

Henderson State University

Analysis Report- Callaway Inc.

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Market Profile

Callaway Golf, Inc.	
Ticker Symbol	ELY
Exchange	NYSE
Industry	Recreation
Sector	Consumer Goods
Peer	Taylor Made
Shares Owned	1,000
Purchase Date	
Purchase Price	13.84
Current Price	7.17
52-wk Low	7.00
52-wk High	16.00
52-wk Change	(55%)
52-wk Relative	(12.81%)
1 Year Target Price	10.33
Market/Book	.77
Market Cap.	6.75 million
Beta	1.10
EPS (ttm)	31.97
Price/Earnings	7.14
PEG	1.06
Dividend & (Yield)	3.84
Dividend Payout	.28
Interest Coverage	0
ROE	11.55

Recommendation:

Buy more shares

Company History:

Callaway started their company in 1982, with Ely Callaway as the founder (which is why the ticker symbol is ELY). Mr. Callaway himself delivered clubs to buyers out of the trunk of his Cadillac. When he first started the company it was named Callaway Hickory Stick USA, and in 1988 he changed the name to Callaway Golf Company. In the early 1990s the company had become to gain notoriety because of the winnings of several players in the Senior PGA and the PGA tours. The company had one of the most anticipated initial public offerings in 1992, and was underwritten by Merrill Lynch, in which they sold 2.6 million shares at a price of \$20 each. The company very quickly had doubled their earnings. In 1995 Callaway Golf Company becomes the number one manufacturer of woods and irons. In 1996 Callaway Golf Ball Company is formed. In 1997 Callaway acquired Odyssey Golf, Inc. and have sales of mid 800 million, more than four times the nearest competitor. In 2001 Ely Callaway retired as C.E.O. and president. 2003, Callaway acquired Top-Flite Golf Inc. Very recently Justin Timberlake was signed on as a celebrity endorsement deal and several of the members on the P.G.A. tour are going to start using the intermediate priced driver (\$299) to show that even the "budget" driver is still a very good product. The company has steadily grown year after year, and headquarters are in the golf rich Carlsbad, California.

Product Mix

- Callaway of course develops and markets golf clubs from a generally affordable level to some pretty pricey models.
- Recently the company has bought out uPlay golf, Top-Flite golf balls and some other small competitors. This has led to the increased percentage of the golf ball market, which about 19% of what their sales has come from recently.
- Wal-mart has just recently started carrying Callaway products, such as golf bags and golf gloves.
- They sell to consumers directly and also sell to third-party distributors directly.
- They use their logo to make licensing agreements for range finders, watches, practice aids, travel gear, and also on other golfing accessories.
- Callaway sells to over 60 countries and these sales account for 47% of sales.

Stock Chart- Six Months



Recent Headlines

- ELY hits 52-week low- morningstar.com 2/18/2009
- Change in Directors or Principal Officers- yahoo.com 2/6/2009
- Callaway Golf halts 401(k) match-morningstar.com 2/6/2009
- Callaway Golf: Cutting 2009 EPS Estimates Again- seekingalpha.com 1/18/2009
- Callaway Golf's Product Line Tops Golf Digest's 2009 "Hot List- morningstar.com 1/14/2009
- Callaway Golf Announces Acquisition of uPlay-morningstar.com 1/5/2009

Industry Overview

Current Rank: 86

Portfolio Percentage Rank: 99

Monetary Policy Indicator: expansive

Industry Opinion:

With this industry being in the bottom of the list it is headed upward according to sector rotation and also with the summer coming and the new economic stimulus plan being signed more and more people are bound to spend money on this industry.

Key Issues Affecting the Industry:

Staying out of debt and getting people to spend hard earned money on sporting equipment

Porter's Five Forces

- 1. Rivalry**
Several private firms, but none in the industry have some kind of product in every facet of the golf game
- 2. Threats of Substitutes**
There is always a threat of substitutes but they do not offer the technological advances that Callaway has brought to the market
- 3. Buying Power**
When customers have the power to use their old equipment and no funds to buy new products they will shun the new Callaway products
- 4. Supplier Power**
As steel and oil prices fluctuate it causes a potential gain or loss for the firm
- 5. Barriers to Enter**
Have to work a hard time to gain market share and also patent technology will be hard to come by. High barrier to entry cost, high supplying cost, large overhead and the temptation to get the firm into large amounts of debt. Pulling golfers from other companies will present a "huge" problem.

