capital turnover from 2002 to 2006 is a good sign of increasing sales. Ideally this number would be higher, but Callaway's current assets are somewhat skewed by the large amount of inventory which is only turned over at the average of 2.59 times a year.

Liquidity Analysis

	2002	2003	2004	2005	2006	Opinion
Current Ratio	3.38	2.95	3.26	3.13	2.21	Positive
Quick Asset Ratio	1.58	1.14	1.13	1.05	.74	Positive
Receivables Turnover	12.42	8.09	8.89	10.18	8.62	Slightly Negative
Days Sales Outstanding	29.4	45.14	41.07	35.86	42.36	Negative
Inventory Turnover	2.59	2.40	3.18	2.42	2.34	Steady
Days Supply of Inventory	140.93	151.96	114.92	151.08	156.11	Slightly Negative
Working Capital Turnover	3.05	3.21	3.42	3.34	3.77	Positive

Overall, management of current assets and liabilities has been efficiently dealt with by Callaway; however, they must improve inventory management and collection of receivables.

Profitability

The Profitability Analysis of a company helps determine a company's ability to efficiently and effectively produce profits. The ratios below provide insight into Callaway's profitability starting with Gross Profit Margin.

Gross Profit Margin: Sales-COGS/Sales

	2002	2003	2004	2005	2006
Callaway	50.45%	45.28%	38.4%	41.52%	39.12%

Gross profit of a company is determined by the difference between sales and cost of goods sold. The gross profit margin ratio measures the percentage of gross profit compared to sales. Callaway's gross profit margin has remained fairly steady over the past three years varying only three percentage points after their margin was on a steady decline over 2002-2004 dropping over 12%. This steady margin shows that Callaway has been able to maintain an increase in sales consistent with an increase in COGS. Callaway understands the importance of gross profit margin to their success, and in November 2006, the company began the implementation of gross margin initiatives designed to positively impact gross margins over the next two years according to their 2006 10-k.

Operating Profit Margin: Operating Income/Sales

	2002	2003	2004	2005	2006
Callaway	17.55%	14.59%	0.89%	7.01%	1.70%

The operating profit margin relates the percentage of operating income to one dollar of sales. The margin was on a decline leading into the net loss in

2004. The 2004 operating income was less than one percent, which is attributed to a 110 million dollar drop in operating income compared to a 120 million dollar increase in sales. The margin rebounded in 2005, but suffered a drop in 2006 coming in at 1.70%. Sales increased by 19 million dollars, but the low percentage is attributed to a 52 million dollar decline in operating income. Callaway's operating profit margin has not remained steady and has shown low numbers over the past three years.

Operating Expense Ratio: Operating expenses/Sales

	2002	2003	2004	2005	2006
Callaway	36.45%	37.19%	41.04%	39.80%	35.47%

The operating expense ratio shows what percentages of operating expenses are contributed to a dollar of sales. Operating expenses for Callaway include selling, general, administrative expenses, and expenses incurred due to research and development. The ratio has been on a decline since 2004 which includes over a four percent decline in 2006. This beneficial decline is a result of implementation of several company-wide restructuring initiatives designed to improve the Company's business processes and reduce the Company's overall expenses (Callaway 10-K 2006).

Net Profit Margin: Net Income/Sales

	2002	2003	2004	2005	2006
Callaway	8.76%	5.59%	(1.08%)	1.33%	2.29%

Net profit margin is an indication of the profitability of a company's operating activities. A company with a differentiation strategy, such as Callaway should lead to higher margins. Callaway demonstrates these margins in 2002-2003. Callaway suffered a net loss in 2004 and has had low net profit margins the past two years as well. This is due to certain integration charges related to

the acquisition of Top-Flite in late 2003. Callaway's net profit margin should continue to gradually increase as the payments of these charges are completed.

Asset Turnover: Sales/Total Assets

	2002	2003	2004	2005	2006
Callaway	1.17	1.09	1.27	1.31	1.20

The revenue productivity of a company's total assets is measured by the asset turnover ratio. This ratio represents the amount of sales attributed to a dollar of assets. Callaway's ratio has remained fairly stable throughout the five year period maintaining a ratio between 1.09 and 1.31. These numbers could be improved, and could be the result of Callaway having large amounts of money tied up in assets.

Return on Assets: Net Income/Total Assets

	2002	2003	2004	2005	2006
Callaway	10.22%	6.08%	(1.37%)	1.74%	2.75%

The return on assets ratio provides insight into how much net income a company can produce for each dollar of assets. Callaway's ROA took a hit in 2004 and has continued through 2006. As mentioned earlier the integration charges from the Top-Flite acquisition led to a loss in 2004 and low levels of net income in 2005 and 2006. Their ROA is improving as the company emerges from these charges. Their net income has gone from a 10 million dollar loss to a 13 million dollar gain to 23 million in 2006.

Return on Equity: Net Income/Equity

	2002	2003	2004	2005	2006
Callaway	12.78%	7.72%	(1.72%)	2.23%	4.04%

The return on equity of a company represents the percentage of equity they return in the form of net income. Much like the net profit margin and ROA, Callaway's ROE has been influenced by the cost of acquisitions. Their ROE has increased steadily over the past three years and will continue to improve as they emerge from the costs of those acquisitions. Their ratios before their net loss provides a measure of the company's potential and where they hope to return.

Profitability Analysis

	2002	2003	2004	2005	2006	Opinion
Gross Profit Margin	50.45%	45.28%	38.40%	41.52%	39.12%	Negative
Operating Income Margin	17.55%	14.59%	0.89%	7.01%	1.70%	Negative
Operating Expense Ratio	36.45%	37.19%	41.04%	39.80%	35.47%	Positive
Net Profit Margin	8.76%	5.59%	(1.08%)	1.33%	2.29%	Positive
Asset Turnover	1.17	1.09	1.27	1.31	1.20	Slightly Positive
Return on Assets	10.22%	6.08%	(1.37%)	1.74%	2.75%	Slightly Positive
Return on Equity	12.78%	7.72%	(1.72%)	2.23%	4.04%	Slightly Positive

The major variable that has caused change in these ratios was the acquisition of Top-Flite. This is represented by the declining gross profit margin and operating income margin and the negative returns on assets and equity in 2004. Callaway's net profit margin, return on assets, and return on equity can be expected to increase in the future. Return on equity can be expected to most likely cap off at around 15% several years down the road.

Capital Structure

A Company can be financed through internal or external resources. A company that grows with internal financing uses their own retained earnings to finance ongoing operations or new operations. These earnings are generated from the company's operations and then used by the company. A company that uses external resources can have two different types of financing. Debt financing and equity financing are two ways a company may obtain cash to finance its operations. Debt financing means a company may issue bonds or take out a loan from a bank in order to get cash now to pay back later. This debt is recorded in the company's liabilities on the balance sheet. The first measure of capital structure we will analyze is the debt to equity ratio. This ratio shows their debt financing to their equity financing.

Debt to Equity Ratio

	2002	2003	2004	2005	2006
Callaway	.2	.27	.25	.28	.47

When looking at Callaway's debt to equity ratio, we find it has been increasing over the past five years. Their ratio is still relatively small, which means the amount of equity they use to finance their operations exceeds their debt financing. Callaway averages about a .29 debt to equity ratio, which tells us that for every dollar of existing equity they have only \$.29 of liability financing. The ratio has been increasing and this means Callaway has been increasing their liabilities when compared to the company's equity. Callaway uses more equity to finance their operations than debt.

Times interest earned is a measure to see if the company has earned enough to repay its interest on borrowed money. To find times interest earned, the operating income is divided by the interest expense. Callaway's times interest earned has fluctuated over the past five years.

Times Interest Earned

	2002	2003	2004	2005	2006
Callaway	66.31	49.81	-26.14	7.55	6.84

The interest expense has remained relatively stable, but the operating income started to dive in 2003 and in 2004. In 2004 Callaway's operating income was negative which came up with a negative times interest earned, showing that they could not pay their interest expense. Times interest earned steadied in 2005 and stayed close in 2006. They can now guarantee their interest payments after the decline in 2004.

The debt service margin measures the company's ability to make payments on debt. The ratio is found by dividing the cash flow from operations by the notes payable liability. Callaway has no disclosure of notes payables and therefore we substituted accounts payable, the difference being a more commonly known short-term liability rather than the long-term liability of notes payable. Regardless, it still shows the ability to pay off debt.

Debt Service Margin*

	2002	2003	2004	2005	2006
Callaway	2.25	1.49	.11	.69	.15

- Accounts Payable substituted for Notes Payable

Callaway's debt service margin declined in 2004 due to a dramatic fall in cash from operations. After 2003 the numbers of the ratios are telling us that for every dollar owed in accounts payable Callaway would not be able to pay it back using the cash from operations.

Capital Structure Analysis

	2002	2003	2004	2005	2006	Opinion
Debt to Equity Ratio	.2	.27	.25	.28	.47	Slightly Unfavorable
Times Interest Earned	66.31	49.81	-26.14	7.55	6.84	Unfavorable
Debt Service Margin	2.25	1.49	.11	.69	.15	Unfavorable

The fact that debt financing is growing at a faster rate than equity, is unfavorable. Additionally a declining times interest earned while debt to equity is increasing, is a bad combination.

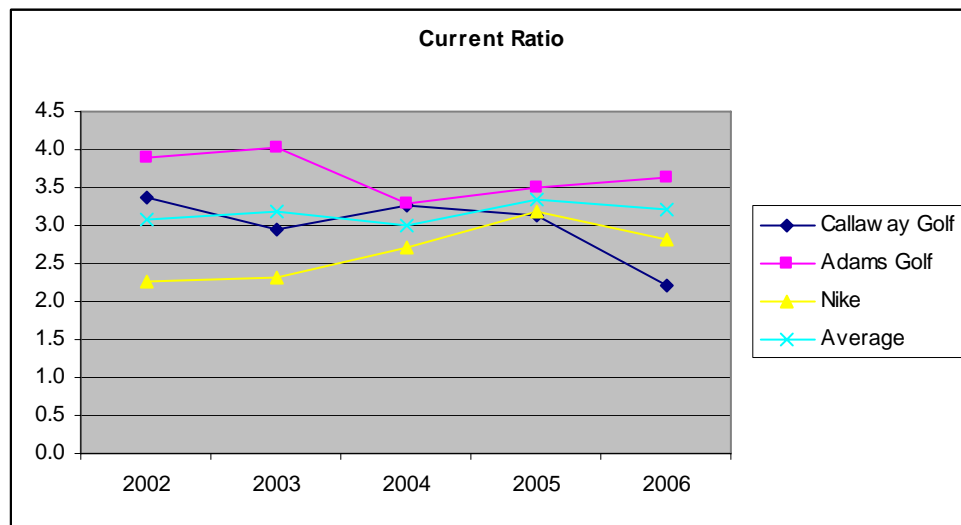
Sustainable Growth Rate

	2002	2003	2004	2005	2006
Callaway	.33%	1.06%	4.27%	3.25%	7.09%

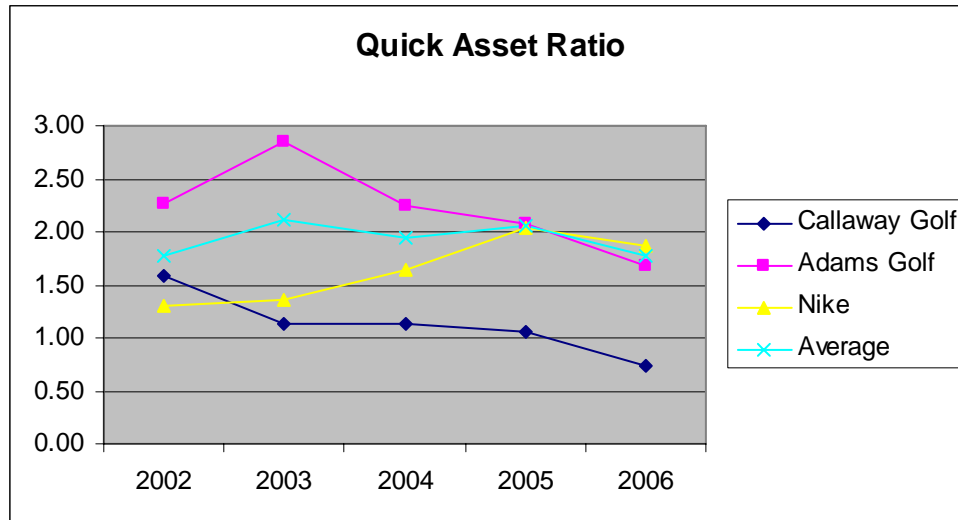
As the graph above shows the sustainable growth rate for Callaway that company has been increasing from year to year due to the fact that the golf industry is seeing more and more competition so Callaway has been improving in business. We project that the company will keep increasing in the future. So after attaining information about the company's growth rate we can solidly show that it will be easy to predict the company's future forecasts. Callaway started its years off really slowly in 2002 because of economic reasons then again from 2004 to 2005 the company had a negative net income which dropped the growth rate of the firm. We can get a better look at the firm by showing the company's internal growth rate then compared to Callaway's competitors in cross sectional analysis.

