CALLAWAY GOLF CO
Form 10-K
March 02, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

or

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

Commission file number 1-10962

Callaway Golf Company

(Exact name of registrant as specified in its charter)

Delaware	**95-3797580**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2180 Rutherford Road

Carlsbad, CA 92008

(760) 931-1771

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

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

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

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

None

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

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

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

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

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

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of June 30, 2011, the aggregate market value of the Registrant s common stock held by nonaffiliates of the Registrant was $400,693,090 based on the closing sales price of the Registrant s common stock as reported on the New York Stock Exchange. Such amount was calculated by excluding all shares held by directors and executive officers and shares held in treasury, without conceding that any of the excluded parties are affiliates of the Registrant for purposes of the federal securities laws.

As of January 31, 2012, the number of shares of the Registrant s common stock and preferred stock outstanding was 65,018,357 and 1,400,000, respectively.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the Registrant s Definitive Proxy Statement to be filed with the Securities and Exchange Commission (Commission) pursuant to Regulation 14A in connection with the Registrant s 2012 Annual Meeting of Shareholders, which is scheduled to be held on May 23, 2012. Such Definitive Proxy Statement will be filed with the Commission not later than 120 days after the conclusion of the Registrant s fiscal year ended December 31, 2011.

Important Notice to Investors: Statements made in this report that relate to future plans, events, liquidity, financial results or performance including statements relating to future cash flows and liquidity, estimated unrecognized stock compensation expense, projected capital expenditures and depreciation and amortization expense, future contractual obligations, the realization of deferred tax assets, including loss and credit carryforwards, the reversal of the deferred tax valuation allowance in future periods, future income tax expense, the estimated amount or timing of charges and savings related to the Company s various restructuring initiatives, the reinvestment of the savings and the benefits to be derived therefrom, as well as the return to profitability and improvements in 2012, are forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are based upon current information and expectations. Actual results may differ materially from those anticipated if the information on which those estimates was based ultimately proves to be incorrect or as a result of certain risks and uncertainties, including changes in economic conditions, credit markets, or foreign currency exchange rates, the level of promotional activity in the marketplace, consumer acceptance and demand for the Company s products, future consumer discretionary purchasing activity (which can be significantly adversely affected by unfavorable economic or market conditions), delays, difficulties, changed strategies, or unanticipated factors including those affecting the success of the Company s Reorganization and Reinvestment Initiatives announced in June 2011, as well as the general risks and uncertainties applicable to the Company and its business. For details concerning these and other risks and uncertainties, see Part I, Item IA, Risk Factors contained in this report, as well as the Company s other reports on Forms 10-Q and 8-K subsequently filed with the Commission from time to time. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by law, the Company undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Investors should also be aware that while the Company from time to time does communicate with securities analysts, it is against the Company s policy to disclose to them any material non-public information or other confidential commercial information. Furthermore, the Company has a policy against distributing or confirming financial forecasts or projections issued by analysts and any reports issued by such analysts are not the responsibility of the Company. Investors should not assume that the Company agrees with any report issued by any analyst or with any statements, projections, forecasts or opinions contained in any such report.

Callaway Golf Company Trademarks: *The following marks and phrases, among others, are trademarks of Callaway Golf Company: Anypoint Apex Backstryke Big Bertha Black Series Tour Designs Callaway Callaway Golf Callaway uPro GO C Grind Chev Chev 18 Chevron Device D.A.R.T Diablo Edge-Diablo Forged Diablo Octane Dimple-in-Dimple Divine Eagle-ERC Flying Lady FTiZ FT Performance FT Tour Fusion Gems Great Big Bertha Heavenwood HX HX Diablo HX Diablo Tour Hex Aerodynamics Hex Black Tour IMIX Legacy Legacy Aero Marksman Never Lay Up Number One Putter in Golf Odyssey OptiFit ORG.14 Razr Fit Razr Hawk Razr X Razr XF Razr X Forged Razr X Muscleback Razr X Tour Rossie S2H2 Sabertooth Solaire Steelhead Strata Stronomic Teron TF design Tech Series Ti-Hot Top-Flite Top-Flite D2 Top-Flite XL Tour Authentic Tour i Tour i(S) Tour iX Tour i(Z) Trade In! Trade Up! Tru Bore uPro uPro MX VFT War Bird White Hot Wh Tour White Hot XG White Ice World s Friendliest XL7000 X-Act XJ Series XL Extreme X-Series X-Series Jaws X-SPANN Xtra Traction Technology XTT Xtra Width Technology XWT-2-Ball.*

CALLAWAY GOLF COMPANY

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PART I.

PART I

Item 1. ***Business***

Callaway Golf Company (the Company or Callaway Golf) was incorporated in California in 1982 with the main purpose of designing, manufacturing and selling high quality golf clubs. The Company became a publicly traded corporation in 1992, and in 1999, reincorporated in the state of Delaware. The Company has evolved over time from a manufacturer of golf clubs to one of the leading manufacturers and distributors of a full line of golf equipment and accessories.

Today, the Company, together with its subsidiaries, designs, manufactures and sells high quality golf clubs (drivers, fairway woods, hybrids, irons, wedges and putters) and golf balls, and also sells golf accessories (such as GPS range finders, golf bags, gloves, footwear, apparel, headwear, eyewear, towels and umbrellas) under the Callaway Golf, Odyssey, Top-Flite and uPro brand names. The Company generally sells its products to retailers, directly and through its wholly-owned subsidiaries, and to third-party distributors. The Company sells pre-owned golf products through its website, www.callawaygolfpreowned.com. In addition, the Company sells Callaway Golf, Top-Flite and Odyssey products direct to consumers online through its website www.shop.callawaygolf.com. The Company also licenses its trademarks and service marks in exchange for a royalty fee to third parties for use on golf and lifestyle products, including apparel, rangefinders, practice aids and travel gear. The Company s products are sold in the United States and in over 100 countries around the world.

Financial Information about Segments and Geographic Areas

Information regarding the Company s segments and geographic areas in which the Company operates is contained in Note 19 to the Notes to the Company s Consolidated Financial Statements for the years ended December 31, 2011, 2010 and 2009, which note is incorporated herein by this reference and is included as part of Item 8 Financial Statements and Supplementary Data.

Products

The Company designs, manufactures and sells high quality golf clubs and golf balls, and designs and sells golf accessories. The Company designs its products to be technologically advanced and in this regard invests a considerable amount in research and development each year. The Company s products are designed for golfers of all skill levels, both amateur and professional, and are generally designed to conform to the Rules of Golf as published by the United States Golf Association (USGA) and the R&A Rules Limited (the R&A). For further discussion on certain risks associated with product design and development, see below, Certain Factors Affecting Callaway Golf Company, contained in Item 1A.

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

	Year Ended December 31,					
	2011		2010(1)		2009(1)	
	(Dollars in millions)					
Drivers, fairway woods and hybrids	$ 212.9	24%	$ 225.2	23%	$ 223.2	23%
Irons	207.8	24%	223.9	23%	232.7	25%
Putters	88.8	10%	106.3	11%	98.3	10%
Golf balls	160.4	18%	176.6	18%	178.7	19%
Accessories and other	216.6	24%	235.7	25%	217.9	23%
Net sales	$ 886.5	100%	$ 967.7	100%	$ 950.8	100%

(1) Certain prior period amounts were reclassified to conform with the current year presentation.

For a discussion regarding the changes in net sales for each product group from 2011 to 2010 and from 2010 to 2009, see below, Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations contained in Item 7.

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

Drivers, Fairway Woods and hybrids. This product category includes sales of the Company s drivers, fairway woods and hybrid products, which are sold under the Callaway Golf and Top-Flite brands. These products are generally made of metal (either titanium or steel) or a combination of metal and a composite material. The Company s products compete at various price levels in the woods category. The Company s drivers, fairway woods and hybrid products are available in a variety of lofts, shafts and other specifications to accommodate the preferences and skill levels of all golfers.

Irons. This product category includes sales of the Company s irons and wedges, which are sold under the Callaway Golf and Top-Flite brands. The Company s irons are generally made of metal (either titanium, steel or special alloy) or a composite material (a combination of metal and polymer materials). The Company s products compete at various price levels in the irons category. The Company s irons are available in a variety of designs, shafts and other specifications to accommodate the preferences and skill levels of all golfers.

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

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

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

Product Design and Development

Product design at the Company is a result of the integrated efforts of its brand management, research and development, manufacturing and sales departments, all of which work together to generate new ideas for golf equipment. The Company has not limited itself in its research efforts by trying to duplicate designs that are traditional or conventional and believes it has created a work environment in which new ideas are valued and explored. In 2011, 2010 and 2009, the Company invested $34.3 million, $36.4 million and $32.2 million, respectively, in research and development. The Company intends to continue to invest substantial amounts in its research and development activities in connection with its development of new products.

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

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

Manufacturing

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

As of December 31, 2011, the Company substantially completed the final phase of its planned Global Operations Strategy Initiatives (see Note 3 Restructuring Initiatives to the Notes to Consolidated Financial Statements). These initiatives were designed to add speed and flexibility to meet customer service demands, optimize efficiencies, and facilitate long-term gross margin improvements. During 2011, the Company (i) completed the reorganization of its manufacturing and distribution centers located in Carlsbad, California, Toronto, Canada, and Chicopee, Massachusetts, (ii) transitioned to the use of third-party logistics in Dallas, Texas and Toronto, Canada, and (iii) completed the establishment of a new production facility in Monterrey, Mexico. As a result of these changes, during 2011, approximately 79% and 67% of the Company s golf club and golf ball production volume, respectively, was generated in regions outside the U.S. compared to 60% during 2010 for both golf clubs and golf balls. At the conclusion of 2011, almost all of the Company s golf club production volume and 75% of golf ball production volume was generated in regions outside of the United States. The Company maintains limited golf club assembly in its facilities in Carlsbad, California and manufactures the balance of golf ball production volume at its facility in Chicopee, Massachusetts.