CALLAWAY GOLF COMPANY
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	<u>Three Months Ended September 30,</u>				<u>Nine Months Ended September 30,</u>			
	<u>2008</u>		<u>2007</u>		<u>2008</u>		<u>2007</u>	
Net sales	\$ 213,451	100 %	\$ 235,549	100 %	\$ 945,932	100 %	\$ 950,173	100 %
Cost of sales	133,320	62 %	141,543	60 %	519,187	55 %	520,321	55 %
Gross profit	80,131	38 %	94,006	40 %	426,745	45 %	429,852	45 %
Operating expenses:								
Selling expense	65,730	31 %	65,808	28 %	226,352	24 %	222,009	23 %
General and administrative expense	20,201	9 %	19,394	8 %	65,480	7 %	65,139	7 %
Research and development expense	6,650	3 %	7,928	3 %	22,112	2 %	23,851	3 %
Total operating expenses	92,581	43 %	93,130	40 %	313,944	33 %	310,999	33 %
Income (loss) from operations	(12,450)	(6)%	876	0%	112,801	12%	118,853	13%
Other income (expense), net	(1,669)		1,223		(3,574)		(2,006)	
Income (loss) before income taxes	(14,119)	(7)%	2,099	1%	109,227	12%	116,847	12%
Provision for (benefit from) income taxes	(6,676)		830		39,897		46,103	
Net income (loss)	\$ (7,443)	(3)%	\$ 1,269	1%	\$ 69,330	7%	\$ 70,744	7%
Earnings (loss) per common share:								
Basic	\$ (0.12)		\$ 0.02		\$ 1.10		\$ 1.05	
Diluted	\$ (0.12)		\$ 0.02		\$ 1.08		\$ 1.03	
Weighted-average shares outstanding:								
Basic	62,494		66,516		63,187		67,250	

Diluted	62,494	67,639	64,029	68,407
Dividends declared per share	\$ 0.07	\$ 0.07	\$ 0.21	\$ 0.21

Economic Outlook- 10K

As expected the recent financial meltdown of the American economy will put a very large strain on Callaway sales. Sales are expected to drop by at least 25% in the domestic United States. However, in the international market where Callaway makes 48% of their sales, the industry is expected to grow and continue to grow in the future years. Asian markets are the new emerging markets and these economies have not been affected to the degree that the U.S. market has and golf courses are being built at a record pace, and demand for Callaway products is still very strong. Discretionary spending is expected to increase because the citizens of these countries are getting to enjoy more time off and they find golf a great way to spend their extra time and money. Higher steel and oil prices are going to have an impact on the cost of sales by increasing them. The company will pump more money into the advertising sector because of the introduction of a new line of irons, fairway woods, and also several new drivers. Growth rates for the company will grow, but not at a rate of the first half of 2008. The firm will continue to grow as a result of increased international sales not domestic sales, and the absence of debt will allow Callaway to emerge into new markets and spend more money on each customer than the rest of the industry. Prices will ultimately have to decrease in the United States market in order to sell golf clubs; this should apply until the current recession takes a back seat to other issues regarding the world economic scene. Although end market demand for LCD televisions, monitors and notebooks currently remains strong, we are cautious about the potential negative impact that economic conditions, particularly the slowing U.S. economy, and political tensions could have on consumer demand. There is no assurance that the end-market rates of growth will continue at the rates experienced in recent years, that we will be able to pace our capacity expansions to actual demand, or that the rate of cost declines will offset price declines in any given period. While the industry has grown rapidly, consumer preferences for panels of differing sizes; prices; or other factors may lead to pauses in market growth. Therefore, it is possible that glass manufacturing capacity may exceed demand from time to time. In addition, changes in foreign exchange rates, principally the Japanese yen, will continue to impact the sales and profitability of this segment.

Financial Ratios

Valuation Ratios

	Company	Industry	Sector	S&P 500
P/E Ratio (TTM)	7.39	5.87	26.17	13.06
P/E High - Last 5 Yrs.	NA	0.07	0.28	29.16
P/E Low - Last 5 Yrs.	NA	0.02	0.08	6.94
Beta	1.14	0.93	0.90	0.90
Price to Sales (TTM)	0.44	0.10	3.31	1.61
Price to Book (MRQ)	0.84	2.03	4.85	2.55
Price to Tangible Book (MRQ)	1.22	2.12	5.95	4.94

Price to Cash Flow (TTM)	4.69	0.97	12.39	6.34
Price to Free Cash Flow (TTM)	--	10.37	24.10	14.04
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% Owned Institutions	--	--	--	--

Dividends

	Company	Industry	Sector	S&P 500
Dividend Yield	3.56	0.01	0.09	3.11
Dividend Yield - 5 Year Avg.	2.04	1.53	1.31	1.94
Dividend 5 Year Growth Rate	0.00	31.82	23.41	11.52
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Payout Ratio(TTM)	27.53	11.01	36.66	40.49

Growth Rates

	Company	Industry	Sector	S&P 500
Sales (MRQ) vs Qtr. 1 Yr. Ago	-1.80	1.44	-13.41	-0.16
Sales (TTM) vs TTM 1 Yr. Ago	-0.66	-0.89	-3.78	9.73
Sales - 5 Yr. Growth Rate	6.54	16.90	9.65	14.32
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EPS (MRQ) vs Qtr. 1 Yr. Ago	80.14	-68.25	-138.61	-86.61
EPS (TTM) vs TTM 1 Yr. Ago	31.97	--	--	--
EPS - 5 Yr. Growth Rate	8.66	21.64	16.63	16.81
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Capital Spending - 5 Yr. Growth Rate	45.54	18.38	14.77	10.02