Cross Sectional (Benchmark) Analysis

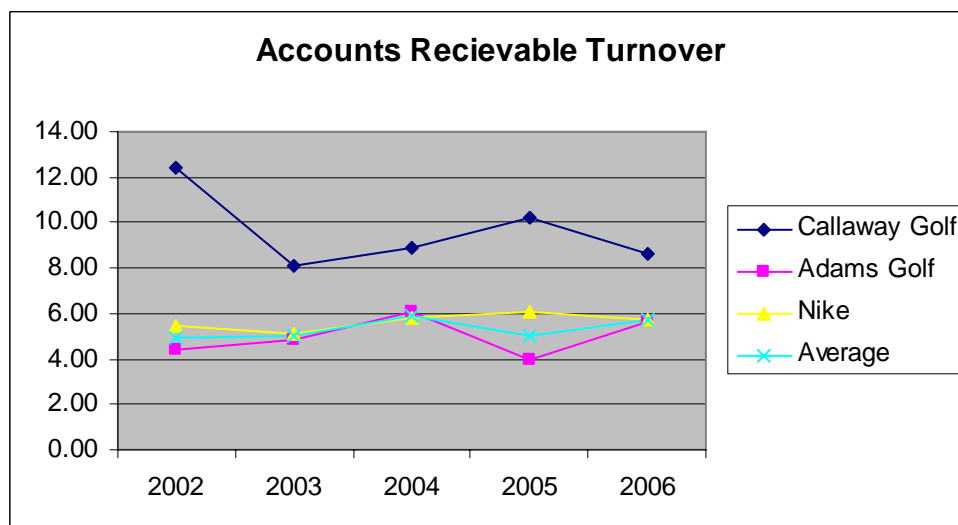
The following is a cross sectional analysis in which we will compare Callaway's ratios with the ratios of their competitors and industry average. We will begin with the liquidity ratios, more specifically, the current ratio.



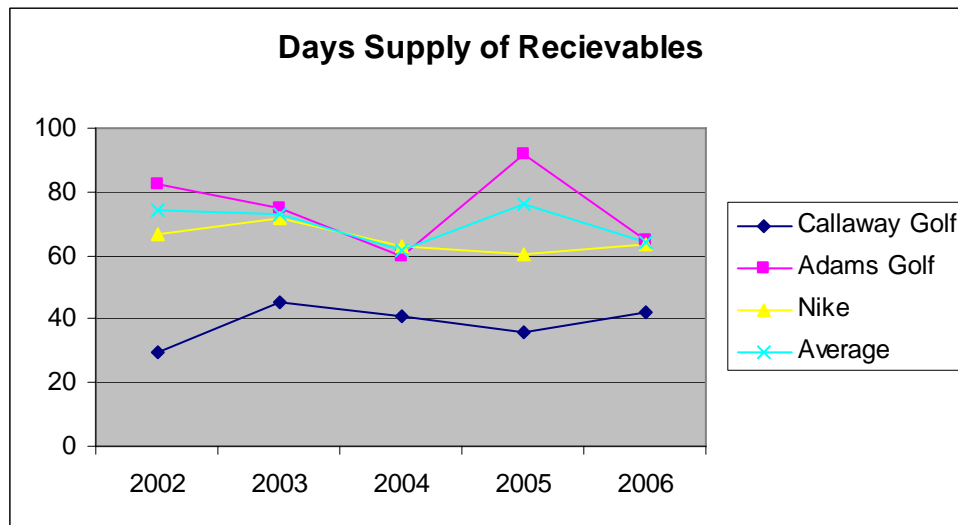
Callaway's current ratio is just above Nike's, just below Adam's, and relatively close to the industry average. Nike's current ratio has been steadily climbing and has risen by one over the past five years. This may suggest that Nike is not efficiently investing their assets. Callaway follows a trend similar to Nike's current ratio, but takes a beneficial decline from 2005 to 2006. It is not possible to determine if Nike took a similar drop, as their 2006 information has not been released. Adam's current ratio is very high, and even goes above 4 in 2003. While as an industry the current ratio is somewhat high, Adam's is consistently higher, and would suggest poor turnover of receiving and reinvesting assets.



Again, as an industry, the quick asset ratio is relatively high. While Nike is on a steady rise that mirrors their current ratio, Callaway and Adams both experience a decline. Callaway's Decline is a result of increased liabilities. Nike's liabilities have also been increasing consistently, however they have also increased their assets at a higher rate. Both assets and liabilities have increased for Adams, liabilities are just increasing at a higher rate. In the past Callaway has had a sufficient amount of quick assets to cover for their liabilities, however if their quick asset ratio continues to decline at the current rate, they may not be able to account for their liabilities.

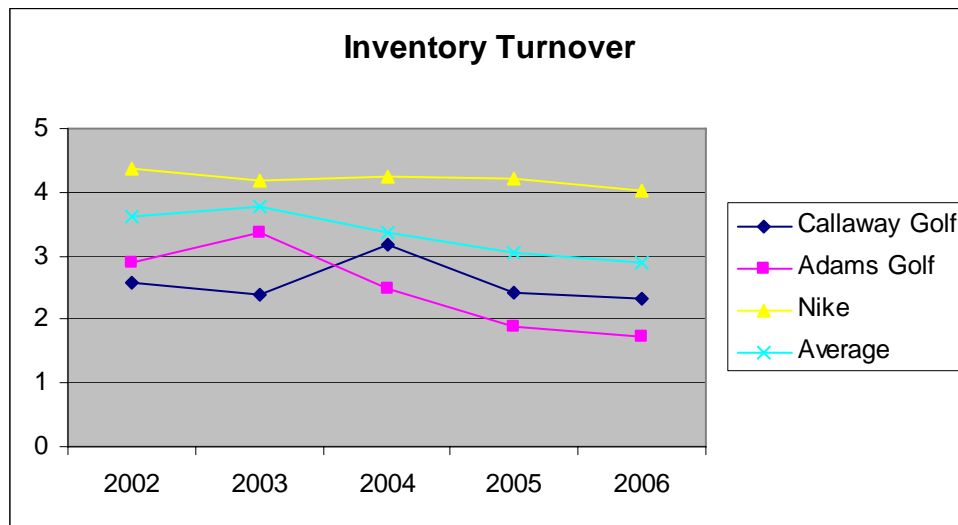


With regards to accounts receivable turnover, Callaway differs greatly from their industry and fluctuates at a much larger rate than their competitors. This means Callaway is greater at collecting their accounts receivable than their competitors. This is a beneficial factor as it decreases the chance of uncollectible debt expenses. While the industry tends to remain steady, Callaway has experienced a large amount of fluctuation the past five years, mainly due to a sharp drop since 2002. This decrease was due to a large increase in accounts receivable. Callaway's ability to stay substantially above their industry's average suggests superior management of accounts with their retailers.

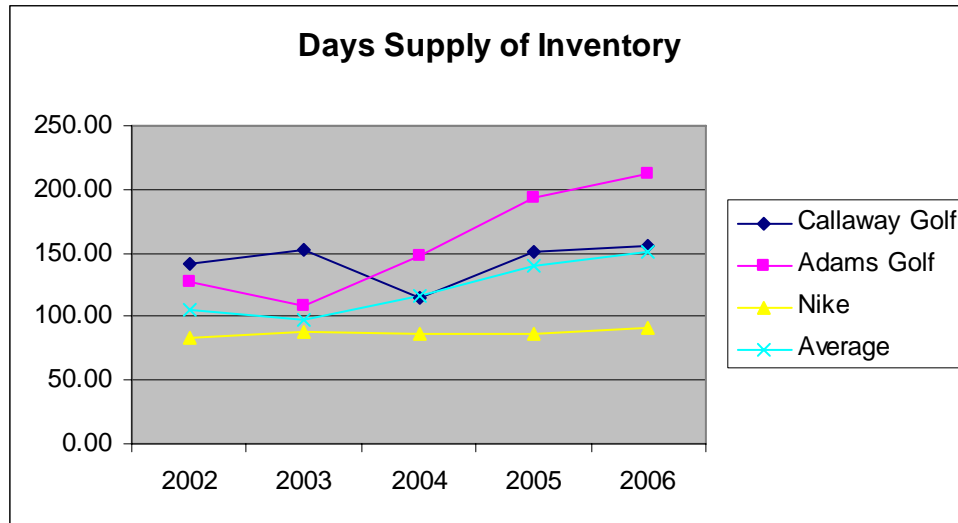


As shown in the accounts receivables turnover, Callaway's days supply of receivables is relatively lower than their competitors. Over the past five years, all the firms have seen fluctuations, however over time there have been no significant changes. This gives Callaway an advantage when compared to their competitors. They are able to collect on their accounts receivables in about the time of a month, while Nike and Adams averages around two months. Both Nike and Adams distribute their product through retail accounts, rather than directly to the end customer, which would suggest that Callaway has a superior ability to manage and collect from their chosen retailers. The lower the days supply of receivables is for a firm, the lower the risk of bad debt expenses. The graph

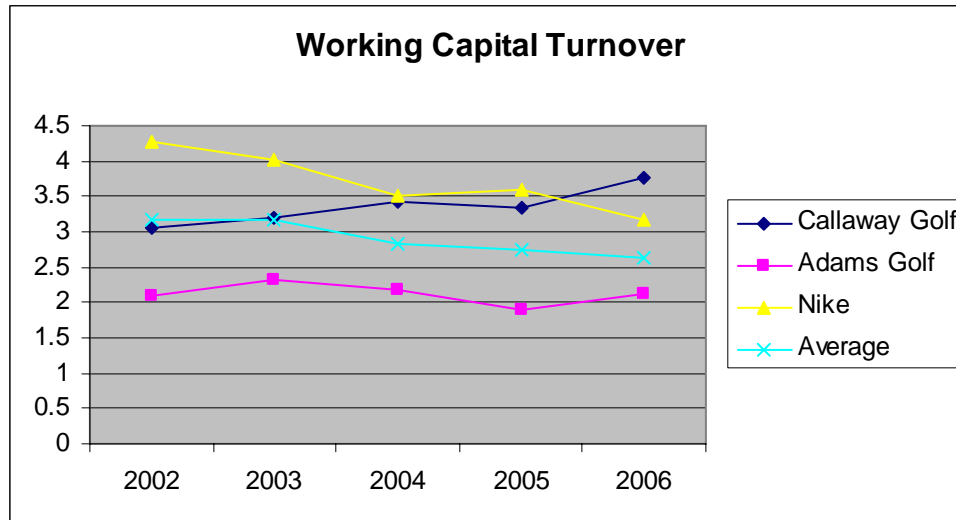
above shows that Callaway risk of bad debt expenses is relatively lower than their competitors if you rely on the days supply of receivables.



While Nike has a consistent inventory turnover, Callaway and Adams have fluctuated, and have currently been following the same trend since 2004. Nike has been successful in maintaining a superior inventory turnover relevant to their industry, while both Callaway and Adams fall below the average. Since 2004 Callaway has been able to stay above Adams golf, but a declining turnover of inventory is still not beneficial. The reason for this decrease is a larger increase in inventory relative to cost of goods sold. A large amount of sitting inventory could be hazardous for a company in the golf industry which is characterized by innovation and research and development. Callaway's increase in turnover from 2003 to 2005 was brought on by a brief decrease in inventory followed by an increase that put Callaway back to its previous trend. Excluding that change, Callaway's inventory turnover has stayed near 2.5.



Again, Nike has experienced a steady days supply of inventory as a result of their inventory turnover. Days supply of inventory can be translated as the number of days it takes a firm to expel current inventory and have new inventory on hand. In the golf industry a lower days supply of inventory is favorable, but the seasonality of the business makes it difficult. With the majority of inventory being sold in the late spring and early summer, this leaves roughly three quarters of the year when sales are in a "down time". Callaway does almost directly flow with the industry average, and also goes along the same pattern as Adams in 2004. Nike would have a lower days supply of inventory as they also deal with less seasonal products as well as golf and apparel products.

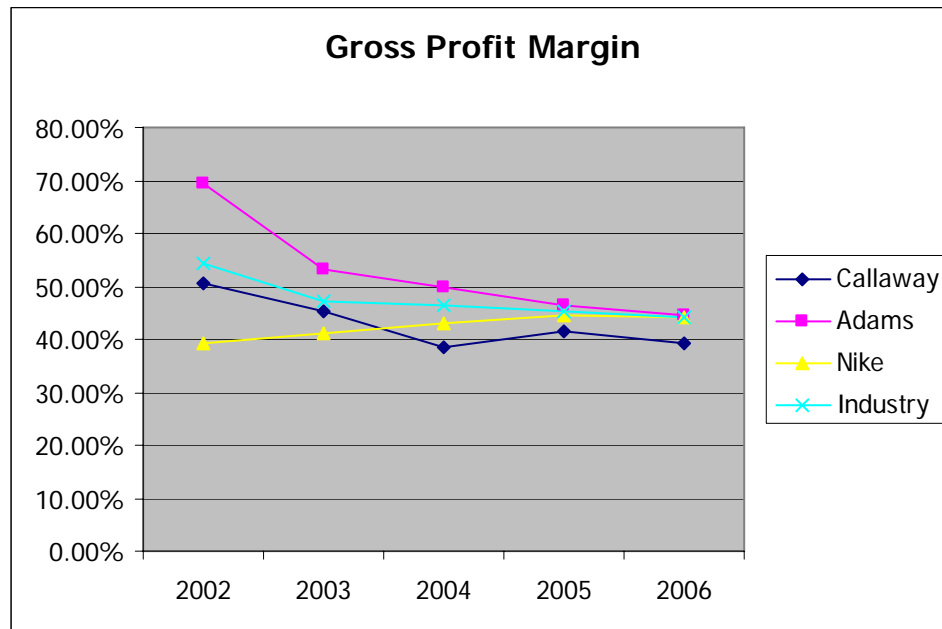


Working capital turnover measures productivity in a company as it evaluates how much sales is generated based on the difference between current assets and current liabilities. A higher working capital turnover indicates that a firm experiences high sales while only needing a limited amount of working capital. Callaway and Nike have the higher working capital turnover while Adams fluctuates between 2 and 2.5. In 2002 Callaway hovered around the industry average until recent years where they have grown to be higher than Nike as Nike's working capital turnover declined. This illustrates a steady growth in sales related to the needed amount of current assets over current liabilities. It should also be noted that the industry average has been on a decline while Callaway has increased, thus Callaway has been outperforming their industry with regards to working capital turnover.

