

Callaway Golf is one of the most prominent golf companies in the world today. The company designs, manufactures, and sells high quality golf equipment and merchandise, ranging from clubs, to balls, and also bags and other accessories. The industry in which they compete is highly competitive, and the company focuses on two main segments, golf balls and golf clubs. Their products are sold globally, and are usually sold to sporting goods retailers and third party distributors.

BUY

Current Price: \$10.40

Target Price: \$13.39

Market Cap: \$983.7M

Ke: 10.26%

WACC: 8.4%

ROE: 37.2%

Net Income Margin: 21.80

Total Asset Turnover: 1.22

Equity Multiplier: 1.31

Cash/Total Assets: 15.72%



Thesis: Callaway seems to be in prime position to experience growth in 2017. Despite some setbacks in fiscal year 2016 and a slow performance in Q4, there are still indications that point towards future growth. Stock price dropped more than 8% as a result, but revenues and earnings still increased overall from 2015. An agreement with an individual Japanese venture and the acquisition of a U.S. golf bag manufacturer should allow for the company to experience growth in newer markets. Callaway differentiates itself from competitors in terms of market position, as they continue to seize market share abroad and find attractive investment opportunities through foreign partnerships and tour representation.

Catalysts: The following are factors that will play a role in the performance of the company down the line:

- **Short Term:** Seasonality, Tour representation, Reduction in number of golf rounds
- **Mid Term:** Acquisitions (OGIO), Increase in international market share, Changes in equipment standards.
- **Long Term:** Global operations, Changes in foreign currency rates, Changes in tax laws.

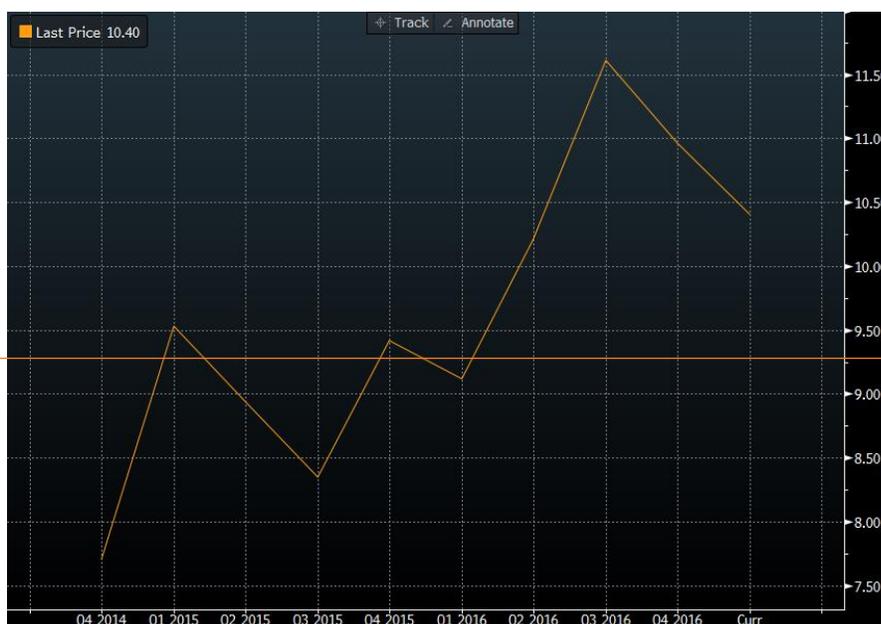
Earnings Performance:

Despite the drop in stock price, Callaway still exhibited revenue growth. Net sales totaling \$871.2 million were reported, up from 3.2% last year. In Q4 alone, despite results being reported as under consensus, the Q4 net sales saw an increase of 6.8% to \$163.7 million, \$10.4 million of which can be attributed to the Japan joint venture, evident of presence in foreign markets. Cash and equivalents increased 152% to \$126 million, while asset-based loans dropped 20%, to \$12 million. In the highly competitive market, Callaway still managed to generate solid profits and maintain good position in market share, actually gaining market share in the golf ball business. Available liquidity year-end was value at \$213 million, a 52% increase. Due to the golf industry being a seasonal business in which predominant sales are the first half of the year, seasonality and slow sales in Q4 can be attributed towards the stock price decline.