Raw Materials

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

Sales and Marketing

Sales in the United States

Of the Company s total net sales, approximately 47%, 48% and 50% were derived from customers within the United States in 2011, 2010 and 2009, respectively. The Company primarily sells to both on- and off-course golf retailers and sporting goods retailers who sell quality golf products and provide a level of customer service appropriate for the sale of such products. The Company also sells certain products to mass merchants. On a consolidated basis, no one customer that distributes golf clubs or golf balls in the United States accounted for more than 6% of the Company s consolidated revenues in 2011, 2010 and 2009. On a segment basis, the golf ball customer base is more concentrated than the golf club customer base. In 2011, the top five golf ball customers accounted for approximately 22% of the Company s total consolidated golf ball sales. A loss of one or more of these customers could have a significant adverse effect upon the Company s golf ball sales.

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

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

The Company also has a separate team of club fitting specialists who focus on the Company s custom club sales. Custom club sales are generated primarily from the utilization of the Company s club fitting programs such as performance centers, which utilize high speed cameras and precision software to capture relevant swing data. All performance centers and participating on-and-off course retail stores are equipped with custom fitting systems that incorporate the use of an extensive variety of clubhead and shaft combinations in order to find a set of golf clubs that fits a golfer s personal specifications. In addition, the Company utilizes tour fitting vans with club fitting and building capabilities. Club fittings are performed by golf professionals who are specifically trained to fit golfers of all abilities into custom-fitted clubs. The Company believes that offering golfers the opportunity to increase performance with custom club specifications increases sales and promotes brand loyalty.

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

Sales Outside of the United States

Of the Company s total net sales, approximately 53%, 52% and 50% of the Company s net sales were derived from sales for distribution outside of the United States in 2011, 2010 and 2009, respectively. The Company does business (either directly or through its subsidiaries and distributors) in more than 100 countries around the world. The Company s management believes that controlling the distribution of its products in certain major markets in the world has been and will continue to be an important element in the future growth and success of the Company.

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

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

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

Sales of Pre-Owned/Outlet Golf Clubs and Online Store

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

The Company also offers the full line of Callaway Golf, Top-Flite and Odyssey products, including drivers, fairway woods, hybrids, irons, putters, golf balls, footwear, eyewear, golf and lifestyle apparel and golf-related accessories, including uPro GPS on-course range finders, through its website www.shop.callawaygolf.com.

Advertising and Promotion

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

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

Competition

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

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

For both golf clubs and golf balls, the Company generally competes on the basis of technology, quality, performance, customer service and price. In order to gauge the effectiveness of the Company s response to such factors, management receives and evaluates Company-generated market trends for U.S. and foreign markets, as well as periodic public and customized market research for the U.S. and U.K. markets from *Golf Datatech* that includes trends from certain on and off course retailers. In addition, the Company utilizes *Sports Marketing Surveys* for the U.K. markets and *GfK Group* for the markets in Japan.

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

Environmental Matters

The Company s operations are subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the environment and establish standards for the handling, generation, emission, release, discharge, treatment, storage and disposal of certain materials, substances and wastes and the remediation of environmental contaminants (Environmental Laws). In the ordinary course of its manufacturing processes, the Company uses paints, chemical solvents and other materials, and generates waste by-products, that are subject to these Environmental Laws. In addition, in connection with the Top-Flite Acquisition, the Company assumed certain monitoring and remediation obligations at its manufacturing facility in Chicopee, Massachusetts.

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

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

Sustainability

The Company believes it is important to conduct its business in an environmentally, economically, and socially sustainable manner. In this regard, the Company has implemented an environmental sustainability initiative which focuses on key performance indicators and business objectives, including reductions of volatile organic compound (VOC) emissions, reductions of hazardous waste, reductions in water usage, improved recycling and development programs which involve the elimination or reduction of undesirable chemicals and solvents in favor of chemically similar functional alternatives. These efforts cross divisional lines and are visible in the following areas within the Company:

- Facilities through the partnership with local utilities to implement energy reduction initiatives such as energy efficient lighting, demand response energy management and heating, ventilation and air conditioning optimization;

- Manufacturing through automation and waste minimization;

- Product development through design efficiency and specification of environmentally preferred substances;

Logistics improvements and packaging minimization; and

Supply chain management through Social, Safety, and Environmental Responsibility audits of suppliers.
These programs are routinely monitored through metrics reporting and reviewed by management.

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

Intellectual Property

The Company is the owner of approximately 3,100 U.S. and foreign trademark registrations and over 2,300 U.S. and foreign patents relating to the Company s products, product designs, manufacturing processes and research and development concepts. Other patent and trademark applications are pending and await registration. In addition, the Company owns various other protectable rights under copyright, trade dress and other statutory and common laws. The Company s intellectual property rights are very important to the Company and the Company seeks to protect such rights through the registration of trademarks and utility and design patents, the maintenance of trade secrets and the creation of trade dress. When necessary and appropriate, the Company enforces its rights through litigation. Information regarding current litigation matters in connection with intellectual property is contained in Item 3 Legal Proceedings below and in Note 17 Commitments and Contingencies Legal Matters to the Notes to Consolidated Financial Statements in this Form 10-K.

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

Licensing

The Company from time to time, in exchange for a royalty fee, licenses its trademarks and service marks to third parties for use on products such as golf apparel, travel gear, rangefinders and practice aids. With respect to its line of golf apparel, the Company has current licensing arrangements with Perry Ellis International for a complete line of men s and women s apparel for distribution in certain retail channels in the United States, Canada and Mexico, and Sanei International Co., Ltd. for a complete line of men s and women s apparel for distribution in Japan, Korea, China and other Asia Pacific countries.

In addition to apparel, the Company has also licensed its trademarks to, among others, (i) IZZO Golf for practice aids, (ii) TRG Accessories, LLC for a collection primarily consisting of travel gear, (iii) Nikon Vision Co., Ltd. for rangefinders, (iv) Sweda Company, LLC for a collection of padfolios, pens and other gift items for the corporate market, and (v) Walman Optical, for a line of prescription Callaway eyewear. In addition, the Company designs and sells its own line of footwear and eyewear, and has entered into buying service agreements with Advanced Manufacturing Group Ltd. for footwear and MicroVision Optical Inc. for eyewear.

Employees

As of December 31, 2011, the Company and its subsidiaries had approximately 2,100 full-time and part-time employees. This number includes a reduction in personnel due in part to the Company s restructuring of its golf club and golf ball manufacturing and distribution operations, which was substantially completed as of

December 31, 2011, and the Company s Reorganization and Reinvestment Initiatives announced in June 2011 (see Note 3 Restructuring Initiatives to the Notes to Consolidated Financial Statements in this Form 10-K). These reductions were offset by an increase in personnel as a result of the Company s efforts to expand operations in regions outside the United States. The Company also employs temporary workers as the business requires.

The Company s golf ball manufacturing employees in Chicopee, Massachusetts, are unionized and are covered under a collective bargaining agreement, which expires on September 30, 2014. In addition, certain of the Company s production employees in Canada and Australia are also unionized. The Company considers its employee relations to be good.

Executive Officers of the Registrant

Biographical information concerning the Company s executive officers is set forth below.

Name	Age	Position(s) Held
Anthony S. Thornley	65	President and Chief Executive Officer, Director
Steven C. McCracken	61	Senior Executive Vice President and Chief Administrative Officer
Bradley J. Holiday	58	Senior Executive Vice President and Chief Financial Officer
Jeffrey M. Colton	39	Senior Vice President, Global Brand and Product
Joseph Urzetta	55	Senior Vice President, Americas
Neil Howie	49	Managing Director, Europe, Middle East and Africa
Alex Boezeman	53	Managing Director, East Asia
Leighton Richards	39	Managing Director, Southeast Asia and South Pacific

Anthony S. Thornley was named interim President and Chief Executive Officer of the Company in June 2011. He has served as a Director of the Company since April 2004 and was the Chair and designated Financial Expert of the Audit Committee until his appointment as President and Chief Executive Officer. From February 2002 to July 2005, he served as President and Chief Operating Officer of QUALCOMM Incorporated, the San Diego-based company that pioneered and developed technologies used in wireless networks throughout much of the world. He previously served as QUALCOMM s Chief Financial Officer from 1994 to February 2002. Prior to joining QUALCOMM, Mr. Thornley worked for Nortel Networks for 16 years, serving in various financial and information systems management positions including Vice President of Public Networks, Vice President of Finance NT World Trade, and Corporate Controller Northern Telecom Limited. Before Nortel, Mr. Thornley worked for Coopers & Lybrand. Mr. Thornley is a Director of Cavium Networks (a semiconductor company). Mr. Thornley received his degree in chemistry from Manchester University, England, and qualified as a chartered accountant.

Steven C. McCracken is Senior Executive Vice President and Chief Administrative Officer of the Company and has served in such capacity since October 2005. He previously served as Senior Executive Vice President, Chief Legal Officer and Secretary from August 2000 until October 2005. He served as Executive Vice President, Licensing and Chief Legal Officer from April 1997 to August 2000. He has served as an Executive Vice President since April 1996 and served as General Counsel from April 1994 to April 1997. He served as Vice President from April 1994 to April 1996. He served as Secretary from April 1994 to December 2008. Prior to joining the Company, Mr. McCracken was a partner at Gibson, Dunn & Crutcher LLP for 11 years, and had been in the private practice of law for over 18 years. During a portion of that period, he provided legal services to the Company. Mr. McCracken serves on the boards of Pro Kids Golf Academy and Learning Center (First Tee of

San Diego) and Top Golf International, Inc. (in which the Company has a minority interest investment). He is also Chair of the U.S. Golf Manufacturers Council. Mr. McCracken received a B.A., magna cum laude, from the University of California at Irvine and a J.D. from the University of Virginia.

Bradley J. Holiday is Senior Executive Vice President and Chief Financial Officer of the Company and has served in such capacity since September 2003. Mr. Holiday previously served as Executive Vice President and Chief Financial Officer beginning in August 2000. Before joining the Company, Mr. Holiday served as Vice President Finance for Gateway, Inc. Prior to Gateway, Inc., Mr. Holiday was with Nike, Inc. in various capacities beginning in April 1993, including Chief Financial Officer Golf Company, where he directed all global financial initiatives and strategic planning for Nike, Inc. s golf business. Prior to Nike, Inc., Mr. Holiday served in various financial positions with Pizza Hut, Inc. and General Mills, Inc. Mr. Holiday has an M.B.A. in Finance from the University of St. Thomas and a B.S. in Accounting from Iowa State University.