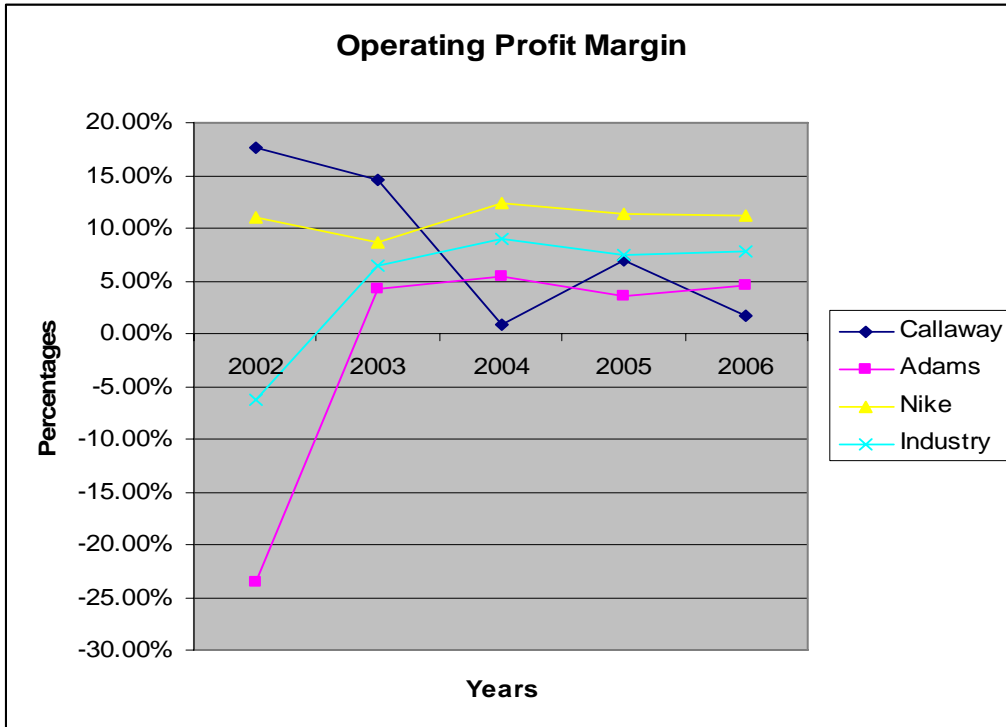
Overall, Callaway's liquidity is declining while the industry average is not changing. This indicated that management has been investing more assets than they had previously. But this may also indicate a growing amount of liabilities. At current times, Callaway would be able to cover growing liabilities, but not indefinitely.

Profitability

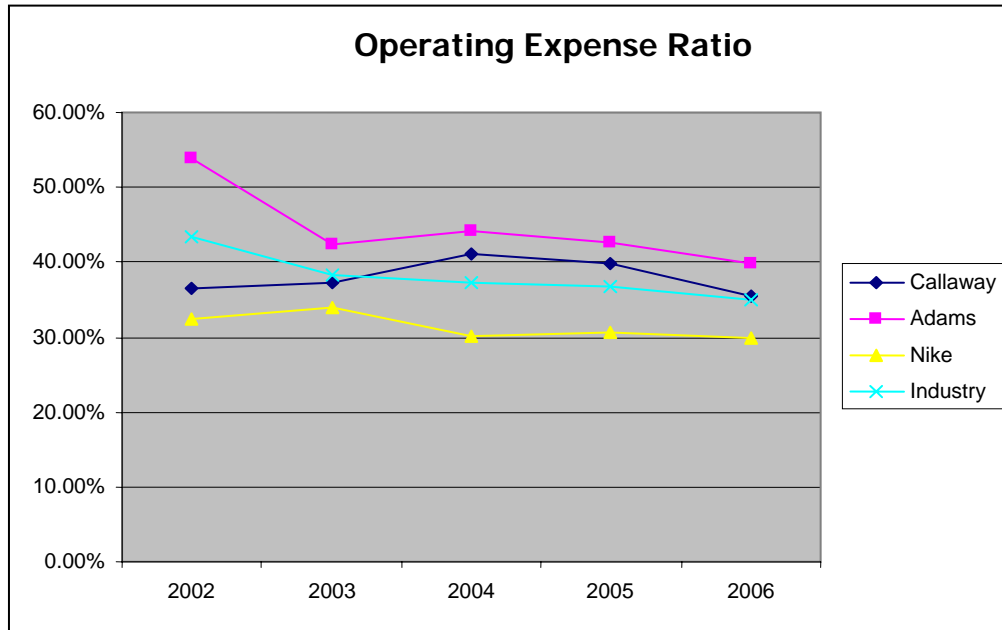
The next set of ratios to be compared between Callaway, their competitors, and the industry are the profitability ratios. We will begin with the gross profit margin.



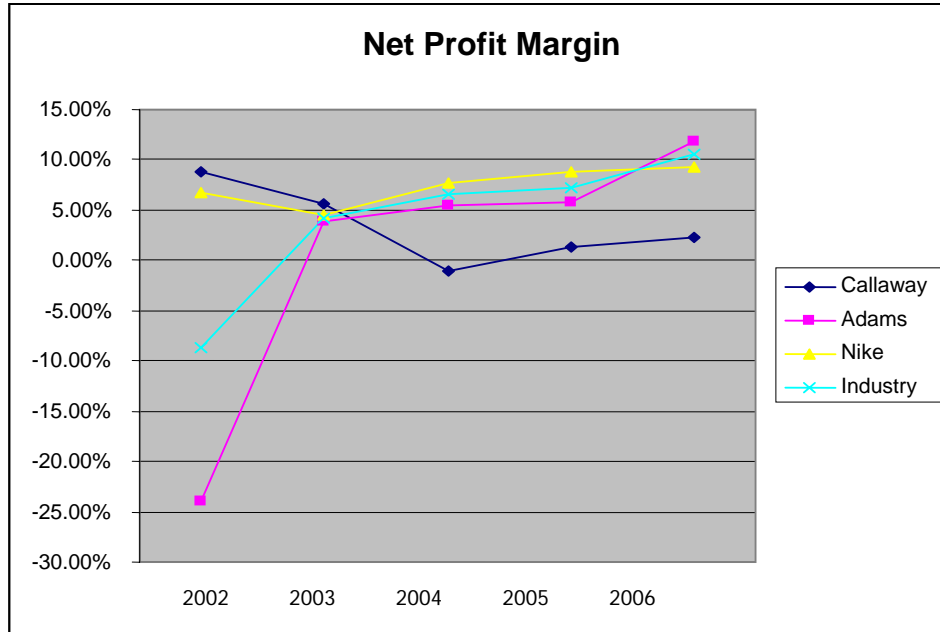
Callaway's gross profit margin was on a steady decline leading into 2004 when they experienced a net loss, but has since leveled off. Much like Callaway, Adams also has experienced a steady decline and has yet to recover still showing a downward trend. Nike on the other hand, has experienced an increasing gross profit margin until 2006. The industry has shown a decreasing margin, but still maintains a higher level than that of Callaway. Callaway's lower margin is not due to a decrease in sales. Their COGS are just increasing at a slightly higher rate than sales. This decline in gross profit margin is unfavorable for Callaway.



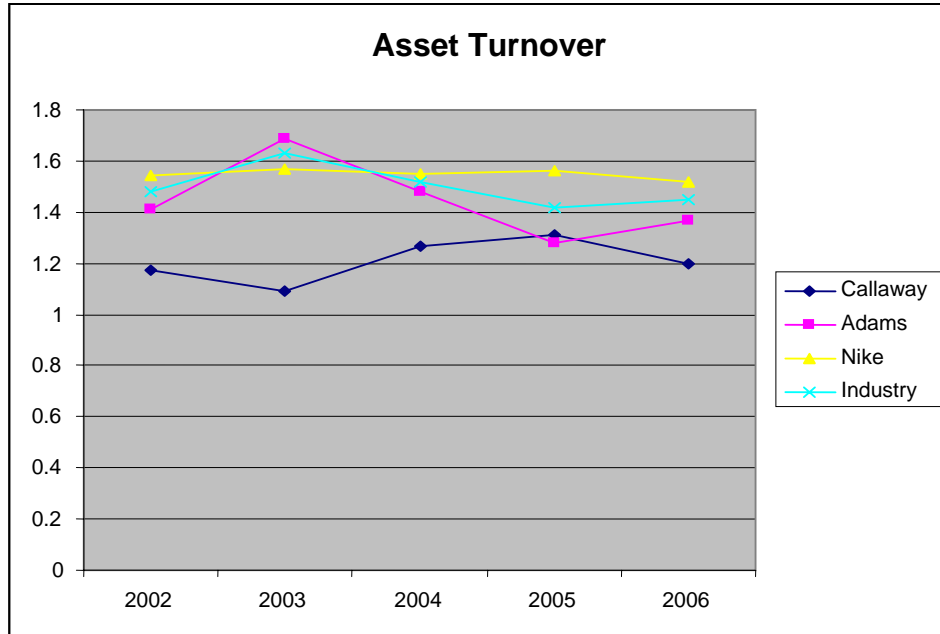
The operating profit margin for Callaway has not remained steady over the past five years; however, the margins for Nike and Adams have since 2003. Adam's suffered a loss in 2002 and have been able to maintain a steady margin between 3.62% and 5.46% the past four years. Unlike Adam's, Callaway's margin has not remained steady since their 2004 loss with the past margins being 7.01% and 1.70%. This unsteady trend and the low margin in 2006 is an unfavorable sign for Callaway.



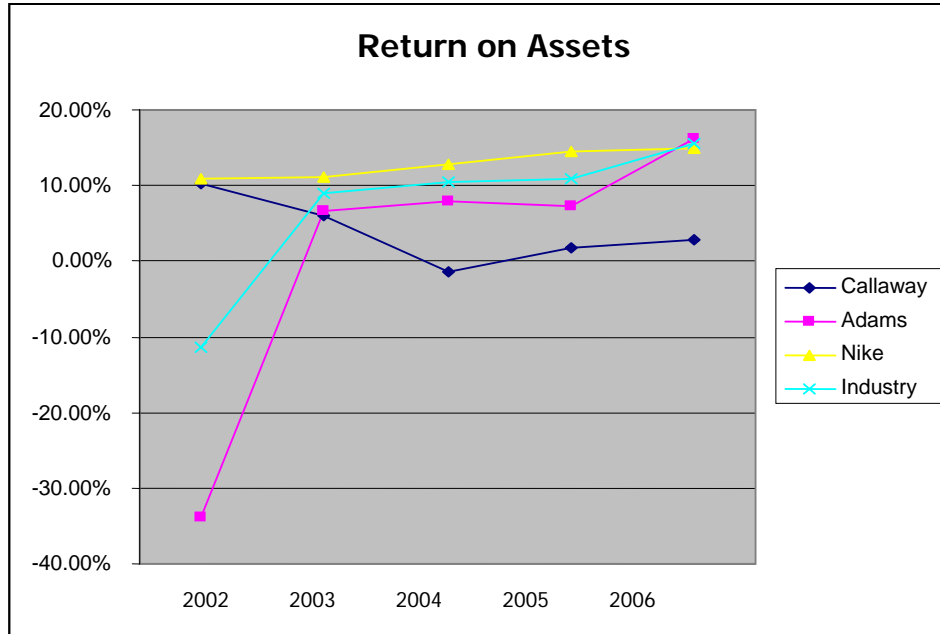
Callaway experienced a three year rise in their operating expense ratio from 2002-2004. The increase in this ratio much like the gross profit margin gives insight into the reasons for their net loss. They have decreased this ratio since 2004, which means that operating expenses account for less dollars of sales. Adams experienced an operating expense ratio in 2002 that was off the charts at 54% compared to Callaway's 36.45% and Nike's 32.55%. This large margin contributed to a loss of almost nine million dollars in 2002. Since 2004 Adams has followed a decreasing trend like Callaway's, where as Nike has remained steady well below the industry average. The industry shows a decreasing margin over the past five years which is a favorable for Callaway and the other firms.