(in millions, except percentages)

	As of Dec. 31, 2016	As of Dec. 31, 2015	Percent Change
Cash & Equivalents	\$126	\$50	↑ +152%
Asset-based Loans	\$12	\$15	↓ (20%)
Available Liquidity⁽¹⁾	\$213	\$140	↑ +52%
Net Accounts Receivable	\$128	\$116	↑ +11%
Inventory	\$189	\$209	↓ (9%)
Cap Ex	\$16	\$14	+13%
D&A	\$17	\$17	(5%)

Source: Q4 Earnings Call, Investor Presentations



Source: Bloomberg

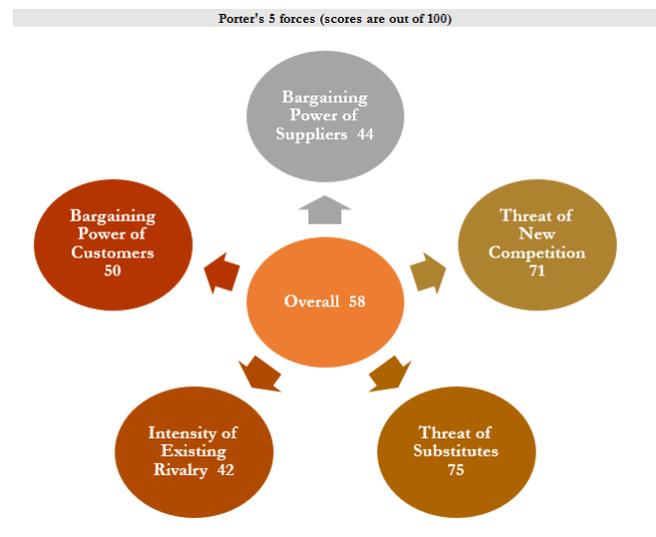
Industry Overview:

Callaway predominantly competes in the golf sector of the sporting goods industry, which as a whole features several top-name companies vying for market share. Competitors try to differentiate themselves through innovative technologies introduced to golf clubs and balls. Companies also have affiliations with touring professionals, who are keystones in driving market share of a brand. Callaway has upheld strong performance in the market, continuing to gain market share with golf balls and golf clubs while establishing gains in other categories as a result of recent investments. The industry is seasonal, which can be affected by the timing of new products or weather conditions. Typically, sales occur predominately in the first half of the year.

Top managers at Callaway intend to continue investing in cutting edge technology and key growth areas to drive share price. New technologies that create greater efficiency are being introduced to new product releases that will surely drive position in the driver and putter market share. Execution from an operational perspective has been the driving factor in order to continually expand and seek attractive investment opportunity whilst creating shareholder value.

Porter's Forces Analysis:

Being the highly competitive industry that Callaway is in, maintaining a competitive advantage is essential. Callaway has done so in the past based on player endorsements and equipment modernization. Marked by longevity in golf circles, the predominant issues would be the threat of new competition and substitutions. However, Callaway has maintained solid operating ability in the past both domestically and internationally. With a larger economy of scale, greater foreign influence, and consistent technology innovation, the company has been put in prime position to continue growth. Substitute products are also an issue, with other large-name companies introducing similar innovations in their club technology. Callaway's recently launched product line of drivers has been received at number one selling in the month of January of this year. As a result, power is strengthened in comparison to any competitors. Continued market presence, innovation, and top representation will drive sales and value in the future.



Market Presence:

With products being sold globally, Callaway has strong presence in both domestic and foreign markets. Fiscal year 2016 introduced gains in market growth for specific segments in multiple markets, which positions the company to continually outperform the industry. Europe saw a record in hard goods market share in 2016, at levels of 22.2%, a gain of 140 basis point year-over-year. Displaying strong sales and margin growth, Callaway also upheld their position as the number 1 brand in that market. Market share is expected to increase considerably in Asia as a result of the Japan apparel joint venture.

Capital Allocation:

Callaway maintains a solid cash balance, and since 2015 has minimal debt. As a result, they are able to continually invest in areas that they believe will spark growth. Tour representation is believed to be a strong driver of market price. Player signed to staff market their equipment worldwide, and Callaway has recently received some big names in the industry that are sure to generate some recognition, such as Daniel Berger, the 2015 PGA Tour Rookie of the Year, or Rory McIlroy, former World No. 1. Management also wants to capitalize on core business operations, stemming from the Japan venture and research and development for club technologies. Other competitors are refraining from activity or exiting an investment as a whole, which is of large value to Callaway.