Financial Strength

	Company	Industry	Sector	S&P 500
Quick Ratio (MRQ)	0.92	2.20	1.14	0.92
Current Ratio (MRQ)	1.93	2.66	1.50	1.11
LT Debt to Equity (MRQ)	--	7.06	37.24	84.64
Total Debt to Equity (MRQ)	15.57	10.94	76.73	107.30

Interest Coverage (TTM)	--	0.00	0.15	32.66
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Profitability Ratios

	Company	Industry	Sector	S&P 500
Gross Margin (TTM)	43.58	7.69	11.95	39.40
Gross Margin - 5 Yr. Avg.	41.43	36.76	26.47	40.99
EBITD Margin (TTM)	10.93	--	--	--
EBITD - 5 Yr. Avg.	7.75	18.14	12.45	18.64
Operating Margin (TTM)	7.54	1.41	2.14	--
Operating Margin - 5 Yr. Avg.	3.93	15.86	8.08	17.82
Pre-Tax Margin (TTM)	9.07	1.10	2.17	14.49
Pre-Tax Margin - 5 Yr. Avg.	4.15	16.82	8.34	17.54
Net Profit Margin (TTM)	5.92	0.62	1.17	10.32
Net Profit Margin - 5 Yr. Avg.	2.84	10.21	5.12	12.31
Effective Tax Rate (TTM)	34.68	9.69	23.01	28.14
Effective Tax Rate - 5 Yr. Avg.	31.65	36.49	39.07	30.53

Management Effectiveness

	Company	Industry	Sector	S&P 500
Return on Assets (TTM)	7.62	0.56	1.14	5.87
Return on Assets - 5 Yr. Avg.	3.67	7.41	4.58	6.24
Return on Investment (TTM)	10.54	0.76	1.67	8.16
Return on Investment - 5 Yr. Avg.	4.73	9.73	6.92	8.47
Return on Equity (TTM)	11.55	0.90	3.67	21.15
Return on Equity - 5 Yr. Avg.	5.06	10.45	10.74	16.16

Efficiency

	Company	Industry	Sector	S&P 500
Revenue/Employee (TTM)	--	8,215,637	31,902,844	327,538
Net Income/Employee (TTM)	--	288,142	612,947	36,524
Receivable Turnover (TTM)	9.63	1.17	6.24	10.14
Inventory Turnover (TTM)	2.47	1.11	5.19	6.22
Asset Turnover (TTM)	1.29	0.18	0.48	0.65

DCF Model	
Beta	1.1
Valueline Safety Rating	3
Expected Growth (EPS)	10.5%
Projected Growth & Dividend Yield	2.5%
Required Rate Return	12.13%
Projected Future P/E	8.46
Annualized HPR	6.40%
PV of Future Price	4.35
Recommendation	Overvalued

P/E Sensitivity

Present Value	Price 2006	P/E 2006	EPS 2006	HPR 2006	Annual Return
1.80	3.51	9.0	0.39	0.74	-4.94%
2.20	4.29	11.0	0.39	0.85	-2.68%
2.60	5.07	13.0	0.39	0.96	-0.66%
3.00	5.85	15.0	0.39	1.07	1.19%
3.41	6.63	17.0	0.39	1.18	2.88%
3.81	7.41	19.0	0.39	1.29	4.45%

4.21 8.19 21.0 0.39 1.40 5.92%

Earnings Sensitivity

Present Value	Price 2006	P/E 2006	EPS 2006	HPR 2006	Annual Return
-1.62	-3.15	15.0	-	(0.18)	#NUM!
-0.08	-0.15	15.0	0.01	0.23	-22.07%
1.46	2.85	15.0	0.19	0.65	-7.07%
3.00	5.85	15.0	0.39	1.07	1.19%
4.55	8.85	15.0	0.59	1.49	7.09%
6.09	11.85	15.0	0.79	1.91	11.74%
7.63	14.85	15.0	0.99	2.33	15.61%

Momentum



Momentum Indicator: -.5

Analyst's Opinion

Why Buy ELY?

No long term debt and substantial cash to fund operations and also finance new research and development

Why not buy ELY?

Less and less people have the money to spend \$1000 on a set of golf clubs, also as the dollar strengthens it will cut more and more into international sales

Final Discussion:

I would buy because current trading levels are at historic lows and international sales are still strong and expected to continue to grow

Works Cited

In Order of Occurrence:

www.callaway.com
www.seekingalpha.com
www.motleyfool.com
www.yahoo.com
www.valueline.com
www.morningstar.com
www.reuters.com
www.stockcharts.com