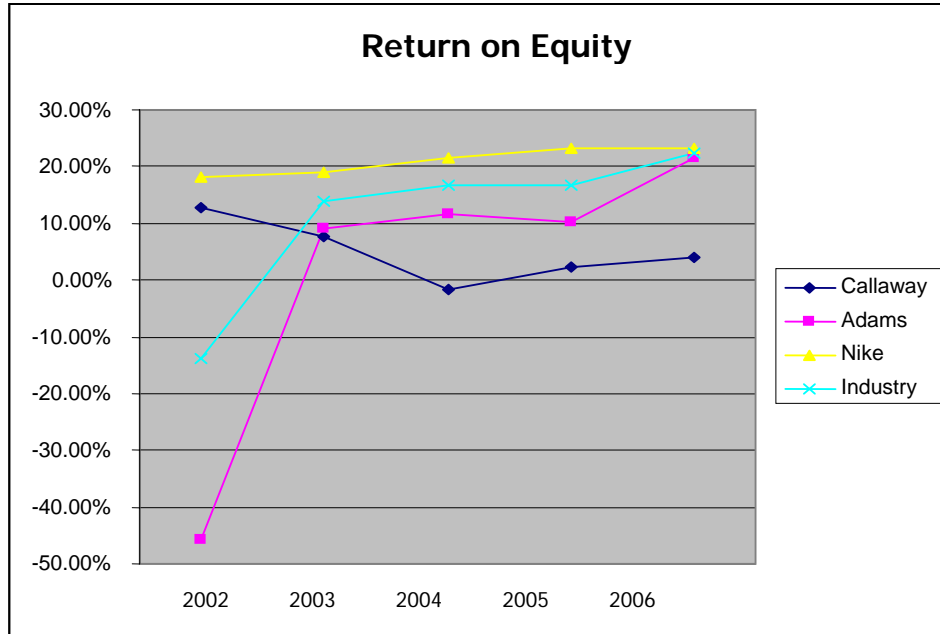
The net profit margin for Callaway shows their three year fall into their net loss, which is mainly due to the acquisition of Top-Flite as mentioned prior. They have showed progress since with steady increases over the past two years. Adams emergence from their 2002 loss is very evident as their margin rose from (24%) to 3.94% which was very close to Callaway's, Nike's, and the industry's average. Nike and Adams continued to improve their margins in 2004 closely resembling the industry average up to 2006. Although Callaway's net profit margin is below the industry average they, as well as the industry, continue to improve this margin which is a favorable effect.



The asset turnover ratio is a measure of the effectiveness of a company's assets generating sales. The asset turnover for Callaway has been below the industry average each year of the past five, and only surpassed Adams slightly in 2005. Their ratio grew from 2003 to 2005, but fell slightly this past year. Adams ratio is a complete contrast to that of Callaway as their ratio increased when Callaway's decreased and vice versa. Nike has remained steady and close to the industry average. Callaway's asset turnover decline in 2006 along with its consistency below the industry average are unfavorable factors affecting this company.



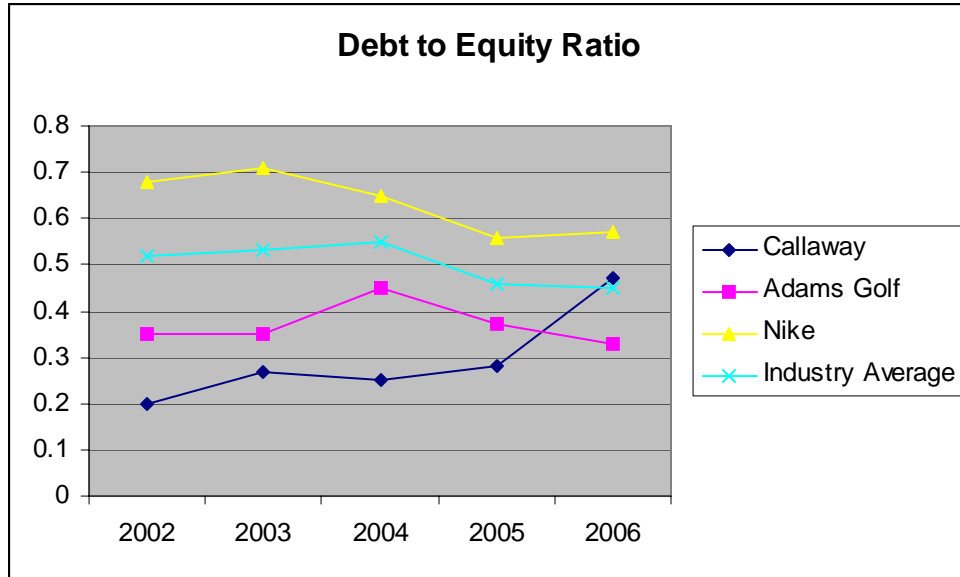
The return on assets of a company is represented by net income divided by total assets. Callaway's 2004 and Adams 2002 ROAs are negative due to their net losses, which is the reasoning for a negative industry average. They both have improved their ROAs consistently since those periods; Adams has more than doubled the past year. Nike has seen slow and steady growth over the five year period, and like most of the other ratios continues to lead the industry. Although Callaway is once again the laggard in the industry their net income is continuing to increase faster than total assets which provide a favorable impact.



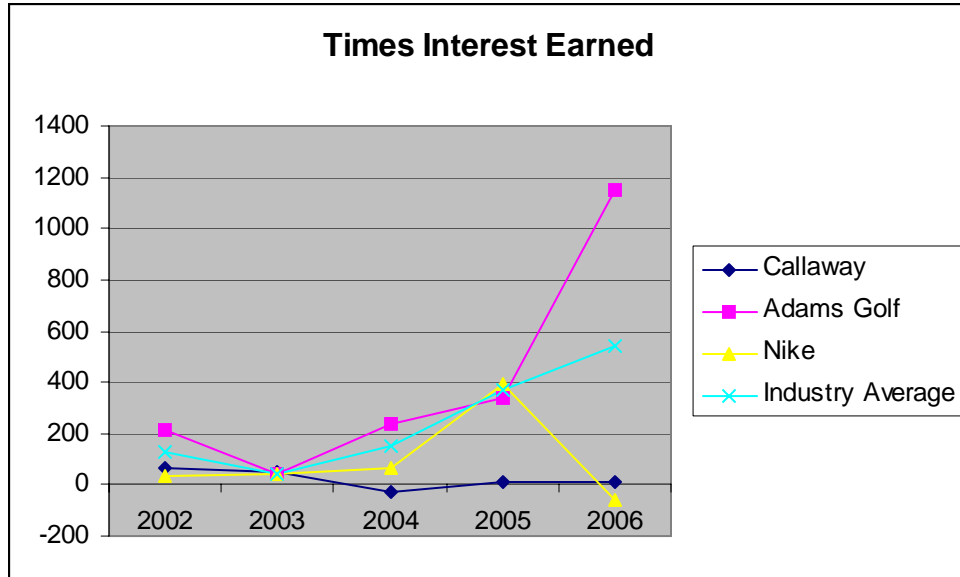
The Return on Equity ratio demonstrates a company's ability to generate net income through their equity, and as in the previous charts the industry is led by Nike with improvements from Callaway and Adams since the effect of their net losses. Although the ratios for Callaway tend to be below the industry average they have not seen a decrease in sales in the past five years, which demonstrates their potential to continually increase their profitability in the future.

Capital Structure

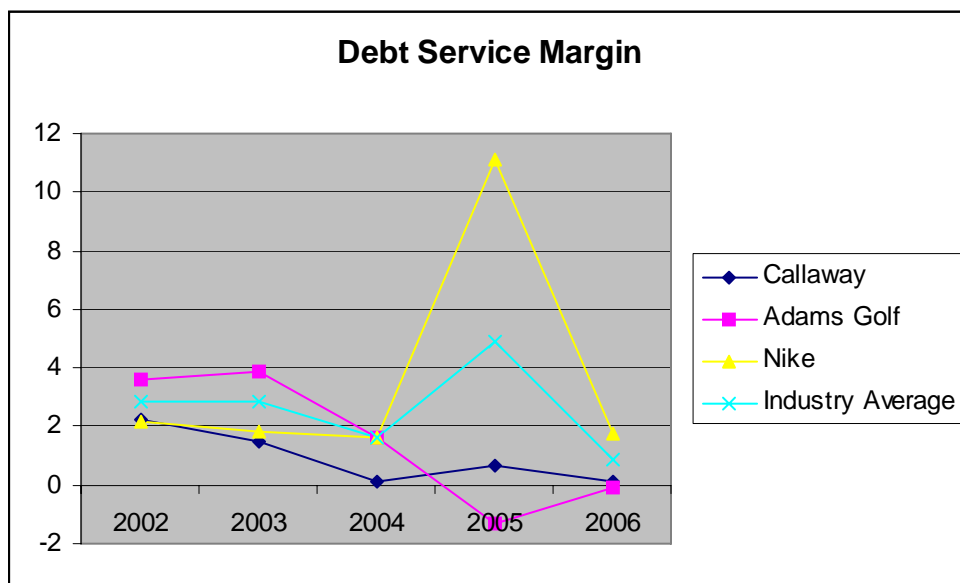
The capital structure ratios, the last set of ratios, will now be presented containing information regarding the debt to equity, times interest earned, and the debt service margin ratios.



Callaway has the lowest debt to equity ratio out of their competitors and the industry. This means they finance their operations and growth with more equity, such as stocks and bonds. Nike, on the other hand, seems to finance a larger percentage of their operations and growth with debt, compared to the rest of the industry. Adams Golf has stayed at a relatively stable rate and is close to the industry mean. These different debt to equity ratios for each company can affect interest rates the companies get on borrowing money. Callaway seems to be in pretty good shape compared to the rest of the market and can borrow on a low interest rate based on their debt to equity ratio.



Adam's Golf has out performed Callaway and the industry in terms of repaying interest debt. Their interest expense in 2006 was low and their operating income was the highest since 2002, exceeding the industry's times interest earned average by a huge amount. Nike ended up at 2006 with a negative figure showing they did not have the ability to pay their debt in 2006. Callaway is not far from Nike and both companies may have over leveraged, showing two low figures compared to the industry.

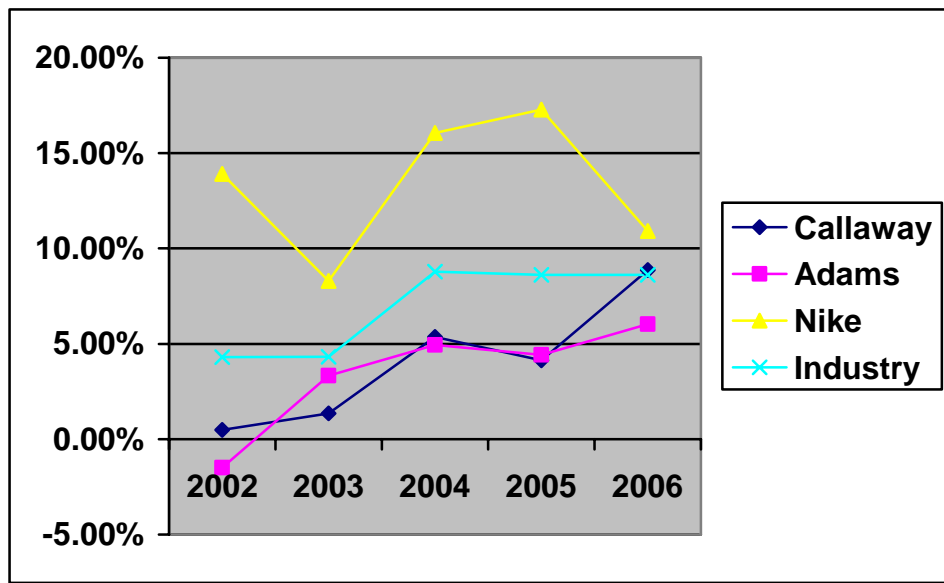


*Accounts payable substituted for notes payable

Nike's debt service margin shot up in 2005, indicating their cash flow from operations went up significantly with accounts payable staying relatively the same. This shows their ability to pay off their current debt was easily high enough. When compared with the industry Nike ended up better off than the competitors after being behind the at the beginning of the five year period. Although Adam's Golf begin to climb back up after a significant decline in 2005, they are still in the negatives showing they could not pay their current debt for the past two years.

Callaway golf moves with the industry when considering debt to equity financing, however they move against the industry with times interest earned. While this is a negative factor for Callaway, it also indicates that they should not have these problems.

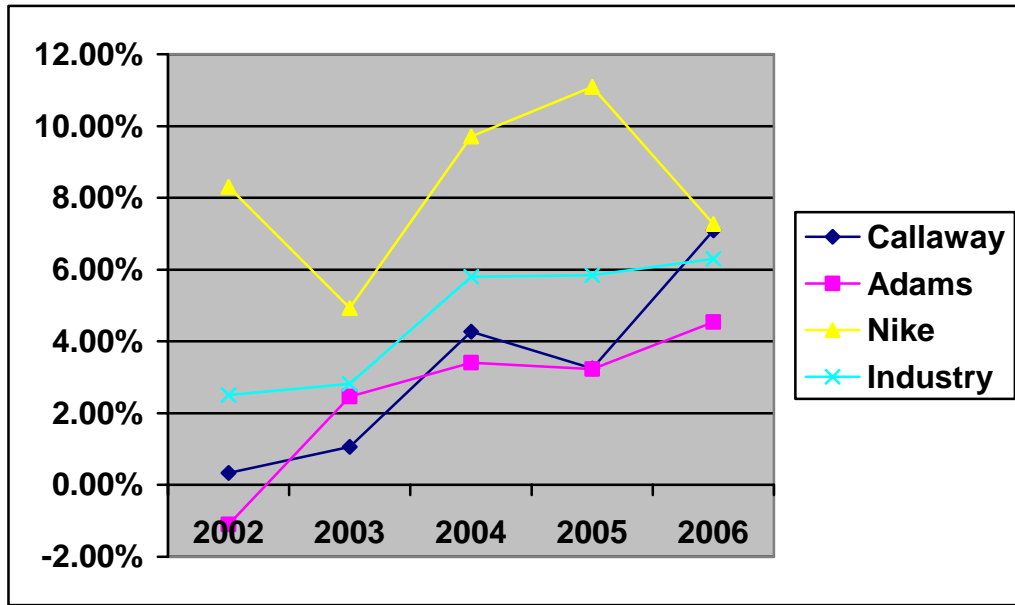
Sustainable Growth Rate



As the graph above shows the sustainable growth rate for Callaway's publicly traded competitors, Callaway is right about in the middle when it comes to its year to year profits. The reason that Nike is so high on the graph is because Nike does not offer separate financials for just the golf aspect of their industry so their growth rate is extremely high compared to Callaway and Nike.