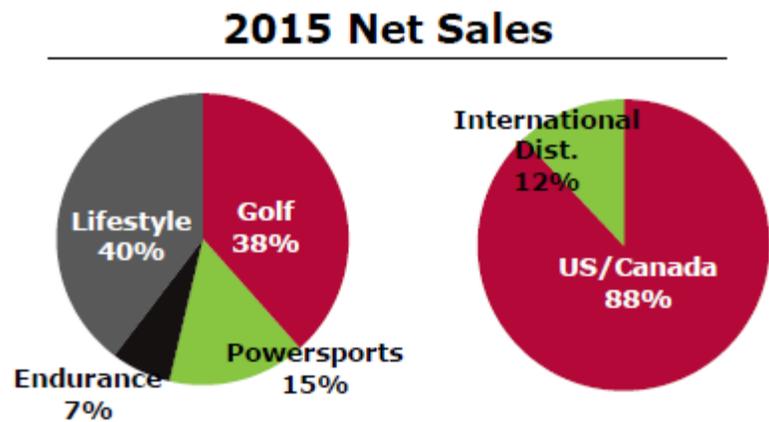


In Millions of USD except Per Share	FY 2014	FY 2015	FY 2016	Current
12 Months Ending	12/31/2014	12/31/2015	12/31/2016	03/03/2017
 Market Capitalization	597.5	883.3	1,031.5	983.7
 - Cash & Equivalents	37.6	49.8	126.0	126.0
 + Preferred Equity	0.0	0.0	0.0	0.0
 + Minority Interest	0.0	0.0	—	—
 + Total Debt	123.8	15.0	12.0	12.0
 Enterprise Value	683.6	848.5	917.5	869.7

Source: Bloomberg

Acquisitions:

In a recent, \$75.5 Million all-cash transaction, Callaway acquired the U.S Bag Manufacturer, OGIO, a lifestyle brand known for its bags and apparel. OGIO generated approximately \$50 million of revenue and \$9 million of adjusted EBITDA in 2016. Golf bags are one of their key products as well, and as displayed in the chart below, takes up a majority share in net sales for the company. The acquisition of OGIO provides a strong fit with Callaway, as it increases economy scale, and overlap in market segments allows for infiltrate other markets, namely lifestyle or leisure. OGIO is a platform for future growth, as more than 60% of sales are in categories outside of golf, which can generate value and create growth for Callaway. Callaway also expects accretive additions to payouts on dividends. Callaway strives to seek any opportunity to invest in new industries, as it can help them to add value and maintain their goal of shareholder wealth and continued growth.



Source: OGIO Acquisition Presentation

Financial Outlook:

ELY	FY 2014	FY 2015	FY 2016
Cash Ratio	0.2	0.28	0.67
Current Ratio	2.09	2.19	2.46
Quick Ratio	0.8	0.93	1.26
Operating Margin	3.47	3.19	5.07
EBITDA Margin	5.86	5.25	6.97
Net Income Margin	1.8	1.73	21.8
ROIC	5.06	4.25	33.39
ROE	5.56	4.14	37.18

The company has shown solid financial stability in previous years, as exhibited by the current and quick ratios, showing that the company is able to pay off short-term debts. The cash ratio could be a bit of a concern, but Callaway's extensive inventory and 2016 share repurchase deal with Topgolf enable the company to have access to other Callaway relies mostly on cash resulting from operations and credit facilities to manage seasonal fluctuations they face. However, they Over a three-year period, marginal performance has been solid, with strong increases this past fiscal year, most notable Net Income, in part due to the individual Japanese venture and completion of the OGIO acquisition for \$75.5 million in cash. Those endeavors coupled with an increase in overall Q4 revenue generated resulted in high returns, and the greater economies of scale will effectively improve operating margins moving forward. Callaway saw no reduction in market share, and has

positioned itself nicely to see more global influence and an increase in sales for its different segments, on top of growth options in newer segments as a result of the OGIO market.