Jeffrey M. Colton is Senior Vice President of Global Brand and Product and has served in such capacity since July 2011. Until July 2011, Mr. Colton held the position of Senior Vice President, U.S., leading the U.S. Sales and Marketing organizations for the Company. He began his career at the Company as a research assistant in 1994 and advanced through positions of increasing responsibility in both research and development and marketing. Mr. Colton earned a Bachelor of Science degree in Applied Physics from Harvey Mudd College in Claremont, California.

Joseph Urzetta is Senior Vice President, Americas and has served in such capacity since July 2011. In this role, Mr. Urzetta is responsible for the sales and marketing functions in the United States, Canada and Latin America. Mr. Urzetta joined Callaway Golf in 2000 as Strategic Account Manager before quickly earning a promotion to Director of Strategic Accounts. He later held the positions of Vice President and Senior Vice President, U.S. Sales. Before joining the Company, Mr. Urzetta was Vice President of Sales for a golf-related software developer. Prior to that, he held several key strategic sales positions for Nike between 1995 and 1999, including Regional Sales Manager and Category Business Manager, Regional Development Sales Manager and Strategic Sales Manager, U.S. Department Stores. Before joining Nike, Mr. Urzetta excelled in several sales and sales management roles in the sporting goods industry. He earned his Bachelor of Arts in Business Administration from St. John Fisher College.

Neil Howie is Managing Director, Europe, Middle East and Africa and has served in such capacity since July 2011. In this role, Mr. Howie is responsibile for the sales and marketing functions in Europe, Middle East and Africa. Until 2011, Mr. Howie held the position of Managing Director of Callaway Golf Europe Ltd. Prior to joining the Company in 1998, Mr. Howie served as Managing Director of Rogue Golf Company Ltd.

Alex M. Boezeman is Managing Director, East Asia and has served in such capacity since July 2011. In this role, Mr. Boezeman is responsible for the sales and marketing functions in East Asia. Until July 2011, Mr. Boezeman held the position of President of Asia Region and Representative Director of Callaway Golf Japan. Prior to joining the Company in 1997, Mr. Boezeman was responsible for the marketing activities of an American tobacco company expanding into Japan and Taiwan. Mr. Boezeman has a degree in international business from the University of Hawaii.

Leighton Richards is Managing Director, Southeast Asia, South Pacific and India and has served in such capacity since July 2011. In this position, Mr. Richards is responsible for the sales and marketing functions in Southeast Asia, South Pacific and India. Mr. Richards joined the Company in 2008 as the National Sales and Marketing Director responsible for the Australian and New Zealand market. He was appointed General Manager, South Pacific in 2009. Prior to joining the Company, Mr. Richards worked in sales and marketing for The Swatch Group beginning in 2005. Mr. Richards has a Bachelor of Commerce with majors in Commercial Law and Management from the Deakin University in Australia.

Information with respect to the Company s employment agreements with its Chief Executive Officer, Chief Financial Officer and other three most highly compensated executive officers will be contained in the Company s definitive Proxy Statement in connection with the 2011 Annual Meeting of Shareholders. In addition, copies of the employment agreements for all the executive officers are included as exhibits to this report.

Access to SEC Filings through Company Website

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

Item 1A. ***Risk Factors***

Certain Factors Affecting Callaway Golf Company

The Company s business, operations and financial condition are subject to various risks and uncertainties. We urge you to carefully consider the risks and uncertainties described below, together with all of the other information in this Annual Report on Form 10-K, including those risks set forth under the heading entitled Important Notice to Investors, and in other documents that the Company files with the U.S. Securities and Exchange Commission, before making any investment decision with respect to the Company s securities. If any of the risks or uncertainties actually occur or develop, the Company s business, financial condition, results of operations and future growth prospects could be adversely affected. Under these circumstances, the trading prices of the Company s securities could decline, and you could lose all or part of your investment in the Company s securities.

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

The Company sells golf clubs, golf balls and golf accessories. These products are recreational in nature and are therefore discretionary purchases for consumers. Consumers are generally more willing to make discretionary purchases of golf products during favorable economic conditions and when consumers are feeling confident and prosperous. Discretionary spending is also affected by many other factors, including general business conditions, interest rates, the availability of consumer credit, taxes, and consumer confidence in future economic conditions. Purchases of the Company s products could decline during periods when disposable income is lower, or during periods of actual or perceived unfavorable economic conditions. A significant or prolonged decline in general economic conditions or uncertainties regarding future economic prospects that adversely affect consumer discretionary spending, whether in the United States or in the Company s international markets, could result in reduced sales of the Company s products, which could have a negative impact on the Company s results of operations, financial condition and cash flows.

The Company s operating results may be adversely affected by the current debt crisis in Europe and elsewhere and by related global economic conditions.

The current Greek debt crisis and related European financial restructuring efforts may cause the value of the European currencies, including the Euro, to further deteriorate, thus reducing the purchasing power of European customers. In addition, the European crisis is contributing to instability in global credit markets. The world has recently experienced a global macroeconomic downturn, and if global economic and market conditions, or economic conditions in Europe, the United States or other key markets, remain uncertain, persist, or deteriorate further, consumer purchasing power and demand for Company products could decline, which could have a material adverse impacts on the Company s operating results and financial condition and cash flows.

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

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

The Company has significant international sales and purchases, and unfavorable changes in foreign currency exchange rates could significantly affect the Company s results of operations.

A significant portion of the Company s purchases and sales are international purchases and sales, and the Company conducts transactions in approximately 19 currencies worldwide. Conducting business in such various currencies exposes the Company to fluctuations in foreign currency exchange rates relative to the U.S. dollar.

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

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

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

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

The Company s primary credit facility is comprised of a $230.0 million secured asset-based revolving credit facility (as amended, the ABL Facility), comprised of a $158.3 million U.S. facility, a $31.7 million Canadian facility and a $40.0 million United Kingdom facility, in each case subject to borrowing base availability under the applicable facility. Borrowing under the U.K. facility will be permitted upon satisfaction of customary conditions relating to delivery of U.K. collateral security documents. The amounts outstanding under the ABL Facility are secured by certain assets, including inventory and accounts receivable, of the Company s U.S., Canadian and U.K. legal entities. The Company s borrowing is limited by the availability ratio, which is expressed as a percentage, of (a) the average daily availability under the ABL Facility to (b) the sum of the Canadian, the U.K. and the U.S. borrowing bases, as adjusted. All applicable margins will be permanently reduced by 0.25% if EBITDA, as defined in the ABL Facility, meets or exceeds $25.0 million over any trailing twelve-month period, and will be permanently reduced by an additional 0.25% if EBITDA meets or exceeds $50.0 million over any trailing twelve-month period.

The ABL Facility includes certain restrictions including, among other things, restrictions on the incurrence of additional debt, liens, dividends and other restricted payments, asset sales, investments, mergers, acquisitions and affiliate transactions. Additionally, the Company will be subject to compliance with a fixed charge coverage ratio covenant during, and continuing 30 days after, any period in which the Company s borrowing base availability falls below $25.0 million. If the Company experiences a decline in revenues or adjusted EBITDA, the Company may have difficulty paying interest and principal amounts due on our ABL Facility or other indebtedness and meeting certain of the financial covenants contained in the ABL Facility. If the Company is unable to make required payments under the ABL Facility, or if the Company fails to comply with the various covenants and other requirements of the ABL Facility or other indebtedness, the Company would be in default thereunder, which would permit the holders of the indebtedness to accelerate the maturity thereof. Any default under the ABL Facility or other indebtedness could have a significant adverse effect on the Company s liquidity, business, operating results and financial condition and ability to make any dividend or other payments on the Company s capital stock.

If the Company is unable to successfully manage the frequent introduction of new products that satisfy changing consumer preferences, it could adversely impact its financial performance and prospects for future growth.

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

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

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

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

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

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

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

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

The Company plans its manufacturing capacity based upon the forecasted demand for its products. The nature of the Company s business makes it difficult to quickly adjust its manufacturing capacity if actual demand for its products exceeds or is less than forecasted demand. If actual demand for its products exceeds the forecasted demand, the Company may not be able to produce sufficient quantities of new products in time to fulfill actual demand, which could limit the Company s sales and adversely affect its financial performance. On the other hand, if actual demand is less than the forecasted demand for its products, the Company could produce excess quantities, resulting in excess inventories and related obsolescence charges that could adversely affect the Company s financial performance.

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

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

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

A significant amount of the Company s golf club products are assembled at the Company s facilities in Monterey, Mexico and a moderate amount of the Company s golf ball products are manufactured at its facilities in Chicopee, Massachusetts. Both golf club and golf balls are shipped from third-party logistics facilities in Dallas, Texas and Toronto, Canada. A significant disruption at any of the Company s golf club or golf ball manufacturing facilities or at the third-party logistics sites could adversely affect the Company s sales, profitability and results of operations.

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

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

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

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

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

The Company faces intense competition in each of its markets and if it is unable to maintain a competitive advantage, loss of market share, revenue, or profitability may result.

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

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

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

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

On a consolidated basis, no one customer that distributes golf clubs or golf balls in the United States accounted for more than 6% of the Company s consolidated revenues in 2011, 2010 and 2009. On a segment basis, the golf ball customer base is much more concentrated than the golf club customer base. In 2011, the top five golf ball customers accounted for approximately 22% of the Company s total consolidated golf ball sales. A loss of one or more of these customers could have a significant adverse effect upon the Company s golf ball sales.