As the industry shows the companies are fairly close. Callaway has been on a steady increase from 2002 with a large jump from 2005 to 2006 due to a large increase in the company's net income.

To get a better grasp we can then look at Callaway and its competitors Internal Growth Rate.



As the two graphs show the internal growth rate and the sustainable growth rate have remained about the same to each other. This just shows that the company is consistent when it comes to dividend per share paid out and net income has steadily been increasing. Again, Callaway is right in the middle of the pack on the industry between Nike and Adams golf. Also, Nike is so high because this is not just the golf aspect of the industry.

Financial Statement Forecasting Methodology

Financial statement forecasting is essential when attempting to value a firm. It is the first step to the eventual intrinsic valuation models such as residual income, free cash flows, etc. It can be reasonably expected that data forecasted in the short run will be accurate to actual outcomes, however in the long run

there will be errors, simply because it is impossible to accurately predict a firms movements so far into the future.

Income Statement

We began our financial statement forecasting for Callaway Golf with the income statement. We projected that net sales would grow for the first year at a rate of 2.75%. Afterwards, net sales would increase by an additional .75% annually, until achieving a steady growth rate of 6.5% per year. In other words, a net sales increase of 2.75% in 2007, 3.5% in 2008, 4.25% in 2009, 5.0% in 2010, 5.75% in 2011, and finally an indefinite 6.5% from 2012 onwards. We chose this method after finding the average increase in total revenue across 5 years to be 6.55%. However the total revenue increases for each of the 5 years individually, were highly fluctuated, and it seemed unlikely that the average of 6.55% increase in net sales would be achieved and maintained right away. Callaway's IGR would also suggest a slower paced growth that will continue to increase over time. We also took into account the demographic of an aging population. Studies have shown that the rounds of golf played increases with age, thus an aging population would suggest an increase in total sales as the "baby boomer" generation continues to age. The rest of our numbers for the forecasted section of our income statement, were derived by assigning a percentage of sales which was found through averaging 5 years of numbers. These averages were also adjusted accordingly for recent trends and the elimination or adjusting for outlier years.

Income Statement for Callaway Golf

	Actual Financial Statements					Forecast Financial Statements									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Revenue	793,219.00	814,032.00	934,564	998,093	1,017,907	1,068,802	1,282,563	1,410,819	1,551,901	1,738,129	1,946,705	2,180,309	2,441,946	2,734,980	3,063,177
Cost of Revenue	393,068.00	445,417.00	575,742	583,679	619,832	609,752	731,702	804,872	885,360	991,603	1,110,595	1,243,866	1,393,130	1,560,306	1,747,543
Gross Profit	400,151.00	368,615.00	358,822	414,414	398,075	459,051	550,861	605,947	666,541	746,526	836,110	936,443	1,048,816	1,174,674	1,315,635
Operating Expenses															
Research and Development	32,182.00	29,529.00	30,557	26,989	26,785	26,720	32,064	35,270	38,798	43,453	48,668	54,508	61,049	68,374	76,579
Selling General and Administrative	256,909.00	273,231.00	352,967	370,219	334,235	371,195	445,434	489,977	538,975	603,652	676,091	757,221	848,088	949,858	1,063,842
Operating Income or Loss	111,060.00	65,855.00	(24,702.00)	17,206	37,055	61,135	73,363	80,699	88,769	99,421	111,352	124,714	139,679	156,441	175,214
Income from Continuing Operations															
Total Other Income/Net Expenses	2,271.00	3,550	1,934	(390.00)	3,364	3,420	4,104	4,515	4,966	5,562	6,229	6,977	7,814	8,752	9,802
Earnings Before Interest and Taxes	113,331.00	69,405	(22,768.00)	16,816	40,419	68,403	82,084	90,292	99,322	111,240	124,589	139,540	156,285	175,039	196,043
Interest Expense	1,660.00	1,522	945	2,279	5,421	6,413	7,695	8,465	9,311	10,429	11,680	13,082	14,652	16,410	18,379
Income Before Tax	111,671.00	67,883	(23,713.00)	14,537	34,998	58,143	69,771	76,749	84,423	94,554	105,901	118,609	132,842	148,783	166,637
Income Tax Expense	42,225.00	22,360	(13,610.00)	1,253	11,708	16,887	20,264	22,291	24,520	27,462	30,758	34,449	38,583	43,213	48,398
Net Income From Continuing Ops	69,446.00	45,523	(10,103.00)	13,284	23,290	41,256	49,507	54,458	59,903	67,092	75,143	84,160	94,259	105,570	118,239
Net Income	69,446.00	45,523	(10,103.00)	13,284	23,290	41,256	49,507	54,458	59,903	67,092	75,143	84,160	94,259	105,570	118,239
Common Size Income Statement	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Revenue	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Cost of Revenue	49.55%	54.72%	61.60%	58.48%	60.89%	57.05%	57.05%	57.05%	57.05%	57.05%	57.05%	57.05%	57.05%	57.05%	57.05%
Gross Profit	50.45%	45.28%	38.39%	41.52%	39.11%	42.95%	42.95%	42.95%	42.95%	42.95%	42.95%	42.95%	42.95%	42.95%	42.95%
Operating Expenses															
Research and Development	4.06%	3.63%	3.26%	2.70%	2.63%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Selling General and Administrative	32.39%	33.57%	37.76%	37.09%	32.84%	34.73%	34.73%	34.73%	34.73%	34.73%	34.73%	34.73%	34.73%	34.73%	34.73%
Total Operating Expenses															
Operating Income or Loss	14.00%	8.09%	-2.64%	1.72%	3.64%	5.72%	5.72%	5.72%	5.72%	5.72%	5.72%	5.72%	5.72%	5.72%	5.72%
Income from Continuing Operations															
Total Other Income/Net Expenses	29.00%	0.44%	0.21%	N/A	0.33%	0.32%	0.32%	0.32%	0.32%	0.32%	0.32%	0.32%	0.32%	0.32%	0.32%
Earnings Before Interest and Taxes	14.29%	8.53%	-2.43%	1.68%	3.97%	6.04%	6.04%	6.04%	6.04%	6.04%	6.04%	6.04%	6.04%	6.04%	6.04%
Interest Expense	21.00%	0.19%	0.10%	0.23%	0.53%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%
Income Before Tax	14.08%	8.34%	-2.54%	1.46%	3.44%	5.44%	5.44%	5.44%	5.44%	5.44%	5.44%	5.44%	5.44%	5.44%	5.44%
Income Tax Expense	5.32%	2.75%	-1.46%	0.13%	1.15%	1.58%	1.58%	1.58%	1.58%	1.58%	1.58%	1.58%	1.58%	1.58%	1.58%
Net Income From Continuing Ops	8.75%	5.59%	-1.08%	1.33%	2.29%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%
Net Income	8.75%	5.59%	-1.08%	1.33%	2.29%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%	3.86%

Balance Sheet

Our methods for financial forecasting Callaway's balance sheet were very similar to the methods we used in forecasting Callaway's income statement. This involved taking 5 years worth of averages for actual numbers, as well as averages for the changes that major items experienced. We determined total assets first by calculating averages and then adjusting for current trends, then distributing out to the sub-categories in the same manor. We also used averages for calculating total liabilities and shareholders' equity. Additionally when calculating liabilities and equity, we took into account ratios that demonstrated the relationship between the changes in assets and the changes in liabilities and equity. We made sure that our assets equaled total liabilities and shareholders equity. Essentially we grew Callaway's equity and assets at a constant rate, and spread the numbers into the subcategories at a pre-determined percentage of assets or total equity and liabilities.

Balance Sheet for Callaway Golf

	Actual Financial Statements					Forecast Financial Statements									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Cash And Cash Equivalents	108,452	47,340	31,657	49,481	46,362	53,987	56,881	59,777	63,000	69,874	71,220	76,993	82,764	89,753	97,937
Net Receivables	63,867	100,664	166,809	138,300	160,040	179,956	189,603	199,256	210,000	232,914	237,398	256,642	275,879	299,177	326,457
Inventory	151,760	185,389	181,230	241,577	265,110	287,930	303,365	318,810	336,000	372,662	379,837	410,627	441,407	478,683	522,332
Other Current Assets	44,948	50,069	14,036	9,232	21,688	31,492	33,181	34,870	36,750	40,760	41,545	44,912	48,279	52,356	57,130
Total Current Assets	369,027	383,462	393,732	438,590	493,200	553,365	583,030	612,713	645,749	716,210	730,000	789,174	848,329	919,969	1,003,856
Property Plant and Equipment	167,340	164,763	135,865	127,739	131,224	130,468	137,462	144,461	152,250	168,863	172,114	186,065	200,012	216,903	236,681
Goodwill	18,202	20,216	30,468	29,068	30,833	31,492	33,181	34,870	36,750	40,760	41,545	44,912	48,279	52,356	57,130
Intangible Assets	103,115	149,635	149,168	146,123	144,326	134,967	142,203	149,442	157,500	174,685	178,049	192,481	206,909	224,383	244,843
Other Assets	16,945	18,201	16,667	16,462	27,543	26,993	28,441	29,888	31,500	34,937	35,610	38,496	41,382	44,877	48,969
Deferred Long Term Asset Charges	5,216	12,289	9,837	6,516	18,821	22,495	23,700	24,907	26,250	29,114	29,675	32,080	34,485	37,397	40,807
Total Non-current Assets	310,818	365,104	342,005.00	325,908.00	352,747	346,415	364,987	383,568	404,250	448,359	456,992	494,035	531,067	575,915	628,430
Total Assets	679,845	748,566	735,737	764,498	845,947	899,780	948,017	996,281	1,049,999	1,164,569	1,186,992	1,283,209	1,379,396	1,495,884	1,632,286
Liabilities															
Current Liabilities															
Accounts Payable	98,352	117,958	107,759	140,184	143,455	152,963	161,163	169,368	178,500	197,977	201,789	218,146	234,497	254,300	277,489
Short/Current Long Term Debt	10,809	12,202	13,039	21	80,000	85,479	90,062	94,647	99,750	110,634	112,764	121,905	131,043	142,109	155,067
Total Current Liabilities	109,161	130,160	120,798	140,205	223,455	238,442	251,225	264,014	278,250	308,611	314,553	340,050	365,540	396,409	432,556
Long Term Debt	19,922	20,076	19,948	19,922	-	24,564	25,881	27,198	28,665	31,793	32,405	35,032	37,658	40,838	44,561
Other Liabilities	-	-	-	-	19,922	21,595	22,752	23,911	25,200	27,950	28,488	30,797	33,106	35,901	39,175
Deferred Long Term Liability	7,375	8,947	8,674	8,323	23,466	24,924	26,260	27,597	29,085	32,259	32,880	35,545	38,209	41,436	45,214
Minority Interest	-	-	-	-	1,987	-	-	-	-	-	-	-	-	-	-
Total Liabilities	136,458	159,183	149,420	168,450	268,830	309,524	326,118	342,721	361,200	400,612	408,325	441,424	474,512	514,584	561,506
Stockholders' Equity															
Common Stock	836	837	848	850	851										
Retained Earnings	439,454	466,441	437,269	430,996	435,074	420,417	444,549	470,066	497,048	525,578	555,747	587,647	621,377	657,044	694,759
Treasury Stock	-130,331	-135,086	-141,384	-141,423	-194,295										
Capital Surplus	371,496	400,939	387,950	393,676	402,628										
Other Stockholder Equity	-138,068	-143,748	-98,366	-88,051	-67,141										
Total Stockholders' Equity	543,387	589,383	586,317	596,048	577,117	597,891	626,916	657,966	694,461	789,860	789,860	850,612	921,463	1,003,625	1,098,456
Total Liabilities and Stockholders' Equity	679,845	748,566	735,737	764,498	845,947	899,780	948,017	996,281	1,049,999	1,164,569	1,186,992	1,283,209	1,379,396	1,495,884	1,632,286