Conclusion:

Callaway has maintained its position as a prominent company in the sporting goods industry. Recent performance has shown that they have a solid capital structure and proven operating ability. Increased revenues and profitability are projected to grow at higher rates. Investment strategies into newer markets, cutting edge technology, minimal debt, proven operating ability, and a reduction in stock price while maintaining growth all point to the undervalue of Callaway. It currently holds an intrinsic value of \$10.35. One year target price is set at \$13.39, which should be attainable with the contributions of this year's investments and the strength of Callaway's operating ability.

Callaway Golf Company (ELY)

CENTER FOR GLOBAL FINANCIAL STUDIES

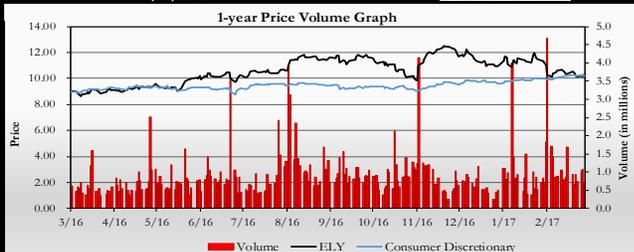
BULLISH

Analysis by Alec Odnoha
3/3/2017

Current Price: \$10.40
Divident Yield: 1.0%

Intrinsic Value: \$109.62
Target Price: \$133.66

Target 1 year Return: 1186.2%
Probability of Price Increase: 100%



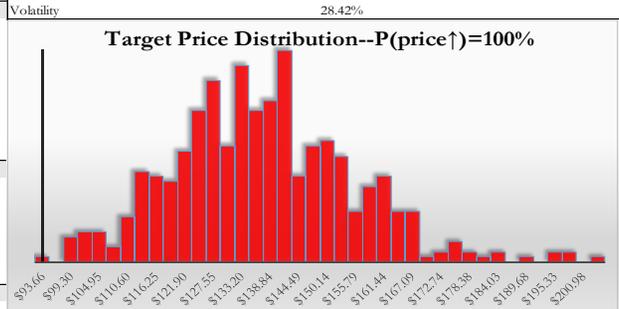
Description
Callaway Golf Company, together with its subsidiaries, designs, manufactures, and sells golf clubs, golf balls, golf bags, and other golf-related accessories in the United States and internationally.

General Information
Sector: Consumer Discretionary
Industry: Leisure Products
Last Guidance: November 3, 2015
Next earnings date: NM
Estimated Country Risk Premium: 4.67%
Effective Tax rate: 24%
Effective Operating Tax rate: 204%

Market Data	
Market Capitalization	\$983.63
Daily volume (mil)	0.90
Shares outstanding (mil)	94.58
Diluted shares outstanding (mil)	95.85
% shares held by institutions	74%
% shares held by investments Managers	71%
% shares held by hedge funds	15%
% shares held by insiders	1.42%
Short interest	1.64%
Days to cover short interest	1.65
52 week high	\$12.56
52-week low	\$8.57
Levered Beta	1.33
Volatility	28.42%

Past Earning Surprises	
Quarter ending	Revenue
12/31/2015	2.22%
3/31/2016	-8.65%
6/30/2016	0.28%
9/30/2016	3.78%
12/31/2016	-9.06%
Mean	-2.28%
Standard error	2.7%

EBITDA	
12/31/2015	-202.92%
3/31/2016	16.09%
6/30/2016	-15.09%
9/30/2016	-148.23%
12/31/2016	-220.05%
Mean	-114.04%
Standard error	48.5%

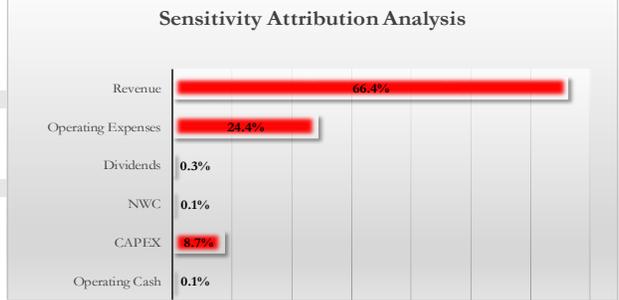


Management	
Brewer, Oliver	Chief Executive Officer, Pre
Julian, Robert	Chief Financial Officer and
Leposky, Mark	Senior Vice President of Glo
Howie, Neil	Managing Director of Europe,
Hocknell, Alan	Senior Vice President of Res
Thomas, Jennifer	Chief Accounting Officer and

Peers	
Acushnet Holdings Corp.	
Nautilus, Inc.	
Malibu Boats, Inc.	
Johnson Outdoors Inc.	
Brunswick Corporation	
MCBC Holdings, Inc.	