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

Terrorist activities and armed conflicts could have an adverse effect upon the United States or worldwide economy and could cause decreased demand for the Company s products as consumers attention and interest are diverted from golf and become focused on issues relating to these events. If such events disrupt domestic or international air, ground or sea shipments, or the operation of the Company s manufacturing facilities, the Company s ability to obtain the materials necessary to manufacture its products and to deliver customer orders would be harmed, which would have a significant adverse affect on the Company s results of operations, financial condition and cash flows. Such events can negatively impact tourism, which could adversely affect the Company s sales to retailers at resorts and other vacation destinations. In addition, the occurrence of political instability and/or terrorist activities generally restricts travel to and from the affected areas, making it more difficult in general to manage the company s international operations.

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

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

The Company s business and operating results are subject to seasonal fluctuations, which could result in fluctuations in its operating results and stock price.

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

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

Due to the seasonality of the Company s business, the Company s business can be significantly adversely affected by unusual or severe weather conditions. Unfavorable weather conditions generally result in fewer golf rounds played, which generally results in reduced demand for all golf products, and in particular, golf balls. Furthermore, catastrophic storms can negatively affect golf rounds played both during the storms and afterward, as storm damaged golf courses are repaired and golfers focus on repairing the damage to their homes, businesses and communities. Consequently, sustained adverse weather conditions, especially during the warm weather months, could materially affect the Company s sales.

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

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

Accounting rules require that the Company s goodwill and intangible assets with indefinite lives be evaluated for impairment at least annually. In addition, accounting rules require that the Company s goodwill and intangible assets, including intangible assets with definite lives, be evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Such indicators include a sustained decline in the Company s stock price or market capitalization, adverse changes in economic or market conditions or prospects, and changes in the Company s operations.

An asset is considered to be impaired when its carrying value exceeds its fair value. The Company determines the fair value of an asset based upon the discounted cash flows expected to be realized from the use and ultimate disposition of the asset. If in conducting an impairment evaluation the Company were to determine that the carrying value of an asset exceeded its fair value, the Company would be required to record a non-cash impairment charge for the difference between the carrying value and the fair value of the asset. If a significant amount of the Company s goodwill and intangible assets were deemed to be impaired, the Company s results of operations and shareholders equity would be significantly adversely affected.

The Company s ability to utilize all or a portion of its U.S. deferred tax assets may be limited significantly if the Company experiences an ownership change.

The Company has a significant amount of U.S. federal and state deferred tax assets, which include net operating loss carryforwards (NOLs) and other losses. The Company s ability to utilize the losses to offset future taxable income may be limited significantly if the Company were to experience an ownership change as defined in section 382 of the Internal Revenue Code of 1986, as amended (the Code). In general, an ownership change will occur if there is a cumulative increase in ownership of the Company s stock by 5-percent shareholders (as defined in the Code) that exceeds 50 percentage points over a rolling three-year period. The determination of whether an ownership change has occurred for purposes of Section 382 is complex and requires significant judgment. The extent to which the Company s ability to utilize the losses is limited as a result of such an ownership change depends on many variables, including the value of the Company s stock at the time of the ownership change. Although the Company s ownership has changed significantly during the three-year period ended December 31, 2011 (due in significant part to the Company s June 2009 preferred stock offering), the Company does not believe there has been a cumulative increase in ownership in excess of 50 percentage points during that period. The Company continues to monitor changes in ownership. If such a cumulative increase did occur in any three year period and the Company were limited in the amount of losses it could use to offset taxable income, the Company s results of operations and cash flows would be adversely impacted.

Changes in equipment standards under applicable Rules of Golf could adversely affect the Company s business.

The Company seeks to have its new golf club and golf ball products satisfy the standards published by the USGA and the R&A in the Rules of Golf because these standards are generally followed by golfers, both professional and amateur, within their respective jurisdictions. The USGA publishes rules that are generally followed in the United States, Canada and Mexico, and the R&A publishes rules that are generally followed in most other countries throughout the world. However, the Rules of Golf as published by the R&A and the USGA are virtually the same, and are intended to be so pursuant to a Joint Statement of Principles issued in 2001.

In the future, existing USGA and/or R&A standards may be altered in ways that adversely affect the sales of the Company s current or future products. If a change in rules were adopted and caused one or more of the Company s current or future products to be nonconforming, the Company s sales of such products would be adversely affected.

The Company s sales could decline if professional golfers do not endorse or use the Company s products.

The Company establishes relationships with professional golfers in order to evaluate and promote Callaway Golf, Odyssey and Top-Flite branded products. The Company has entered into endorsement arrangements with members of the various professional tours, including the Champions Tour, the PGA Tour, the LPGA Tour, the PGA European Tour, the Japan Golf Tour and the Nationwide Tour. While most professional golfers fulfill their contractual obligations, some have been known to stop using a sponsor s products despite contractual commitments. If certain of the Company s professional endorsers were to stop using the Company s products contrary to their endorsement agreements, the Company s business could be adversely affected in a material way by the negative publicity or lack of endorsement.

The Company believes that professional usage of its golf clubs and golf balls contributes to retail sales. The Company therefore spends a significant amount of money to secure professional usage of its products. Many other companies, however, also aggressively seek the patronage of these professionals and offer many inducements, including significant cash incentives and specially designed products. There is a great deal of competition to secure the representation of tour professionals. As a result, it is expensive to attract and retain such tour professionals. The inducements offered by other companies could result in a decrease in usage of the Company s products by professional golfers or limit the Company s ability to attract other tour professionals. A decline in the level of professional usage of the Company s products could have a material adverse effect on the Company s sales and business.

Failure to adequately enforce the Company s intellectual property rights could adversely affect its business.

The golf club industry, in general, has been characterized by widespread imitation of popular club designs. The Company has an active program of monitoring, investigating and enforcing its proprietary rights against companies and individuals who market or manufacture counterfeits and knockoff products. The Company asserts its rights against infringers of its copyrights, patents, trademarks, and trade dress. However, these efforts may not be successful in reducing sales of golf products by these infringers. Additionally, other golf club manufacturers may be able to produce successful golf clubs which imitate the Company s designs without infringing any of the Company s copyrights, patents, trademarks, or trade dress. The failure to prevent or limit such infringers or imitators could adversely affect the Company s reputation and sales.

The Company may become subject to intellectual property suits that could cause it to incur significant costs or pay significant damages or that could prohibit it from selling its products.

The Company s competitors also seek to obtain patent, trademark, copyright or other protection of their proprietary rights and designs for golf clubs and golf balls. From time to time, third parties have claimed or may claim in the future that the Company s products infringe upon their proprietary rights. The Company evaluates any such claims and, where appropriate, has obtained or sought to obtain licenses or other business arrangements. To date, there have been no significant interruptions in the Company s business as a result of any claims of infringement. However, in the future, intellectual property claims could force the Company to alter its existing products or withdraw them from the market or could delay the introduction of new products.

Various patents have been issued to the Company s competitors in the golf industry and these competitors may assert that the Company s golf products infringe their patent or other proprietary rights. If the Company s golf products are found to infringe third-party intellectual property rights, the Company may be unable to obtain a license to use such technology, and it could incur substantial costs to redesign its products or to defend legal actions.

The Company s brands may be damaged by the actions of its licensees.

The Company licenses its trademarks to third-party licensees who produce, market and sell their products bearing the Company s trademarks. The Company chooses its licensees carefully and imposes upon such licensees various restrictions on the products, and on the manner, on which such trademarks may be used. In addition, the Company requires its licensees to abide by certain standards of conduct and the laws and regulations of the jurisdictions in which they do business. However, if a licensee fails to adhere to these requirements, the Company s brands could be damaged. The Company s brands could also be damaged if a licensee becomes insolvent or by any negative publicity concerning a licensee or if the licensee does not maintain good relationships with its customers or consumers, many of which are also the Company s customers and consumers.

Sales of the Company s products by unauthorized retailers or distributors could adversely affect the Company s authorized distribution channels and harm the Company s reputation.

Some of the Company s products find their way to unauthorized outlets or distribution channels. This gray market for the Company s products can undermine authorized retailers and foreign wholesale distributors who promote and support the Company s products, and can injure the Company s image in the minds of its customers and consumers. On the other hand, stopping such commerce could result in a potential decrease in sales to those customers who are selling the Company s products to unauthorized distributors or an increase in sales returns over historical levels. While the Company has taken some lawful steps to limit commerce of its products in the gray market in both the United States and abroad, it has not stopped such commerce.

The Company has significant international operations and is exposed to risks associated with doing business globally.

The Company s management believes that controlling the distribution of its products in certain major markets in the world has been and will be an element in the future growth and success of the Company. The Company sells and distributes its products directly in many key international markets in Europe, Asia, North America and elsewhere around the world. These activities have resulted and will continue to result in investments in inventory, accounts receivable, employees, corporate infrastructure and facilities. In addition, there are a limited number of suppliers of golf club components in the United States, and the Company has increasingly become more reliant on suppliers and vendors located outside of the United States. The operation of foreign distribution in the Company s international markets, as well as the management of relationships with international suppliers and vendors, will continue to require the dedication of management and other Company resources. The Company manufactures most of its products outside of the United States.

As a result of this international business, the Company is exposed to increased risks inherent in conducting business outside of the United States. In addition to foreign currency risks, these risks include:

- Increased difficulty in protecting the Company s intellectual property rights and trade secrets;
- Unexpected government action or changes in legal or regulatory requirements;
- Social, economic or political instability;
- The effects of any anti-American sentiments on the Company s brands or sales of the Company s products;
- Increased difficulty in ensuring compliance by employees, agents and contractors with the Company s policies as well as with the laws of multiple jurisdictions, including but not limited to the U.S. Foreign Corrupt Practices Act, local international environmental, health and safety laws, and increasingly complex regulations relating to the conduct of international commerce;
- Increased difficulty in controlling and monitoring foreign operations from the United States, including increased difficulty in identifying and recruiting qualified personnel for its foreign operations; and
- Increased exposure to interruptions in air carrier or ship services.

Any significant adverse change in circumstances or conditions could have a significant adverse effect upon the Company s operations, financial performance and condition.