Balance Sheet for Callaway Golf

	Actual Financial Statements					Forecast Financial Statements										
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Cash And Cash Equivalents	15.95%	12.35%	4.30%	6.47%	5.41%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
Net Receivables	9.39%	26.25%	22.67%	18.09%	18.92%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	
Inventory	22.32%	48.35%	24.63%	31.60%	31.34%	32.00%	32.00%	32.00%	32.00%	32.00%	32.00%	32.00%	32.00%	32.00%	32.00%	
Other Current Assets	6.61%	13.06%	1.91%	1.21%	2.65%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	
Total Current Assets	54.28%	51.23%	53.52%	57.37%	58.30%	61.50%	61.50%	61.50%	61.50%	61.50%	61.50%	61.50%	61.50%	61.50%	61.50%	
Property Plant and Equipment	24.61%	22.01%	18.47%	16.71%	15.51%	14.50%	14.50%	14.50%	14.50%	14.50%	14.50%	14.50%	14.50%	14.50%	14.50%	
Goodwill	2.68%	2.70%	4.14%	3.80%	3.64%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	
Intangible Assets	15.17%	19.99%	20.27%	19.11%	17.06%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	
Other Assets	2.49%	2.43%	2.27%	2.15%	3.26%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	
Deferred Long Term Asset Charges	0.77%	1.64%	1.34%	0.85%	2.22%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	
Total Assets	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	
Liabilities																
Current Liabilities																
Accounts Payable	#REF!	#REF!	14.65%	18.34%	16.96%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	
Short/Current Long Term Debt	#REF!	#REF!	1.77%	-	9.46%	9.50%	9.50%	9.50%	9.50%	9.50%	9.50%	9.50%	9.50%	9.50%	9.50%	
Total Current Liabilities	#REF!	#REF!	16.42%	18.34%	26.41%	26.50%	26.50%	26.50%	26.50%	26.50%	26.50%	26.50%	26.50%	26.50%	26.50%	
Long Term Debt	2.93%	#REF!	2.71%	2.61%	-	2.73%	2.73%	2.73%	2.73%	2.73%	2.73%	2.73%	2.73%	2.73%	2.73%	
Other Liabilities	#REF!	#REF!	1.18%	1.09%	2.35%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	
Deferred Long Term Liability	-	-	-	-	2.77%	2.77%	2.77%	2.77%	2.77%	2.77%	2.77%	2.77%	2.77%	2.77%	2.77%	
Minority Interest	-	-	-	-	0.23%	-	-	-	-	-	-	-	-	-	-	
Total Liabilities	#REF!	#REF!	20.31%	22.03%	31.78%	34.40%	34.40%	34.40%	34.40%	34.40%	34.40%	34.40%	34.40%	34.40%	34.40%	
Stockholders' Equity																
Common Stock	#REF!	#REF!	0.12%	0.11%	0.10%	0.11%	0.11%	0.11%	0.11%	0.11%	0.11%	0.11%	0.11%	0.11%	0.11%	
Retained Earnings	#REF!	#REF!	59.43%	56.38%	51.43%	47.00%	47.00%	47.00%	47.00%	47.00%	47.00%	47.00%	47.00%	47.00%	47.00%	
Treasury Stock	#REF!	#REF!	-19.22%	-18.47%	-22.97%	-20.01%	-20.01%	-20.01%	-20.01%	-20.01%	-20.01%	-20.01%	-20.01%	-20.01%	-20.01%	
Capital Surplus	#REF!	#REF!	52.73%	51.49%	47.59%	44.50%	44.50%	44.50%	44.50%	44.50%	44.50%	44.50%	44.50%	44.50%	44.50%	
Other Stockholder Equity	#REF!	#REF!	-13.37%	-11.52%	-7.94%	-6.00%	-6.00%	-6.00%	-6.00%	-6.00%	-6.00%	-6.00%	-6.00%	-6.00%	-6.00%	
Total Stockholders' Equity	#REF!	#REF!	79.69%	77.97%	68.22%	65.60%	65.60%	65.60%	65.60%	65.60%	65.60%	65.60%	65.60%	65.60%	65.60%	
Total Liabilities and Stocholders' Equity	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	

Statement of Cash Flows

The statement of cash flows contained fewer forecast able numbers compared to the income statement and balance sheet. Trends were difficult to predict; however, Net Income has been previously forecasted in the income state. When deciding which information is relevant to the forecast we must try to observe any noticeable trends in the past five years. The cash flows from operations (CFFO) was difficult to forecast because of the 2004 net loss. This year is an outlier and was not figured in the data. CFFO was forecasted as an average percentage of net income for the four remaining years and increased proportionally with net income. The average percentage of depreciation and amortization as related to CFFO on the common size statement of cash flows was used to determine its increasing trend for the next ten years. Capital expenditures and cash flows from investing (CFFI) were both forecasted using averages from the past three years and grown according to the growth during that span.

Statement of Cash Flows for Callaway Golf

	Actual Financial Statements					Forecast Financial Statements									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net income (loss)	\$ 69,446	\$ 45,523	\$ (10,103)	\$ 13,284	\$ 23,290	\$ 41,256	\$ 49,507	\$ 54,448	\$ 59,903	\$ 67,092	\$ 75,143	\$ 84,160	\$ 94,259	\$ 105,570	\$ 118,239
Depreciation and amortization	\$ 37,640	\$ 44,496	\$ 51,154	\$ 38,260	\$ 32,274	\$ 33,888	\$ 40,665	\$ 44,724	\$ 49,205	\$ 55,110	\$ 61,723	\$ 69,130	\$ 77,425	\$ 86,716	\$ 97,122
Noncash compensation	\$ 314	\$ 15	\$ 1,741	\$ 6,527	\$ 11,921										
Loss on disposal of long-lived assets	\$ 1,168	\$ 24,163	\$ 7,669	\$ 4,031	\$ 1,135										
Deferred taxes	\$ 11,357	\$ (8,320)	\$ 7,707	\$ (3,906)	\$ 979										
Tax benefit from exercise of stock options	\$ 5,479	\$ (982)	\$ 2,161	\$ 2,408	\$ -										
Net noncash foreign currency hedging loss	\$ (4,328)	\$ 2,619	\$ 1,811	\$ -	\$ -										
Changes in assets and liabilities															
Accounts receivable, net	\$ (9,279)	\$ 12,698	\$ (1,048)	\$ 2,296	\$ (12,128)										
Inventories, net	\$ 21,785	\$ 4,897	\$ 10,299	\$ (65,595)	\$ (16,842)										
Other assets	\$ 10,202	\$ (4,743)	\$ 1,554	\$ 7,583	\$ (4,475)										
Accounts payable and accrued expenses	\$ 11,579	\$ 2,561	\$ (17,122)	\$ 32,423	\$ (4,525)										
Accrued employee compensation and benefits	\$ (2,383)	\$ (3,898)	\$ (5,895)	\$ 5,121	\$ (6,376)										
Accrued warranty expense	\$ (21,400)	\$ (838)	\$ (584)	\$ 1,224	\$ 98										
Income taxes receivable and payable	\$ 6,185	\$ 4,004	\$ (40,711)	\$ 26,676	\$ (6,936)										
Other liabilities	\$ (922)	\$ 1,572	\$ (273)	\$ (351)	\$ (1,128)										
Cash from operating activities	\$ 139,214	\$ 118,743	\$ 8,360	\$ 69,981	\$ 17,287	\$ 44,589	\$ 53,507	\$ 58,847	\$ 64,743	\$ 72,513	\$ 81,215	\$ 90,960	\$ 101,875	\$ 114,100	\$ 127,793
Capital expenditures	\$ (73,502)	\$ (7,810)	\$ (25,809)	\$ (33,942)	\$ (32,453)										
Investment in golf related ventures	\$ -	\$ -	\$ -	\$ -	\$ (10,008)										
Proceeds from sale of capital assets	\$ 871	\$ 178	\$ 431	\$ 1,363	\$ 469										
Acquisitions, net of cash acquired	\$ -	\$ 160,321	\$ (9,204)	\$ -	\$ 374										
Cash from investing activities	\$ (67,633)	\$ (167,929)	\$ (34,582)	\$ (32,579)	\$ (41,618)	\$ (8,363)	\$ 19,768	\$ 20,902	\$ 22,102	\$ 23,371	\$ 24,712	\$ 26,131	\$ 27,631	\$ 29,217	\$ 30,894
Issuance of common stock	\$ 18,305	\$ 17,994	\$ 20,311	\$ 14,812	\$ 9,606										
Acquisition of treasury stock	\$ (46,457)	\$ (4,755)	\$ (6,298)	\$ (39)	\$ (52,872)										
Dividends paid, net	\$ (18,601)	\$ (18,536)	\$ (19,069)	\$ (19,557)	\$ (19,212)	\$ (20,482)	\$ (20,482)	\$ (23,408)	\$ (23,408)	\$ (23,408)	\$ (23,408)	\$ (23,408)	\$ (23,408)	\$ (23,408)	\$ (23,408)
Proceeds from (payments on) line of credit	\$ -	\$ -	\$ 13,000	\$ (13,000)	\$ 80,000										
Minority interest in consolidated subsidiary	\$ -	\$ -	\$ -	\$ -	\$ 1,987										
Tax benefit from exercise of stock options	\$ -	\$ -	\$ -	\$ -	\$ 578										
Other financing activities	\$ -	\$ -	\$ -	\$ (44)	\$ (16)										
Cash from financing activities	\$ (49,127)	\$ (13,414)	\$ 7,944	\$ (17,828)	\$ 20,071										
Foreign exchange effects	\$ 1,735	\$ 1,488	\$ 2,595	\$ (1,750)	\$ 1,411										
Net increase (decrease) in cash and cash equivalents	\$ 24,189	\$ (61,112)	\$ (15,683)	\$ 17,824	\$ (3,119)										
Cash and cash equivalents at beginning of year	\$ 84,263	\$ 108,452	\$ 47,340	\$ 31,657	\$ 49,481										
Cash and cash equivalents at end of year	\$ 108,452	\$ 47,340	\$ 31,657	\$ 49,481	\$ 46,362										

Statement of Cash Flows for Callaway Golf

	Actual Financial Statements					Forecast Financial Statements									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net income (loss)	49.88%	38.34%	-120.85%	18.98%	134.73%	91.92%	91.92%	91.92%	91.92%	91.92%	91.92%	91.92%	91.92%	91.92%	91.92%
Depreciation and amortization	27.04%	37.47%	611.89%	54.67%	186.70%	76.47%	76.47%	76.47%	76.47%	76.47%	76.47%	76.47%	76.47%	76.47%	76.47%
Noncash compensation	0.23%	0.01%	20.83%	9.33%	68.96%										
Loss on disposal of long-lived assets	0.84%	20.35%	91.73%	5.76%	6.57%										
Deferred taxes	8.16%	-7.01%	92.19%	-5.58%	5.66%										
Tax benefit from exercise of stock options	3.94%	-0.83%	25.85%	3.44%	0.00%										
Net noncash foreign currency hedging loss	-3.11%	2.21%	21.66%	0.00%	0.00%										
Changes in assets and liabilities															
Accounts receivable, net	-6.67%	10.69%	-12.54%	3.28%	-70.16%										
Inventories, net	15.65%	4.12%	123.19%	-93.73%	-97.43%										
Other assets	7.33%	-3.99%	18.59%	10.84%	-25.89%										
Accounts payable and accrued expenses	8.32%	2.16%	-204.81%	46.33%	-26.18%										
Accrued employee compensation and benefits	-1.71%	-3.28%	-70.51%	7.32%	-36.88%										
Accrued warranty expense	-15.37%	-0.71%	-6.99%	1.75%	0.57%										
Income taxes receivable and payable	4.44%	3.37%	-486.97%	38.12%	-40.12%										
Other liabilities	-0.66%	1.32%	-3.27%	-0.50%	-6.53%										
Cash from operating activities	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Analysis and Forecasting Conclusion

After forecasting the financial statements for Callaway Golf, we believe they will continue to grow at a relatively good rate for their industry. Their company is currently at a point where they are satisfying the costs of the acquisition of Top-Flite golf, and beginning to reap the benefits. With this in mind, the acquisition made it difficult to accurately forecast the results of such a purchase as it occurred in September of 2003 and did not have an affect until 2004. It is difficult to realize exactly how much this will increase sales in the future. As noted in Callaway's 10-K, the aging population of the United States should also be beneficial for the golf industry and Callaway in particular, and should be apparent with an increase in sales for years to come.

The largest weakness for our forecasting is the fact that Callaway is a company that has experienced many fluctuations in the past 5 years due to acquisitions and the industry itself. The golf industry is highly seasonal and can experience great changes based on something as simple as the weather. We attempted to carefully exam the trends that Callaway experienced before their acquisition, as well as the results and increases they have experienced afterwards. At some points we even excluded outlier years when determining growth rates and liability portions. We also assume that this investment will prove to be beneficial to the company.

For this draft we have computed and analyzed ratios that reflect liquidity, profitability, capital structure, and growth for Callaway Golf. Additionally, we organized information from Callaway's Income Statement, Balance Sheet, and Statement of Cash Flows. We also computed the common size version for each of the preceding. This information was used to assess Callaway's situation in the golf industry for the past 5 years, as well as forecast out 10 years worth of information based on our findings. The results of these forecasts are the following.

Valuation Analysis

Valuation is the process of converting a forecast into an estimate of the value of the firm (PH&B). With the forecasts computed prior, we will use several valuation methods to estimate a price for Callaway Golf. Each valuation method has advantages and disadvantages, and when put together they add value to the analysis for investors.

Cost of Capital

The cost of capital is a weighted average of the cost of equity and the cost of debt. Firm finance their operation from three main transactions they are issuing stock, debt, and reinvesting back into their corporation. In order to obtain a WACC you must have consistent inputs into your formulas of cost of debt, equity, expected return and the risk free rate.

To come up with the numbers for the cost of debt we must run regressions which were run using a 6 month treasury bond. We had to look up the monthly market return off of the S&P 500 and also use a respective risk free rate. We used the 6 month bond because it had the highest explanatory power for us which is the highest adjusted r squared in respect to the other bonds on the market. When the regressions were run we obtained a beta which was concluded using the highest adjusted r squared. The beta that we have chosen to use is 1.64 with an adjusted r squared of 28.46% which was the highest of all the models. After completing regressions and finding a pretty accurate beta we then plugged it in to the CAPM model to find the cost of equity. The cost of equity is important to the firm because it is the number that investors are required to return on investments.

$$K_e = 4.44 + 1.64(.0463)$$

Cost of Debt

The calculation of the cost of debt isn't as complex as finding the beta. All of the respective information is found on the balance sheets for the company or in discussions. To find the cost of debt you get the total of current and long term liabilities then finding a weighted average and multiplying them each by its interest rates.

$$K_d = 6.76\% \text{ (before tax)}$$

$$K_d = 4.39\% \text{ (after tax)}$$

Weighted Average Cost of Capital

The weighted average cost of capital has two possible outcomes it has a before tax and an after tax. For our calculations we used the after tax formula since it gives a more accurate representation of Callaway since we pay taxes on all of our revenues.

$$\text{WAAC after tax} = V_e/V_f (K_e) + V_d/V_f (K_d) (1 - \text{tax rate})$$

$$\text{After tax} = 577,117/845,947(.1203) + 268,830/845,947(.0676) (1 - .35) = 9.60\%$$

The formula above show how WACC was calculated using the after tax formula. This is a more accurate representation as a said because if we were to calculate WACC before tax it would not include the tax rate which would be a wrong representation of our firm due to the fact that we pay taxes on our revenues.