Profitability	
ROIC	-32.9%
NOPAT Margin	-26%
Revenue/Invested Capital	1.29
ROE	-34.9%
Adjusted net margin	-27%
Revenue/Adjusted Book Value	1.31

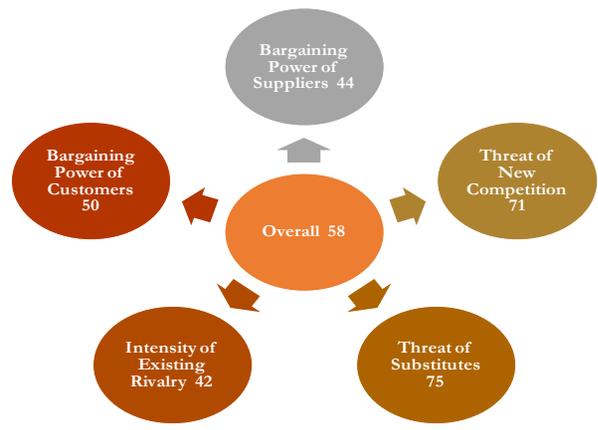
Total compensations growth	
Chief Executive Officer, Pre	-0.61% per annum over 3y
Chief Financial Officer and	N/M
Senior Vice President of Glo	14.03% per annum over 2y
Managing Director of Europe,	13.43% per annum over 3y
Senior Vice President of Res	-100% per annum over 1y
Chief Accounting Officer and	N/M



Invested Funds	
Total Cash/Total Capital	14.0%
Estimated Operating Cash/Total Capital	4.9%
Non-cash working Capital/Total Capital	17.7%
Invested Capital/Total Capital	74.2%

Total return to shareholders	
Chief Executive Officer, Pre	11.44% per annum over 3y
Chief Financial Officer and	0% per annum over 0y
Senior Vice President of Glo	6.21% per annum over 2y
Managing Director of Europe,	11.44% per annum over 3y
Senior Vice President of Res	22.86% per annum over 1y
Chief Accounting Officer and	N/M

Porter's 5 forces (scores are out of 100)



Period	Revenue growth
Base Year	3.2%
12/31/2017	5.6%
12/31/2018	2.2%
12/31/2019	2.4%
12/31/2020	2.6%
12/31/2021	2.8%
12/31/2022	3.0%
12/31/2023	3.2%
12/31/2024	3.4%
12/31/2025	3.6%
12/31/2026	3.9%
Continuing Period	4.1%

Valuation	NOPAT margin	ROIC/WACC
Base Year	-25.6%	-3.24
12/31/2017	9.0%	1.23
12/31/2018	9.4%	1.25
12/31/2019	10.5%	1.35
12/31/2020	11.8%	1.53
12/31/2021	13.1%	1.73
12/31/2022	14.6%	1.97
12/31/2023	16.2%	2.22
12/31/2024	17.7%	2.48
12/31/2025	19.2%	2.74
12/31/2026	20.8%	3.02
Continuing Period	22.4%	3.30

Period	Invested Capital
Base Year	\$723.48
12/31/2017	\$728.11
12/31/2018	\$683.09
12/31/2019	\$673.91
12/31/2020	\$677.15
12/31/2021	\$669.72
12/31/2022	\$700.54
12/31/2023	\$745.47
12/31/2024	\$754.09
12/31/2025	\$761.91
12/31/2026	\$768.94
Continuing Period	

Net Claims	Price per share
Base Year	\$24.45
12/31/2017	\$26.67
12/31/2018	\$29.06
12/31/2019	\$31.55
12/31/2020	\$34.14
12/31/2021	\$36.81
12/31/2022	\$39.60
12/31/2023	\$42.50
12/31/2024	\$45.50
12/31/2025	\$48.59
12/31/2026	\$51.76
Continuing Period	