Changes in tax laws and unanticipated tax liabilities could adversely affect our effective income tax rate and profitability.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective income tax rate in the future could be adversely affected by a number of factors, including: changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws, the outcome of income tax audits in various jurisdictions around the world, and any repatriation of non-US earnings for which we have not previously provided for U.S. taxes. We regularly assess all of these matters to determine the adequacy of our tax provision, which is subject to significant discretion.

The Company relies on increasingly complex information systems for management of its manufacturing, distribution, sales and other functions. If the Company s information systems fail to perform these functions adequately or if the Company experiences an interruption in their operation, including a breach in cyber security, its business and results of operations could suffer.

All of the Company s major operations, including manufacturing, distribution, sales and accounting, are dependent upon the Company s complex information systems. The Company s information systems are vulnerable to damage or interruption from:

- Earthquake, fire, flood, hurricane and other natural disasters;
- Power loss, computer systems failure, Internet and telecommunications or data network failure; and
- Hackers, computer viruses, software bugs or glitches.

Any damage or significant disruption in the operation of such systems or the failure of the Company s information systems to perform as expected could disrupt the Company s business, result in decreased sales, increased overhead costs, excess inventory and product shortages and otherwise adversely affect the Company s operations, financial performance and condition.

Unauthorized access to, or accidental disclosure of, consumer personally-identifiable information that the Company collects through its websites may result in significant expenses and negatively impact our reputation and business.

There is growing concern over the security of personal information transmitted over the Internet, consumer identity theft and user privacy. While the Company has implemented security measures, the Company s computer systems may be susceptible to electronic or physical computer break-ins, viruses and other disruptions and security breaches. Any perceived or actual unauthorized disclosure of personally-identifiable information regarding visitors to the Company s websites or otherwise, whether through a breach of the Company s network by an unauthorized party, employee theft, misuse or error or otherwise, could harm the Company s reputation, impair the Company s ability to attract website visitors, or subject the Company to claims or litigation arising from damages suffered by consumers, and adversely affect the Company s operations, financial performance and condition.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

The Company and its subsidiaries conduct operations in both owned and leased properties. The Company s principal executive offices and domestic operations are located in Carlsbad, California. The Company has five buildings that are utilized in its Carlsbad operations, which are comprised of corporate offices and the Company s performance center, as well as manufacturing, research and development, warehousing and distribution facilities. These buildings comprise approximately 515,000 square feet of space. The Company owns two of these buildings, representing approximately 269,000 square feet of space, and leases three properties representing approximately 246,000 square feet of space. The lease terms expire between March 2012 and November 2017.

The Company also owns a golf ball manufacturing plant, warehouse and offices that encompass approximately 869,000 square feet in Chicopee, Massachusetts.

In addition, the Company leases a golf club manufacturing facility in Monterrey, Mexico comprised of approximately 180,000 square feet. The lease term for this facility expires in February 2018.

The Company owns and leases additional properties domestically and internationally, including properties in Texas, Australia, Canada, Japan, Korea, the United Kingdom, China, Thailand, Malaysia and India. The Company s operations at each of these properties are used to some extent for both the golf club and golf ball businesses. The Company believes that its facilities currently are adequate to meet its requirements.

Item 3. ***Legal Proceedings***

The information set forth in Note 17 Commitments and Contingencies, to the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

Item 4. ***Mine Safety Disclosures***

Not applicable.

PART II

Item 5. ***Market for Registrant s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities***

The Company s common stock is listed, and principally traded, on the New York Stock Exchange (NYSE). The Company s symbol for its common stock is ELY. As of January 31, 2012, the approximate number of holders of record of the Company s common stock was 7,900. The following table sets forth the range of high and low per share sales prices of the Company s common stock and per share dividends for the periods indicated.

	Year Ended December 31,					
	2011			2010		
Period:	**High**	**Low**	**Dividend**	**High**	**Low**	**Dividend**
First Quarter	$ 8.37	$ 6.60	$ 0.01	$ 9.50	$ 7.37	$ 0.01
Second Quarter	$ 7.20	$ 5.82	$ 0.01	$ 10.19	$ 6.00	$ 0.01
Third Quarter	$ 6.92	$ 5.10	$ 0.01	$ 7.34	$ 5.80	$ 0.01
Fourth Quarter	$ 6.07	$ 4.70	$ 0.01	$ 8.48	$ 6.64	$ 0.01

The Company intends to continue to pay quarterly dividends subject to capital availability and quarterly determinations that cash dividends are in the best interests of its stockholders. Future dividends may be affected by, among other items, the Company s views on potential future capital requirements, projected cash flows and needs, changes to our business model and certain restrictions limiting dividends imposed by the Company s credit facility (see Item 7 Sources of Liquidity below).

Performance Graph

The following graph presents a comparison of the cumulative total shareholder return of the Company s common stock since December 31, 2006 to two indices: the Standard & Poor s 500 Index (S&P 500) and the Standard & Poor s 600 Smallcap Index (S&P 600). The S&P 500 tracks the aggregate price performance of equity securities of 500 large-cap companies that are actively traded in the U.S., and is considered to be a leading indicator of U.S. equity securities. The S&P 600 is a market value-weighted index that tracks the aggregate price performance of equity securities from a broad range of small-cap stocks traded in the U.S. The graph assumes an initial investment of $100 at December 31, 2006 and reinvestment of all dividends in ELY stock on the dividend payable date.

	2006	2007	2008	2009	2010	2011
Callaway Golf (NYSE: ELY)	$ 100.00	$ 122.96	$ 67.10	$ 55.20	$ 59.39	$ 40.96
S&P 500	$ 100.00	$ 103.53	$ 63.69	$ 78.62	$ 88.67	$ 88.67
S&P 600 Smallcap	$ 100.00	$ 98.78	$ 67.18	$ 83.15	$ 103.93	$ 103.76

The Callaway Golf Company index is based upon the closing prices of Callaway Golf Company common stock on December 31, 2006, 2007, 2008, 2009, 2010 and 2011 of $14.41, $17.43, $9.29, $7.54, $8.07 and $5.53, respectively.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

In November 2007, the Board of Directors authorized a repurchase program (the November 2007 repurchase program) for the Company to repurchase shares of its common stock up to a maximum cost to the Company of $100.0 million, which will remain in effect until completed or otherwise terminated by the Board of Directors. During the three months ended December 31, 2011, the Company did not repurchase any shares of its common stock. As of December 31, 2011, the Company remained authorized to repurchase up to $73.6 million of its common stock under this program.

Item 6. ***Selected Financial Data***

The following statements of operations data and balance sheet data for the five years ended December 31, 2011 were derived from the Company s audited consolidated financial statements. Consolidated balance sheets at December 31, 2011 and 2010 and the related consolidated statements of operations and cash flows for each of the three years in the period ended December 31, 2011 and notes thereto appear elsewhere in this report. The following data should be read in conjunction with the annual consolidated financial statements, related notes and other financial information appearing elsewhere in this report.

	Year Ended December 31,				
	2011(1),(2),(3),(4),(5)	2010(2),(3),(4)	2009(2),(3)	2008(2),(7),(8)	2007(2)
	(In thousands, except per share data)				
Statement of Operations Data:					
Net sales	$ 886,528	$ 967,656	$ 950,799	$ 1,117,204	$ 1,124,591
Cost of sales	575,226	602,160	607,036	630,371	631,368
Gross profit	311,302	365,496	343,763	486,833	493,223
Selling, general and administrative expenses	358,081	355,716	342,084	373,275	371,020
Research and development expenses	34,309	36,383	32,213	29,370	32,020
Income (loss) from operations	(81,088)	(26,603)	(30,534)	84,188	90,183
Interest income	546	2,886	1,807	2,312	2,202
Interest expense	(1,618)	(848)	(1,754)	(4,666)	(5,363)
Other income (expense), net	(8,101)	(10,997)	878	(449)	1,253
Change in energy derivative valuation account				19,922	
Income (loss) before income taxes	(90,261)	(35,562)	(29,603)	101,307	88,275
Income tax provision (benefit)	81,559	(16,758)	(14,343)	35,131	33,688
Net income (loss)	(171,820)	(18,804)	(15,260)	66,176	54,587
Dividends on convertible preferred stock	10,500	10,500	5,688		
Net income (loss) allocable to common shareholders	$ (182,320)	$ (29,304)	$ (20,948)	$ 66,176	$ 54,587
Earnings (loss) per common share:					
Basic	$ (2.82)	$ (0.46)	$ (0.33)	$ 1.05	$ 0.82
Diluted	$ (2.82)	$ (0.46)	$ (0.33)	$ 1.04	$ 0.81
Dividends paid per common share	$ 0.04	$ 0.04	$ 0.10	$ 0.28	$ 0.28

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	2011[1]	2010[9]	December 31, 2009[6],[9] (In thousands)	2008[8],[9]	2007[9]
Balance Sheet Data:					
Cash and cash equivalents	$ 43,023	$ 55,043	$ 78,314	$ 38,337	$ 49,875
Working capital	$ 251,545	$ 368,563	$ 360,654	$ 235,713	$ 272,154
Total assets	$ 727,112	$ 876,012	$ 866,963	$ 846,371	$ 829,111
Long-term liabilities	$ 46,514	$ 13,967	$ 14,594	$ 21,559	$ 44,322
Total Callaway Golf Company shareholders equity	$ 509,956	$ 684,267	$ 698,291	$ 569,188	$ 559,263

(1) The Company s provision for income taxes for the year ended December 31, 2011 includes $52.5 million of tax expense in order to establish a valuation allowance against its U.S. deferred tax assets and $21.6 million related to the recognition of certain prepaid tax expenses on intercompany profits. The reduction of deferred tax assets had a corresponding decrease in working capital and total assets, as well as an increase in long-term liabilities. See Note 16 Income Taxes to the Notes to Consolidated Financial Statements in this Form 10-K.

(2) The Company has been actively implementing multiple phases of the gross margin improvement initiatives that were announced in 2006. As such, the Company s operating statements for the years ended December 31, 2011, 2010, 2009, 2008 and 2007 include pre-tax charges of $24.7 million, $14.8 million, $6.2 million, $12.7 million and $8.9 million, respectively, in connection with these initiatives. See Note 3 Restructuring Initiatives to the Notes to Consolidated Financial Statements in this Form 10-K.