Comparables Valuation

When you need to obtain your companies price per share you have to complete method of comparables to get an industry average. The method of comparables does not give you an accurate average because most of the time the companies you are comparing yours too does not give an accurate depiction

of the industry you are in. When obtaining an average you do not use Callaway as part of the average. As I said the method of comparables is probably the least accurate way to obtain a price per share but it is quick and easy.

Method of Comparables

	PPS	EPS	BPS	DPS
ELY	14.41	.32	7.89	.28
NKE	99.03	.36	12.93	.65
ADGO.OB	1.97	.38	1.74	0

Trailing Price/Earnings

ELY	75.84
NKE	42.69
ADGO	14.07
Industry	28.38
Est. Share Price	9.08

The trailing price over earnings ratio concludes that the estimated share price would be 9.08 which is undervalue of Callaway's current price of 16.17. These results were found by taking the price per share for the current period and then dividing it by the earning per share from the last period. You then take the average of the industry and multiply it by Callaway's current earnings per share to obtain the estimated share price.

Forward Price/Earnings

ELY	17.79
NKE	139.48
ADGO	0
Industry	69.74
Est. Share Price	56.49

The forward price over earnings share price is estimated to be 56.49. To solve for the forward price over earnings we took the analysts estimates of the EPS and took the current price per share and divided the two. We then took an industry average. To obtain the estimated share price we took the industry average and multiplied it by Callaway's earnings per share.

Market/Book

ELY	1.83
NKE	7.66
ADGO	1.13
Industry	4.40
Est. Share Price	1.41

The market to book has estimated that we will have a estimated share price of 1.41 which way overvalues Callaway at 16.17. This number is really low due to the fact that Callaway and the competing companies have fairly high BPS. This makes that numbers low because when you find the value you take the PPS divided by the BPS. You then take an industry average excluding Callaway and then multiply the industry average by Callaway's BPS to obtain estimated earnings per share.

Dividends/Price

ELY	.02
NKE	.01
ADGO	.00
Industry	.01
Est. Share Price	.2

To find the share price we took the dividends per share and divided it by the price per share. We then took an industry average excluding Callaway and Adam's because you don't include zeroes in the average. To obtain the estimated share price we took Callaway's dividends per share and divided it by the industry average.

P.E.G Ratio

ELY	54.92
NKE	266.81
ADGO	3.80
Industry	135.31
Est. Share Price	42.76

The price earning growth estimates the share price to be 42.76 which still overvalues Callaway at 16.17. We found these prices by taking the Price over Earnings then dividing that by 1 minus the earnings per share growth rate. We then took the industry average and multiplied it by 1 minus Callaway's growth rate to obtain the estimated share price.

Intrinsic Valuation Methods:

Discounted Dividends

The first model that will be discussed is the discounted dividends model. This model incorporates dividends paid and also projected dividends to be paid. The cost of equity is used as the discount rate and also a growth rate of the dividends. We have ten years of dividends forecasted out and used the discount rate to discount them back and find a proper valuation according to this valuation model. We had to use a perpetuity for the end of the model, because we assume that dividends will be paid indefinitely, also discounted back to present year dollars.

We have created different scenarios in a sensitivity analysis of different possibilities of cost of equity and growth rate. The different combinations formulate a different valuation prices. We believe the middle price of \$6.37 to be closest to our valuation, but with a small adjustment of cost of equity or change of a growth rate, a price can change easily. This is showing that the dividend discount model lacks much explanatory power of a correct price using the dividend discount model.

	ke						
g	0.02	0.05	0.08	0.12	0.15	0.18	0.22
0.01	\$97.62	\$19.45	\$10.26	\$6.40	\$5.00	\$4.05	\$3.14
0.02	NA	\$22.30	\$10.53	\$6.40	\$4.98	\$4.03	\$3.13
0.04	-\$28.11	\$45.11	\$11.45	\$6.37	\$4.92	\$3.99	\$3.11
0.06	-\$7.15	-\$23.31	\$14.23	\$6.33	\$4.85	\$3.94	\$3.08
0.07	-\$2.96	-\$6.21	\$19.79	\$6.30	\$4.80	\$3.91	\$3.07
	Overvalued (<90%)			\$14.55			
	Undervalued (>110%)			\$17.79			

Discounted Free Cash Flows

The discounted free cash flows model is different than the other valuation models in that it uses the WACC as the discount rate. As mentioned earlier, Callaway's WACC is 9.6%. First, you must calculate the FCF, which is done by subtracting cash flows from investing activities from cash flows from operations. Your calculated FCF is then multiplied by a present value factor $(1/(1+WACC)^t)$, which accounts for each forecasted year individually. A terminal value perpetuity is then estimated and discounted back just as the FCF. The PV of the FCF and PV terminal value perpetuity make up the value of the firm. The value of the firm is then subtracted from the 2006 total liabilities found on the balance sheet. This gives us an estimated market value of equity, which is then divided by the number of shares outstanding completing our valuation of the firm.

A Sensitivity Analysis is run to show how the price can be manipulated if the WACC and growth rate are changed. The sensitivity analysis reveals that the closest estimated price, as compared to the observed share price, is found when the WACC is 2 to 3% above the growth rate. These cases are most evident when WACC equals 6% and the growth rate is 3.5%, which concludes a \$16.51 share price. WACC at 9.6% and growth at 7% estimates the share price at \$16.03, the closest value to the April 1, 2007 observed price of \$16.17. The Sensitivity Analysis is provided below.

	Sensitivity Analysis						
	WACC						
g	0.03	0.045	0.06	0.075	0.096	0.105	0.12
-0.01	\$26.77	7.77	\$6.24	5.25	\$4.34	\$4.05	\$3.66
0.015	\$7.14	13.8	\$9.41	7.22	\$5.51	\$5.03	\$4.40
0.025	\$79.83	20.43	\$11.95	8.55	\$6.21	\$5.59	\$4.81
0.035	-\$78.76	40.33	\$16.51	10.56	\$7.14	\$6.31	\$5.31
0.055	-\$15.32	-39.26	\$80.41	20.58	\$10.36	\$8.61	\$6.77
0.07	-\$9.38	-15.38	-\$39.40	80.69	\$16.03	\$12.07	\$8.64
	Overvalued (<90%)			\$14.55			
	Undervalued (>110%)			\$17.79			

Residual Income

It is important to note that the intrinsic valuation model of residual income has the highest explanatory power out of all the other valuation methods. Residual income uses cost of equity to discount values to an implied price and is calculated in the following manner. Book value of equity per share, (BPS), is calculated for every forecasted year by taking the initial years BPS and adding earnings per share while subtracting dividends per share. Afterwards, a years "Normal Income" is calculated by taking the previous years BPS and multiplying it by the cost of equity. Next, every years earnings per share is subtracted by the given years normal income, and this gives us a years residual income which is discounted by the cost of equity to the current year. In addition to this a terminal

value residual income is discounted back to present dollars after accounting for a determined growth rate.

With a cost of equity of 12.03%, and a growth rate of 0, we calculated Callaway Golf's implied price to be \$6.39, which is substantially less than the observed price per share of \$16.17. This would imply that the firm is significantly overvalued. If Callaway would be able to lower their cost of equity and achieve a growth rate, they would improve their implied value; however it is not realistically likely that they would become a fairly valued firm based on the residual income model. The negative numbers on the sensitivity analysis are a result of the growth rate exceeding the cost of equity, while the cell that reads not applicable is a result of the cost of equity equaling the growth rate.

				ke				
g		0.02	0.05	0.08	0.12	0.15	0.18	0.22
0.01		\$97.62	\$19.45	\$10.26	\$6.40	\$5.00	\$4.05	\$3.14
0.02	NA		\$22.30	\$10.53	\$6.40	\$4.98	\$4.03	\$3.13
0.04		-\$28.11	\$45.11	\$11.45	\$6.37	\$4.92	\$3.99	\$3.11
0.06		-\$7.15	-\$23.31	\$14.23	\$6.33	\$4.85	\$3.94	\$3.08
0.07		-\$2.96	-\$6.21	\$19.79	\$6.30	\$4.80	\$3.91	\$3.07
	Overvalued (<90%)				\$14.55			
	Undervalued (>110%)				\$17.79			

Long Run Residual Income

The intrinsic valuation model of long run residual income, determines the value of the firm using the terminal return on equity, cost of equity, and average growth in book value. The formula is depicted as:

$$= BVE_0 (1 + ((ROE - K_e) / (K_e - G))$$

Callaway's return on equity is calculated by dividing the firms forecasted net income by their forecasted book value of equity. And in turn, Callaway's estimated growth in equity is calculated by averaging the firm's forecasted

beginning book value of equity by the end book value of equity. In Callaway's case, their return on equity is at a growing stage. This is because of their acquisition of Top Flite Golf. It would be aggressive to forecast a rapid growth in ROE after their negative net income in 2003, and growing income since. However we are assuming an implied ROE of 15% which would be a reasonable terminal ROE assumption as they must have a ROE above their cost of equity of 12.03%, in order to create value.

Out of all the intrinsic valuation models, long run residual income gives us the closest implied price to actual price for Callaway, of \$12.61. With this being said, the implied price would indicate that Callaway is slightly over-valued which is the most favorable implied valuation we have obtained. If they would be able to increase their return on equity to above 15%, with their current cost of equity, Callaway may be able to achieve an implied price that would merit them as a fairly valued firm. Similarly, if Callaway would be able to lower their cost of equity, their implied value would increase dramatically and may even suggest them to be an undervalued company. The reason we believe this model demonstrates such a good explanatory power of Callaway's price, is the fact that terminal ROE excludes the difficulties of forecasting the results of a company who's net income has fluctuated in the amounts that it has recently.

Sensitivity Analysis					
g	0.11	0.13	0.15	0.17	0.19
0.08	\$26.34	\$38.48	\$50.63	\$62.77	\$74.92
0.1	\$10.55	\$15.42	\$20.28	\$25.15	\$30.01
0.1203	\$6.56	\$9.58	\$12.61	\$15.63	\$18.66
0.14	\$4.80	\$7.01	\$9.22	\$11.44	\$13.65
0.16	\$3.77	\$5.51	\$7.25	\$8.99	\$10.73
Overvalued (<90%)			\$14.55		
Undervalued (>110%)			\$17.79		

Abnormal Earnings Growth

When computing Abnormal Earnings Growth, expected earnings per share and dividends paid are an integral part of the valuation. You begin by calculating DRIP, which is done by multiplying dividends per share by k_e . Then find the Cum-Dividends Earnings by adding the DRIP plus the expected price per share. Normal Earnings are then computed by multiplying the k_e times your “benchmark” earnings, which is the EPS from the previous year. Subtract the Normal Earnings from the Cum-Dividends Earnings to find your AEG for that year. In order to create value for the firm the AEG must be greater than zero, or value is destroyed. Callaway manages to create value for all of the forecasted years. A PV Factor using k_e is used to calculate the PV of AEG. The total PV of AEG is subtracted from your Core EPS, which is the EPS for the first forecasted year (2007) to find Callaway’s total average EPS. The intrinsic value per share is calculated by subtracting the growth rate from k_e and dividing that total by the total average EPS ($.78/ (.1203-0)$).

The Sensitivity Analysis shows that at 15% k_e and 10% growth the estimated share price of \$16.15 is very close to the observed price of \$16.17. When we show negative growth of -2.5% at a k_e of 2% the estimated price is also close at \$17.41. When growth ranges from 10 to 50% the price is negative unless the k_e is 18% or 22%.

		Sensitivity Analysis						
		k_e						
g		0.02	0.05	0.08	0.12	0.15	0.18	0.22
-0.025	17.41	10.52	7.57	5.53	4.61	3.96	3.34	
-0.01	26.11	13.15	8.83	6.17	5.05	4.28	3.56	
0.1	-\$9.79	-\$15.78	-\$39.73	\$40.10	\$16.15	\$10.16	\$6.83	
0.2	-\$4.35	-\$5.26	-\$6.62	-\$10.02	-\$16.15	\$40.62	\$40.96	
0.5	-\$1.63	-\$1.75	-\$1.89	-\$2.11	-\$2.31	-\$2.54	-\$2.93	

Overvalued (<90%)			\$14.55
Undervalued (>110%)			\$17.79

Altman Z-Score Credit Analysis

The Altman Z-Score is a fairly new valuation tool which assesses a firm's likeliness to go bankrupt. Through historical evaluations it has proven to be a very reliable valuation. It states that if a firm has a Z-Score of 1.8 or less, there is a high chance that it will go bankrupt in the near future, while if a firm has a Z-Score above 2.7, there is a smaller threat of imminent bankruptcy. The formula itself consists of major ratios that are weighted to give the firm a score. The actual equation is as follows:

$$\text{Z-Score} = 1.2(\text{Working Capital/Total Assets}) + 1.4(\text{Retained Earnings/Total Assets}) + 3.3(\text{Earnings before Interest and Taxes}) + 0.6(\text{Market Value of Equity/Book Value of Liabilities}) + 1.0 (\text{Sales/Total Assets})$$

The Z-Score for Callaway Golf comes to 2.46, which is in between the two check numbers of 1.8 and 2.7. This would indicate that Callaway is not in any immediate danger of going bankrupt; however they are not above the score of 2.7 which would suggest that they are not completely safe from the possibility of bankruptcy. The Z-Score of 2.46 would suggest that Callaway Golf does have some credit problems. The major disadvantage of this is the fact that creditors weigh the Z-Score very highly, to the point of over-weighting, when considering loans. This would mean that Callaway would likely pay a premium expense for loans and notes payable.