(3) The Company s operating statement for the year ended December 31, 2011 includes pre-tax charges of $16.3 million in connection with the Reorganization and Reinvestment Initiatives announced in June 2011. See Note 3 Restructuring Initiatives to the Notes to Consolidated Financial Statements in this Form 10-K. For the years ended December 31, 2010 and 2009, the Company recognized pre-tax charges of $4.0 million and $5.2 million, respectively, in connection with workforce reductions announced in the fourth quarter in 2010 and April 2009.

(4) In 2011 and 2010, the Company recognized a pre-tax impairment charge of $5.4 million and $7.5 million, respectively, in connection with certain trademarks and trade names. Additionally, in 2011, the Company recognized a pre-tax impairment charge of $1.1 million in connection with the write-off of goodwill. For further discussion, see Note 9 Goodwill and Intangible Assets to the Notes to Consolidated Financial Statements in this Form 10-K.

(5) In March 2011, the Company completed the sale of three of its buildings located in Carlsbad, California. In connection with this sale, the Company recognized a pre-tax gain of $6.2 million. See Note 7 Sale of Buildings to the Notes to Consolidated Financial Statements in this Form 10-K.

(6) On June 15, 2009, the Company sold 1.4 million shares of its 7.50% Series B Cumulative Perpetual Convertible Preferred Stock, $0.01 par value (preferred stock). As a result, total shareholders equity as of December 31, 2009, 2010 and 2011 includes net proceeds of $134.0 million in connection with the issuance of preferred stock. For further discussion, see Note 4 Preferred Stock Offering to the Notes to Consolidated Financial Statements in this Form 10-K.

(7) The Company s financial condition as of December 31, 2008, 2009, 2010 and 2011 includes certain assets and liabilities that were acquired in the uPlay, LLC asset acquisition on December 31, 2008. The Company s operating statements for the years ended December 31, 2009, 2010 and 2011 include the results of operations of uPlay, LLC.

(8) In the fourth quarter of 2008, the Company reversed a $19.9 million energy derivative valuation account.

(9) Working capital, total assets and total Callaway Golf Company shareholders equity for these periods have been corrected from the amounts previously reported. This correction resulted in a $0.9 million decrease to short-term net deferred tax assets, an $8.1 million decrease to long-term net deferred tax assets and a $9.0 million decrease to shareholders equity. See Note 16 Income Taxes to the Notes to Consolidated Financial Statements in this Form 10-K.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the Consolidated Financial Statements, the related notes and the Important Notice to Investors that appear elsewhere in this report.

Critical Accounting Policies and Estimates

The Company s discussion and analysis of its results of operations, financial condition and liquidity are based upon the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, shareholders equity, sales and expenses, as well as related disclosures of contingent assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an ongoing basis, the Company reviews its estimates to ensure that the estimates appropriately reflect changes in its business and new information as it becomes available.

Management believes the critical accounting policies discussed below affect its more significant estimates and assumptions used in the preparation of its consolidated financial statements. For a complete discussion of all of the Company s significant accounting policies, see Note 2 Significant Accounting Policies to the Notes to Consolidated Financial Statements in this Form 10-K.

Revenue Recognition

Sales are recognized in accordance with Accounting Standards Codification (ASC) Topic 605, Revenue Recognition, as products are shipped to customers, net of an allowance for sales returns and accruals for sales programs. The Company records a reserve for anticipated returns through a reduction of sales and cost of sales in the period that the related sales are recorded. Sales returns are estimated based upon historical returns, current economic trends, changes in customer demands and sell-through of products. In addition, from time to time, the Company offers sales programs that allow for specific returns. The Company records a reserve for anticipated returns related to these sales programs based on the terms of the sales program as well as historical returns, current economic trends, changes in customer demands and sell-through of products. Historically, the Company s actual sales returns have not been materially different from management s original estimates. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate the allowance for sales returns. However, if the actual costs of sales returns are significantly different than the recorded estimated allowance, the Company may be exposed to losses or gains that could be material. Assuming there had been a 10% increase over the recorded estimated allowance for 2011 sales returns, pre-tax loss for the year ended December 31, 2011 would have been increased by approximately $3.5 million.

The Company also records estimated reductions to revenue for sales programs such as incentive offerings. Sales program accruals are estimated based upon the attributes of the sales program, management s forecast of future product demand, and historical customer participation in similar programs. The Company s primary sales program, the Preferred Retailer Program, offers longer payment terms during the initial sell in period, as well as potential rebates and discounts, for participating retailers in exchange for providing certain benefits to the Company, including the maintenance of agreed upon inventory levels, prime product placement and retailer staff training. Under this program, qualifying retailers can earn either discounts or rebates based upon the amount of product purchased. Discounts are applied and recorded at the time of sale. For rebates, the Company accrues an estimate of the rebate at the time of sale based on the customer s estimated qualifying current year product purchases. The estimate is based on the historical level of purchases, adjusted for any factors expected to affect the current year purchase levels. The estimated year-end rebate is adjusted quarterly based on actual purchase levels, as necessary. The Preferred Retailer Program is generally short term in nature and the actual costs of the program are known as of the end of the year and paid to customers shortly after year-end. In addition to the Preferred Retailer Program, the Company from time to time offers additional sales program incentive offerings which are also generally short term in nature. Historically the Company s actual costs related to its Preferred Retailer Program and other sales programs have not been materially different than its estimates.

Revenues from gift cards are deferred and recognized when the cards are redeemed. In addition, the Company recognizes revenue from unredeemed gift cards when the likelihood of redemption becomes remote and under circumstances that comply with any applicable state escheatment laws. The Company s gift cards have no expiration. To determine when redemption is remote, the Company analyzes an aging of unredeemed cards (based on the date the card was last used or the activation date if the card has never been used) and compares that information with historical redemption trends. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to determine the timing of recognition of gift card revenues. However, if the Company is not able to accurately determine when gift card redemption is remote, the Company may be exposed to losses or gains that could be material. The deferred revenue associated with outstanding gift cards decreased from $3.2 million at December 31, 2010 to $2.0 million at December 31, 2011.

Revenues from course credits in connection with the use of the Company s uPro GPS on-course range finders are deferred when purchased and recognized when customers download the course credits for usage. Deferred revenue associated with unused course credits remained constant at $2.6 million at both December 31, 2011 and 2010.

Allowance for Doubtful Accounts

The Company maintains an allowance for estimated losses resulting from the failure of its customers to make required payments. An estimate of uncollectible amounts is made by management based upon historical bad debts, current customer receivable balances, age of customer receivable balances, the customer s financial condition and current economic trends, all of which are subject to change. If the actual uncollected amounts significantly exceed the estimated allowance, the Company s operating results would be significantly adversely affected. Assuming there had been a 10% increase over the 2011 recorded estimated allowance for doubtful accounts, pre-tax loss for the year ended December 31, 2011 would have been increased by approximately $0.7 million.

Inventories

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

The calculation of the Company s allowance for obsolete or unmarketable inventory requires management to make assumptions and to apply judgment regarding inventory aging, forecasted consumer demand and pricing, regulatory (USGA and R&A) rule changes, the promotional environment and technological obsolescence. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate the allowance. However, if estimates regarding consumer demand are inaccurate or changes in technology affect demand for certain products in an unforeseen manner, the Company may need to increase its inventory allowance, which could significantly adversely affect the Company s operating results. Assuming there had been a 10% increase over the 2011 recorded estimated allowance for obsolete or unmarketable inventory, pre-tax loss for the year ended December 31, 2011 would have been increased by approximately $1.7 million.

Long-Lived Assets

In the normal course of business, the Company acquires tangible and intangible assets. The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets (including property, plant and equipment, investments, goodwill and other intangible assets) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable or exceeds its fair value. Determining whether an impairment has occurred typically requires various estimates and assumptions, including determining the amount of undiscounted cash flows directly related to the potentially impaired asset, the useful life over which cash flows will occur, the timing of the impairment test, and the asset s residual value, if any.

To determine fair value, the Company uses its internal cash flow estimates discounted at an appropriate rate, quoted market prices, royalty rates when available and independent appraisals as appropriate. Any required impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value and is recorded as a reduction in the carrying value of the asset and a charge to earnings.

The Company uses its best judgment based on current facts and circumstances related to its business when making these estimates. However, if actual results are not consistent with the Company s estimates and assumptions used in calculating future cash flows and asset fair values, the Company may be exposed to losses that could be material. As of December 31, 2011, the fair values of the Company s reporting units in the U.S., United Kingdom, Canada and Korea, as well as the fair value of certain trade names and trademarks substantially exceeded their carrying values. However, during the second quarter of 2011, the Company determined that the discounted expected cash flows from trade names, trademarks and other intangible assets the Company acquired in 2003 as part of the acquisition of the assets of TFGC Estate, Inc. (f/k/a The Top-Flite Golf Company) were $5.4 million less than the carrying value of those assets. As a result, the Company recorded an impairment charge of $5.4 million to reduce the carrying value of these assets. In addition, in the fourth quarter of 2011, the Company conducted an impairment test on goodwill related to its reporting unit in Australia. In completing the impairment analysis, the Company determined that the discounted expected cash flows from this subsidiary were $1.1 million less than the subsidiary s net book value including goodwill. As a result, the Company recorded an impairment charge of $1.1 million to write-off the goodwill balance. For further discussion, see Note 9 to the Notes to the Consolidated Financial Statements Goodwill and Intangible Assets in this Form 10-K.

Warranty Policy

The Company has a stated two-year warranty policy for its golf clubs. The Company s policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company s stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty.

The Company s estimates for calculating the warranty reserve are principally based on assumptions regarding the warranty costs of each club product line over the expected warranty period. Where little or no claims experience may exist, the Company s warranty obligation calculation is based upon long-term historical warranty rates of similar products until sufficient data is available. As actual model-specific rates become available, the Company s estimates are modified to ensure that the forecast is within the range of likely outcomes.

Historically, the Company s actual warranty claims have not been materially different from management s original estimated warranty obligation. The Company does not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to calculate the warranty obligation. However, if the number of actual warranty claims or the cost of satisfying warranty claims significantly exceeds the estimated warranty reserve, the Company may be exposed to losses that could be material. Assuming there had been a 10% increase over the 2011 recorded estimated allowance for warranty obligations, pre-tax loss for the year ended December 31, 2011 would have been increased by approximately $0.8 million.

Income Taxes

Current income tax expense or benefit is the amount of income taxes expected to be payable or receivable for the current year. A deferred income tax asset or liability is established for the difference between the tax basis of an asset or liability computed pursuant to ASC Topic 740, Income Taxes, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. In accordance with the applicable accounting rules, the Company maintains a valuation allowance for a deferred tax asset when it is deemed it to be more likely than not that some or all of the deferred tax asset will not be realized. In evaluating whether a valuation allowance is required under such rules, the Company considers all available positive and negative evidence, including prior operating results, the nature and reason for any losses, its forecast of future taxable income, and the dates on which any deferred tax assets are expected to expire. These assumptions require a significant amount of judgment, including estimates of future taxable income. These estimates are based on the Company s best judgment at the time made based on current and projected circumstances and conditions. As a result of the Company s evaluation during 2011, the Company recorded a $52.5 million increase to income tax expense in order to establish a valuation allowance against its U.S. deferred tax assets. In addition, the Company has discontinued recognizing income tax benefits related to its U.S. net operating losses until it is determined that it is more likely than not that the Company will generate sufficient taxable income to realize the benefits from its U.S. deferred tax assets. For further information, see Note 16 Income Taxes to the Notes to Consolidated Financial Statements in this Form 10-K.

Pursuant to ASC Topic 740-25-6, the Company is required to accrue for the estimated additional amount of taxes for uncertain tax positions if it is deemed to be more likely than not that the Company would be required to pay such additional taxes.

The Company is required to file federal and state income tax returns in the United States and various other income tax returns in foreign jurisdictions. The preparation of these income tax returns requires the Company to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax paid by the Company. The Company accrues an amount for its estimate of additional tax liability, including interest and penalties, for any uncertain tax positions taken or expected to be taken in an income tax return. The Company reviews and updates the accrual for uncertain tax positions as more definitive information becomes available. Historically, additional taxes paid as a result of the resolution of the Company s uncertain tax positions have not been materially different from the Company s expectations. Information regarding income taxes is contained in Note 16 Income Taxes to the Notes to Consolidated Financial Statements.

Share-based Compensation

The Company accounts for share-based compensation arrangements in accordance with ASC Topic 718, Stock Compensation, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. ASC Topic 718 further requires a reduction in share-based compensation expense by an estimated forfeiture rate. The forfeiture rate used by the Company is based on historical forfeiture trends. If actual forfeitures are not consistent with the Company s estimates, the Company may be required to increase or decrease compensation expenses in future periods.

The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options and stock appreciation rights (SARs) at the date of grant. The Black-Scholes option valuation model requires the input of highly subjective assumptions including the Company s expected stock price volatility, the expected dividend yield, the expected life of an option or SAR and the risk-free rate, which is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option or SAR. The Company uses historical data to estimate the expected price volatility and the expected option or SAR life. The Company uses forecasted dividends to estimate the expected dividend yield. The Company believes a forecasted calculation is more appropriate than using historical data since the amount of dividends paid have decreased beginning in 2009. Changes in subjective input assumptions can materially affect the fair value estimates of an option or SAR. Furthermore, the estimated fair value of an option or SAR does not necessarily represent the value that will ultimately be realized by an employee. Compensation expense is recognized on a straight-line basis over the vesting period for stock options. Compensation expense for SARs is recognized on a straight-line basis over the vesting period based on an estimated fair value, which is remeasured each reporting period. Once vested, the SARs continued to be remeasured to fair value until they are exercised.

The Company records compensation expense for restricted stock awards and restricted stock units (collectively restricted stock) based on the estimated fair value of the award on the date of grant. The estimated fair value is determined based on the closing price of the Company s common stock on the date of grant multiplied by the number of shares awarded. Compensation expense is recognized on a straight-line basis over the vesting period, reduced by an estimated forfeiture rate.

Phantom stock units (PSUs) are a form of share-based awards that are indexed to the Company s stock and are settled in cash. As such, these awards are classified as liabilities. Because phantom stock units are settled in cash, compensation expense recognized over the vesting period will vary based on changes in fair value. Fair value is remeasured at the end of each interim reporting period through the settlement date of the awards and is based on the closing price of the Company s stock.

Recent Accounting Pronouncements

Information regarding recent accounting pronouncements is contained in Note 2 Significant Accounting Policies to the Notes to Consolidated Financial Statements, which is incorporated herein by this reference.

Results of Operations

Overview of Business and Seasonality

The Company designs, manufactures and sells high quality golf clubs and golf balls and also sells golf apparel, golf footwear, golf bags, gloves, eyewear and other golf-related accessories, including uPro GPS on-course measurement devices. The Company designs its products to be technologically advanced and in this regard invests a considerable amount in research and development each year. The Company s golf products are designed for golfers of all skill levels, both amateur and professional.

The Company has two operating segments that are organized on the basis of products, namely the golf clubs segment and golf balls segment. The golf clubs segment consists primarily of Callaway Golf and Top-Flite woods, hybrids, irons, wedges and putters as well as Odyssey putters. This segment also includes other golf-related accessories described above and royalties from licensing of the Company s trademarks and service marks as well as sales of pre-owned golf clubs. The golf balls segment consists primarily of Callaway Golf and Top-Flite golf balls. As discussed in Note 19 Segment Information to the Notes to Consolidated Financial Statements, the Company s operating segments exclude a significant amount of corporate general administrative expenses and other income (expense) not utilized by management in determining segment profitability.

In most of the regions where the Company does business, the game of golf is played primarily on a seasonal basis. Weather conditions generally restrict golf from being played year-round, except in a few markets, with many of the Company s on-course customers closing for the cold weather months. The Company s business is therefore also subject to seasonal fluctuations. In general, during the first quarter, the Company begins selling its products into the golf retail channel for the new golf season. This initial sell-in generally continues into the second quarter. The Company s second quarter sales are significantly affected by the amount of reorder business of the products sold during the first quarter. The Company s third quarter sales are generally dependent on reorder business but are generally less than the second quarter as many retailers begin decreasing their inventory levels in anticipation of the end of the golf season. The Company s fourth quarter sales are generally less than the other quarters due to the end of the golf season in many of the Company s key markets. However, fourth quarter sales can be affected from time to time by the early launch of product introductions related to the new golf season of the subsequent year. This seasonality, and therefore quarter to quarter fluctuations, can be affected by many factors, including the timing of new product introductions. In general, however, because of this seasonality, a majority of the Company s sales and most, if not all, of its profitability generally occurs during the first half of the year.

Over half of the Company s business is conducted outside of the United States and is conducted in currencies other than the U.S. dollar. As a result, changes in foreign currency rates can have a significant effect on the Company s financial results. The Company enters into foreign currency exchange contracts to mitigate the effects of changes in foreign currency rates. While these foreign currency exchange contracts can mitigate the effects of changes in foreign currency rates, they do not eliminate those effects, which can be significant. These effects include (i) the translation of results denominated in foreign currency into U.S. dollars for reporting purposes, (ii) the mark-to-market adjustments of certain intercompany balance sheet accounts denominated in foreign currencies, and (iii) the mark-to-market adjustments on the Company s foreign currency exchange contracts. In general, the Company s overall financial results are affected positively by a weaker U.S. dollar and are affected negatively by a stronger U.S. dollar as compared to the foreign currencies in which the Company conducts its business. As a result of the continued weakening trend of the U.S. dollar in 2011, the translation of foreign currency exchange rates had a net positive impact on the Company s financial results during year ended 2011.

Executive Summary

The Company s 2011 results reflect the impact of a challenging golf market as well as an unfavorable shift in the competitive landscape driven by the success of certain competitor products launched during the year. These factors, combined with the absence of a fourth quarter woods launch by the Company and the negative impact of natural disasters in Japan, Australia and South East Asia, resulted in an 8% decline in sales and a 300 basis point decline in gross margins with relatively flat operating expenses in 2011 compared to 2010. These declines were partially offset by the positive effects of changes in foreign currency rates on sales and gross margins during the period as well as savings from the Company s ongoing gross margin initiatives and current year restructuring initiatives, as discussed below in more detail.

Net loss for the year ended December 31, 2011 increased to $171.8 million compared to $18.8 million in the comparable period of 2010. Diluted loss per share increased to $2.82 in 2011 compared to $0.46 in 2010. The Company s net loss for the years ended December 31, 2011 and 2010 include the following charges:

	2011	2010
Pre-tax Global Operation Strategy charges	$ (24.7)	$ (14.8)
Pre-tax impairment charges	(6.5)	(7.5)
Pre-tax charges related to the Reorganization and Reinvestment Initiatives	(16.3)	
Pre-tax gain on sale of buildings	6.2	
Income tax (provision) benefit[1]	(81.6)	16.8
Total charges	$ (122.9)	$ (5.5)

(1) The Company s income tax provision for 2011 includes charges of $52.5 million related to the establishment of a valuation allowance against its U.S deferred tax assets, and $21.6 million related to the recognition of certain prepaid tax expenses on intercompany profits. See Note 16 Income Taxes to the Notes to Consolidated Financial Statements included in this Form 10-K.

In June 2011, as a result of the Company s performance, the Company announced a restructuring plan (the Reorganization and Reinvestment Initiatives) that involved personnel changes at all levels of the organization and a reevaluation of business processes. The restructuring was designed to deliver annualized pre-tax savings of approximately $50 million with the Company reinvesting approximately half that amount in brand and marketing initiatives for 2012. During 2011, the Company completed substantially all of the personnel changes and has reorganized the Company to provide for increased focus on the different product categories and regions of the Company s business with the intent to achieve sustained profitability in each area. The Company is on track to achieve the $50 million annual savings target communicated last June and has begun investing a significant portion of those savings in the Company s newly developed 2012 globally integrated brand and marketing initiatives.