While Callaway is much closer to the upper end of the grey area between 1.8 and 2.7, this is an unfavorable sign of credit problems which does hinder the firm.

Valuation Conclusion:

After assessing the value of Callaway Golf using several methods, we conclude that Callaway Golf is overvalued. While some of the models we used seem to be more accurate than others, all of them point to the fact that Callaway Golf's true dollar value per share is substantially lower than their stated price as of April 1st, 2007. The intrinsic valuation model which produced the highest price

per share was the long run residual income model which gave an implied price of \$12.61 per share. The model that produced the lowest price per share was the discounted dividend model which gave an implied price per share of \$2.70. The other models we used, and their yielded price per share, were free cash flows at \$5.39, residual income at \$6.39, and abnormal earnings growth at \$6.67.

Callaway's actual price per share was \$14.41, and with discounted dividends, one would exclude it as an outlier. If you average the results of all these findings, you come up with a share price of \$6.75. If you exclude discounted dividends as an outlier then the implied price would be \$7.77. Regardless of what may be an outlier and what may not, it is evident that Callaway Golf's price per share is well below the stated price of \$14.41. Therefore we confidently, and positively asses Callaway Golf as overvalued.

Appendix-1 Cost of Debt and Equity

Cost of Debt

Liabilities		Interest	Weight	
Current Liabilities				
Accounts Payable	143455	0.055	0.5336	0.029349
Short/Current Long Term Debt	80000	0.1	0.2976	0.029759
Other Current Liabilities	-			
Total Current	223455			
Long Term Liabilities				
Long Term Debt	-			
Other Liabilities	19922	0.04	0.0741	0.002964
Deferred Long Term Liability Charges	23466	0.06	0.0873	0.005237
Minority Interest	1987	0.045	0.0074	0.000333
Total Long Term	45375			
Total Liabilities	268830		1.0000	
Total				0.067642

Cost of Equity

$$\text{CAPM} = R_f + B(\text{MRP})$$

$$.1203 = .0444 + 1.64(.0463)$$

$$K_e = .1203 = 12.03\%$$

Appendix-2 Regression

6 Month Regression

24 MONTH SUMMARY OUTPUT

6 Month

<u>Regression Statistics</u>	
Multiple R	0.434242
R Square	0.188566
Adjusted R	0.153286
Standard E	0.093345
Observatio	25

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.046571	0.046571	5.344884	0.030085
Residual	23	0.200405	0.008713		
Total	24	0.246976			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.003161	0.019885	-0.158967	0.875082	-0.044296	0.037974	-0.044296	0.037974
X Variable	2.316796	1.002118	2.311901	0.030085	0.243758	4.389835	0.243758	4.389835

36 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.357221
R Square	0.127607
Adjusted R	0.102681
Standard E	0.101876
Observatio	37

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.053135	0.053135	5.11952	0.02997
Residual	35	0.363259	0.010379		
Total	36	0.416393			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.008568	0.017512	-0.489254	0.627714	-0.044119	0.026983	-0.044119	0.026983
X Variable	1.913319	0.845615	2.262636	0.02997	0.196629	3.63001	0.196629	3.63001

48 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.43416
R Square	0.188495
Adjusted R	0.171229
Standard E	0.093105
Observatio	49

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.094636	0.094636	10.91706	0.001828
Residual	47	0.407425	0.008669		
Total	48	0.502061			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.007448	0.014739	-0.505348	0.615676	-0.037099	0.022203	-0.037099	0.022203
X Variable	1.904264	0.576334	3.304097	0.001828	0.744829	3.0637	0.744829	3.0637

72 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.533522
R Square	0.284645
Adjusted R	0.27457
Standard E	0.099468
Observatio	73

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.279519	0.279519	28.25147	1.17E-06
Residual	71	0.70247	0.009894		
Total	72	0.981989			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.001986	0.011669	-0.170152	0.865374	-0.025253	0.021282	-0.025253	0.021282
X Variable	1.638759	0.308315	5.315212	1.17E-06	1.023997	2.253522	1.023997	2.253522

5 Year Regression

24 MONTH SUMMARY OUTPUT

5 Year

Regression Statistics

Multiple R	0.432468
R Square	0.187028
Adjusted R	0.151682
Standard E	0.093251
Observatio	25

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.046011	0.046011	5.291268	0.030842
Residual	23	0.2	0.008696		
Total	24	0.246011			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.006954	0.019865	-0.350042	0.729492	-0.048047	0.03414	-0.048047	0.03414
X Variable	2.30282	1.001106	2.300276	0.030842	0.231874	4.373766	0.231874	4.373766

36 MONTH SUMMARY OUTPUT

Regression Statistics

Multiple R	0.355888
R Square	0.126656
Adjusted R	0.101704
Standard E	0.101775
Observatio	37

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.052576	0.052576	5.075856	0.030632
Residual	35	0.362532	0.010358		
Total	36	0.415108			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.011948	0.017494	-0.682936	0.499143	-0.047463	0.023568	-0.047463	0.023568
X Variable	1.903237	0.844769	2.252966	0.030632	0.188264	3.61821	0.188264	3.61821

48 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.435681
R Square	0.189818
Adjusted R	0.17258
Standard E	0.093035
Observatio	49

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.095311	0.095311	11.01163	0.001754
Residual	47	0.40681	0.008656		
Total	48	0.502121			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.010583	0.014728	-0.718603	0.475943	-0.040212	0.019045	-0.040212	0.019045
X Variable	1.91105	0.575899	3.318378	0.001754	0.752491	3.06961	0.752491	3.06961

72 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.531084
R Square	0.282051
Adjusted R	0.271939
Standard E	0.099486
Observatio	73

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.276068	0.276068	27.89276	1.34E-06
Residual	71	0.70272	0.009897		
Total	72	0.978788			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.00403	0.011671	-0.345287	0.730899	-0.027302	0.019242	-0.027302	0.019242
X Variable	1.628612	0.30837	5.28136	1.34E-06	1.01374	2.243484	1.01374	2.243484

20 Year Regression

24 MONTH SUMMARY OUTPUT

20 Year

Regression Statistics

Multiple R	0.434703
R Square	0.188966
Adjusted R	0.153704
Standard E	0.09344
Observatio	25

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.046789	0.046789	5.358876	0.029892
Residual	23	0.200814	0.008731		
Total	24	0.247603			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.005703	0.019905	-0.286501	0.77706	-0.04688	0.035475	-0.04688	0.035475
X Variable	2.322197	1.003142	2.314925	0.029892	0.247041	4.397354	0.247041	4.397354

36 MONTH SUMMARY OUTPUT

Regression Statistics

Multiple R	0.357447
R Square	0.127768
Adjusted R	0.102847
Standard E	0.10202
Observatio	37

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.053362	0.053362	5.126948	0.029858
Residual	35	0.364286	0.010408		
Total	36	0.417648			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.011346	0.017537	-0.646979	0.521866	-0.046947	0.024255	-0.046947	0.024255
X Variable	1.917413	0.84681	2.264277	0.029858	0.198296	3.63653	0.198296	3.63653

48 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.434888
R Square	0.189128
Adjusted R	0.171875
Standard E	0.093222
Observatio	49

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.095267	0.095267	10.96229	0.001792
Residual	47	0.408448	0.00869		
Total	48	0.503715			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.010196	0.014757	-0.690915	0.493017	-0.039884	0.019492	-0.039884	0.019492
X Variable	1.910601	0.577058	3.310935	0.001792	0.74971	3.071491	0.74971	3.071491

72 MONTH SUMMARY OUTPUT

<u>Regression Statistics</u>	
Multiple R	0.531246
R Square	0.282223
Adjusted R	0.272113
Standard E	0.099589
Observatio	73

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>ignificance F</i>
Regressor	1	0.276877	0.276877	27.91647	1.33E-06
Residual	71	0.704182	0.009918		
Total	72	0.981059			

	<i>Coefficient</i>	<i>standard Err</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>ower 95.0%</i>	<i>pper 95.0%</i>
Intercept	-0.003847	0.011683	-0.329304	0.742896	-0.027143	0.019449	-0.027143	0.019449
X Variable	1.630998	0.30869	5.283604	1.33E-06	1.015487	2.246509	1.015487	2.246509

Appendix-3 WACC

Weighted Average Cost of Capital

$$V_d/V_f (K_d) (1-T) + V_e/V_f (K_e)$$

$$268830/845947 (.0676) (1-.35) + 577117/845947 (.1203)$$

$$\text{WACC} = .096 = 9.6\%$$

Appendix-4 Method of Comparables

	Method of Comparables						
	2001	2002	2003	2004	2005	2006	2007
Callaway							
PPS	19.15	13.25	16.85	13.5	13.84	14.41	16.17
EPS	0.89	1.05	0.67	0.14	0.19	0.32	0.81
EPS Growth		0.18	0.362	0.79	0.357	0.684	
BPS		8.23	8.79	8.49	8.51	7.89	
DPS		0.28	0.28	0.28	0.28	0.28	
Forward P/E		19.78	120.36	71.05	43.25	17.79	
Trailing P/E	21.52	12.62	25.15	96.43	72.84	45.03	
M/B		1.61	1.92	1.59	1.63	1.83	
D/P		0.021	0.017	0.021	0.02	0.02	
PEG		39.93	39.11	-53.87	53.48	54.92	
Price/Sales		0.017	0.021	0.014	0.014	0.014	
P/EBIT		11.83	24.78	-56.25	92.27	41.17	
P/EBITDA		19.2	36.63	-135	106.46	62.65	
P/FCF per share		12.22	-22.95	-35.52	25.9	-43.23	
Enterprise		11.41	17.28	-76.7	62.54	38.78	
Nike							
PPS	56.24	44.47	68.46	90.69	86.79	99.03	106.43
EPS	1.29	1.25	0.9	1.8	2.32	0.36	0.71
EPS Growth		0.031	0.28	1	0.289	0.845	
BPS		7.22	7.57	9.09	10.81	12.93	
DPS		0.25	0.31	0.43	0.53	0.65	
Trailing P/E		34.47	54.77	100.77	48.22	42.69	
Forward P/E		49.41	38.03	39.09	241.08	139.48	
M/B		6.16	9.04	9.98	8.03	7.66	
D/P		0.005	0.004	0.005	0.006	0.007	
PEG		19.28	106.98	0	29.23	266.81	
Price/Sales		0.004	0.006	0.007	0.006	0.006	
P/EBIT		4.37	6.1	6.25	4.67	4.62	
P/EBITDA		6.66	9.25	9.59	7.16	7.11	
P/FCF per share		30.37	51.1	45.78	37.41	129.68	
Enterprise		10.5	10.07	9.24	8.4	7.78	

Adams

PPS	0.38	0.25	0.71	1.4	1.2	1.97	2.00
EPS	0.63	0.4	0.09	0.14	0.14	0.38	NA
EPS Growth		0.365	0.775	0.556	0	1.71	
BPS		0.87	0.99	1.17	1.41	1.74	
DPS		0	0	0	0	0	
Trailing P/E		-0.4	1.78	15.56	8.57	14.07	
Forward P/E		2.78	5.07	10.00	3.16	NA	
M/B		0.29	0.72	1.2	0.85	1.13	
D/P		0	0	0	0	0	
PEG		0.88	7.89	22.52	4.83	3.8	
Price/Sales		6.59	1.39	2.46	2.12	2.59	
P/EBIT		-0.002	0.0003	0.043	0.036	0.054	
P/EBITDA		-0.003	0.035	0.045	0.037	0.022	
P/FCF per share		-1.62	4	5.3	-4.19	-54.88	
Enterprise		-3.6	20.06	17.79	16.93	7.23	

Industry

Average Trailing P/E	17.035	28.275	58.165	28.395	28.38		
Average Forward P/E	26.09	21.55	24.55	122.12	NA		
D/P	0.0025	0.002	0.0025	0.003	0.0035		
M/B	3.225	4.88	5.59	4.44	4.395		
Average PEG	10.08	57.435	11.26	17.03	135.305		

Appendix-6 Altman Z-Score

Total Assets	845947				
Working Capital	269745	493200	223455		
Retained Earnings	435074				
EBIT	40419				
Market Value of Equity	16.17				
Book Value of Liabilities	268380				
Sales	1017907				
	WC/TA	RE/TA	EBIT/TA	MVE/BVL	Sales/TA
	0.31887	0.51430	0.04778	0.00006	1.20328
Multiple	1.2	1.4	3.3	0.6	1
	0.382641	0.720026	0.157673	3.62E-05	1.203275
Altman Z-Score	2.46				

$$1.2((493200-223455)/845947) + 1.4(435074/845947) + 3.3(40419/845947) + 0.6(16.17/268380) + 1(1017907/845947)=2.46$$

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