Management believes it is making the changes that are necessary to take the Company back to a strong leadership position in the golf equipment industry and that the increased investment in brand and demand creation initiatives will generate higher sales which together with savings from its Reorganization and Reinvestment Initiatives, the continued strength of the Company s brands in the marketplace, the new technology embedded in the Company s 2012 products, and anticipated increased efficiency in its supply and distribution operations resulting from the completion of the Company s Global Operations Strategy Initiatives (the GOS Initiatives) this year should result in much improved 2012 financial performance for the Company.

Years Ended December 31, 2011 and 2010

Net sales for the year ended December 31, 2011 decreased $81.2 million (8%) to $886.5 million compared to $967.7 million for the year ended December 31, 2010. This decrease was due to a decline in sales in the golf clubs and golf balls segments, as noted below (dollars in millions):

	Years Ended December 31,		Decline	
	2011	**2010(1)**	**Dollars**	**Percent**
Net sales				
Golf clubs	$ 726.1	$ 791.1	$ (65.0)	(8)%
Golf balls	160.4	176.6	(16.2)	(9)%
	$ 886.5	$ 967.7	$ (81.2)	(8)%

(1) Certain prior period amounts have been reclassified to conform to the current year presentation.

For further discussion of each operating segment s results, see Golf Club and Golf Ball Segments Results below.

Net sales information by region is summarized as follows (dollars in millions):

	Years Ended December 31,		Growth (Decline)	
	2011	**2010**	**Dollars**	**Percent**
Net sales:				
United States	$ 419.4	$ 468.2	$ (48.8)	(10)%
Europe	133.6	130.1	3.5	3%
Japan	149.8	164.8	(15.0)	(9)%
Rest of Asia	82.7	89.5	(6.8)	(8)%
Other foreign countries	101.0	115.1	(14.1)	(12)%
	$ 886.5	$ 967.7	$ (81.2)	(8)%

Net sales in the United States decreased $48.8 million (10%) to $419.4 million during 2011 compared to 2010. This decrease was primarily due to the timing of planned product launches as well as an unfavorable shift in the competitive landscape driven by the success of certain competitor products launched in 2011. The Company s sales in regions outside of the United States decreased $32.4 million (6%) to $467.1 million during 2011 compared to the prior year. This decrease was largely caused by an unfavorable shift in the competitive landscape combined with the natural disasters in Japan, Australia and in South East Asia in 2011. These decreases were partially offset by increases in sales in Europe and in some of the Company s emerging markets (China and India). The Company s reported net sales in regions outside the United States during 2011 were favorably affected by the translation of foreign currency sales into U.S. dollars based upon 2011 exchange rates.

If 2010 rates were applied to 2011 reported sales in regions outside the U.S. and all other factors were held constant, net sales in such regions would have been $29.0 million less than the net sales reported for 2011.

Gross profit decreased $54.2 million to $311.3 million in 2011 from $365.5 million in 2010. Gross profit as a percentage of net sales (gross margin) decreased to 35% in 2011 compared to 38% in 2010. The decrease in gross margin was primarily attributable to (i) a decrease in production volumes which resulted in unfavorable absorption of fixed costs, (ii) the recognition of certain costs in connection with the final phase of the Company s GOS Initiatives, and (iii) a decline in sales in Japan which generally have the highest gross margins of the Company s sales. These decreases were partially offset by (i) cost reductions on golf club components costs as well as reductions on club conversion costs primarily related to the Company s GOS Initiatives, (ii) a reduction of closeout activity across most product categories, and (iii) favorable changes in foreign currency in 2011. See Segment Profitability below for further discussion of gross margins.

Selling expenses increased by $8.0 million to $265.3 million (30% of net sales) for the year ended December 31, 2011 compared to $257.3 million (27% of net sales) in the comparable period of 2010. The dollar increase was primarily due to increases of $5.8 million in advertising and promotional activities and $5.1 million in charges related to the Company s Reorganization and Reinvestment Initiatives, partially offset by a decrease of $4.8 million in employee costs.

General and administrative expenses decreased by $5.7 million to $92.8 million (10% of net sales) for the year ended December 31, 2011 compared to $98.4 million (10% of net sales) in the comparable period of 2010. This decrease was primarily due to a reduction of $8.8 million in employee related expenses and a $6.2 million net gain recognized in connection with the sale of three of the Company s buildings in March 2011. These decreases were partially offset by charges of $9.4 million related to the Company s Reorganization and Reinvestment Initiatives.

Research and development expenses decreased by $2.1 million to $34.3 million (4% of net sales) for the year ended December 31, 2011 compared to $36.4 million (4% of net sales) in the comparable period of 2010 primarily due to a reduction of $1.4 million in employee related charges.

Other expense decreased by $2.9 million to $8.1 million for the year ended December 31, 2011 compared to $11.0 million in the comparable period of 2010. This decrease was primarily attributable to a decrease in net foreign currency hedging losses.

The Company s provision for income taxes totaled $81.6 million for the year ended December 31, 2011, compared to an income tax benefit of $16.8 million in the comparable period of 2010. In 2011, the Company recorded tax expense of $52.5 million in order to establish a valuation allowance against its U.S. deferred tax assets, which also resulted in the recognition of certain prepaid tax expenses of $21.6 million related to intercompany profits. The Company recognized income tax expense despite pre-tax losses in 2011 due to the impacts of (i) the establishment of a valuation allowance against net U.S. deferred tax assets, (ii) the recognition of prepaid tax expenses, and (iii) the recognition of tax expense calculated on foreign pre-tax income. Due to the effects of its deferred tax asset valuation allowance, the Company s effective tax rate for the year ended December 31, 2011 is not comparable to the effective tax rate for the year ended December 31, 2010 as the Company s income tax amount is not directly correlated to the amount of its pre-tax income.

Net loss for the year ended December 31, 2011 increased to $171.8 million compared to $18.8 million in the comparable period of 2010. Diluted loss per share increased to $2.82 in 2011 compared to $0.46 in 2010. The Company s net loss for the years ended December 31, 2011 and 2010 include the following charges:

	2011	2010
Pre-tax Global Operation Strategy charges	$ (24.7)	$ (14.8)
Pre-tax impairment charges	(6.5)	(7.5)
Pre-tax charges related to the Reorganization and Reinvestment Initiatives	(16.3)	
Pre-tax gain on sale of buildings	6.2	
Income tax (provision) benefit[1]	(81.6)	16.8
Total charges	$ (122.9)	$ (5.5)

(1) The Company s income tax provision for 2011 includes charges of $52.5 million related to the establishment of a valuation allowance against its U.S deferred tax assets, and $21.6 million related to the recognition of certain prepaid tax expenses on intercompany profits. See Note 16 Income Taxes to the Notes to Consolidated Financial Statements included in this Form 10-K.

Golf Clubs and Golf Balls Segments Results for the Years Ended December 31, 2011 and 2010

Golf Clubs Segment

Net sales information for the golf clubs segment by product category is summarized as follows (dollars in millions):

	Years Ended December 31,		Decline	
	2011	2010[1]	Dollars	Percent
Net sales:				
Woods	$ 212.9	$ 225.2	$ (12.3)	(5)%
Irons	207.8	223.9	(16.1)	(7)%
Putters	88.8	106.3	(17.5)	(16)%
Accessories and other	216.6	235.7	(19.1)	(8)%
	$ 726.1	$ 791.1	$ (65.0)	(8)%

(1) Certain prior period amounts have been reclassified to conform to the current year presentation.

The $12.3 million (5%) decrease in net sales of woods to $212.9 million for the year ended December 31, 2011 was primarily due to a decrease in sales volume partially offset by an increase in average selling prices. The decrease in sales volume was primarily due to the earlier launch timing of the 2011 Diablo Octane drivers and fairway woods, which were launched early in the fourth quarter of 2010 compared to the prior year launch of Diablo Edge drivers and fairway woods during the first quarter of 2010. Additionally sales volumes were negatively impacted by the natural disasters in Japan, Australia and South East Asia during 2011. The increase in average selling prices was primarily due to a favorable shift in product mix from sales of moderately priced drivers and fairway woods in 2010 to sales of more premium drivers in 2011 combined with less closeout activity during the year ended December 31, 2011 compared to the prior year.

The $16.1 million (7%) decrease in net sales of irons to $207.8 million for the year ended December 31, 2011 was primarily attributable to a decline in sales volume partially offset by an increase in average selling prices. The decline in sales volume was primarily due to fewer new irons models launched in 2011 compared to the prior year. Additionally, sales volumes were negatively impacted by the natural disasters in Japan, Australia

and South East Asia during 2011 as well as a push in 2010 to sell irons and wedges which became nonconforming in 2011. The increase in average selling prices primarily resulted from the current year launch of the more premium Razr X irons compared to the prior year launch of the more moderately priced Big Bertha Diablo irons and the value-priced X-24 Hot and X-20 NG irons.

The $17.5 million (16%) decrease in net sales of putters to $88.8 million for the year ended December 31, 2011 was primarily attributable to a decline in sales volume partially offset by an increase in average selling prices. The decrease in sales volume resulted primarily from fewer new putter models offered during 2011 compared to the prior year as well as a general downturn in the putters category. The increase in average selling prices was attributable to a decrease in closeout activity during 2011 compared to 2010.

The $19.1 million (8%) decrease in net sales of accessories and other products to $216.6 million for the year ended December 31, 2011 was primarily attributable to a decline in sales of the Company s GPS devices as well as a decline in sales of packaged sets, gloves, headwear and accessories. These decreases were partially offset by an increase in sales of the Company s footwear and apparel primarily due to increased closeout activity with certain retailers in 2011.

Golf Balls Segment

Net sales information for the golf balls segment is summarized as follows (dollars in millions):

	Years Ended December 31,		Decline	
	2011	**2010(1)**	**Dollars**	**Percent**
Net sales:				
Golf balls	$ 160.4	$ 176.6	$ (16.2)	(9)%

(1) Certain prior period amounts have been reclassified to conform to the current year presentation.
The $16.2 m