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HAR-TRU Sports: Serving Up Growth in 2011

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HAR-TRU Sports

Serving Up Growth In 2011

Roger R. Schnorbus

Littleton M. Maxwell

This case was prepared from various referenced sources and was developed solely for classroom discussion; the case is not intended to serve as an endorsement, source of primary data or an illustration of either effective or ineffective handling of a business situation. The authors gratefully acknowledge information and insights provided by Mr. Randy Fuddy, General Manager of HAR-TRU Sports and other members of his staff.

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INTRODUCTION

Randy Fuddy, the General Manager of HAR-TRU Sports (HTS), a division of the Luck Companies set a deadline of mid August, 2011 to develop a five year strategic/ growth plan for his business. In fiscal 2010, the division had achieved net sales of \$10 million and Fuddy's objective was to grow the business to \$15 million by fiscal 2015.

HTS manufactured and sold products for use in the tennis industry; its main product, which comprised 57% of net sales (\$5.7m) in 2010, was the aggregate material used in clay court surfaces. This material was sold to clay court builders/installers and to owners/operators of existing clay court facilities under the HAR-TRU brand.

Although HTS was the dominant supplier of the clay aggregate material in the United States, there were several problems that the business faced:

- 1) Tennis participation in the U.S. as measured by play frequency declined by 8% from 2009 to 2010. This decline occurred both with frequent and regular players. On the positive side, total play participation from 2003 to 2010 increased by 15%.
- 2) Clay courts require both seasonal and daily maintenance versus various hard court surfaces. This partially explains why only 11% of all tennis courts in the U.S. have a clay surface.
- 3) HTS's net sales exhibited a steady decline from a high of \$12 million in 2006 to \$10 million in 2010.
- 4) The HAR-TRU brand has achieved a degree of awareness in the clay court market place. Major issues exist in terms of brand extendibility in HTS's accessory products and services.
- 5) Future growth of the clay aggregate material product was projected to average only 4% per year from 2011 to 2015. Therefore, other sources of growth were necessary to achieve the desired net sales target of \$15 million.

On the positive side, growth opportunities existed geographically in both the western US and in global markets although it would be organizationally challenging to service such markets. Also, various new tennis accessory products and services were being developed by HTS to complement a myriad of existing products.

TENNIS INDUSTRY

A) Size and Segments

In 2010, the U.S. tennis industry generated revenues of approximately \$5.7b. Four prime segments comprised the industry (See Exhibit 1 for segment breakout and growth rate change).

- 1) Tennis Facilities - Revenue generated at both public and private facilities; represented approximately 50% of the total revenue and grew by 5% from 2009.

- 2) Program Delivery - Revenue generated from tennis instruction/lessons; also grew by 5%.
- 3) Pro Tour - Revenue generated at professional tournaments and events grew by 2%.
- 4) Player Equipment Retail - Includes tennis balls, racquets and apparel; revenue in this segment was down by 9% from 2009; decline driven by decreased player participation.

B) Tennis Participation

Tennis was the fastest growing traditional sport in the U.S. from 2003 to 2010 exhibiting a total increase of 15% in player participation. However play frequency declined by 8% from 2009 to 2010 driven by a 12% decline in frequent player usage. A major cause for this decline was the sagging U.S. economy. Projections for future growth through 2015 average 5% per year driven by increases in the under 10 age and senior segments and recovery in the frequent player segment.

C) Tennis Associations

The Tennis Industry Association (TIA) is the not for profit trade association whose mission is to promote the growth and economic vitality of tennis. The TIA works closely with the United State Tennis Association (USTA), the International Tennis Federation (ITF) and other industry partners including manufacturers, organizations, coaches, facilities, tournaments, court builders and media to increase tennis participation and awareness.

The TIA's central platforms are frequent player growth, economic growth (defining the overall worth of the industry and pathways for growth) and communications and positioning (displaying the positive benefits of tennis). A prime goal for the TIA is to increase the number of frequent players (play at least 21 times per year) from 5.4 million in 2010 to 7.5 million in 2015.

To improve industry communication, the TIA has established a website (TennisIndustry.org) which is a central source for industry related research, news and events.

D) Tennis Industry Programs

The following programs have been initiated by the various tennis associations to increase player participation.

- 1) Quick Start Tennis Program - In an effort to increase the exposure of youth tennis, the USTA and ITF have mandated that all age 10 and under tournaments will be held on scalable courts with scalable equipment by 2012. As a result, smaller racquets, smaller courts and softer tennis balls will be required. To incent the Quick Start Program, the USTA is offering 50% funding to communities, schools, clubs and

facilities to paint lines on existing courts for 36 and 60 foot tennis play. It is estimated that there are 3.2 million tennis players, age 10 and under in the U.S.

- 2) Cardio Tennis Program - Designed to exploit the wellness aspect of playing tennis for all age groups. Websites include tennis health.com and growing tennis.com.

E) Industry Trends

- 1) Technology/Internet Usage - The ability to access industry information as well as to purchase equipment and reserve court times will increase dramatically in the future. Websites that are both consumer friendly and offer ease of access are essential for success. Also organizations are developing and integrating new technologies via social and mobile platforms
- 2) Equipment Sales - Tennis racquet and tennis shoe purchases are expected to increase in pro/specialty retail outlets versus other retailers/mass merchants. Consumers are willing to pay higher prices for the expertise found in the specialty shops.

TENNIS COURTS

The total number of tennis courts in the U.S. was estimated to be 270,000 in 2010. This includes both indoor and outdoor courts. The Tennis Industry Association (TIA) did a representative sampling to determine the percent breakout of indoor versus outdoor facilities and a breakout of court surfaces. Results from this sampling indicate:

- 1) Approximately 90% (243,000) of the total number of courts were outdoor versus 27,000 indoor.
- 2) Of the 243,000 outdoor courts, 82% or 200,000 were hard courts versus 11.1% or 27,300 clay courts. The remaining outdoor courts were synthetic grass surfaces.
- 3) Of the 27,000 indoor facilities, 87% or 23,500 were hard courts versus 10% or 2,700 clay courts. The remaining indoor courts were carpet surfaces.

Therefore, the number of clay courts in the U.S. was estimated to be 30,000 or 11% of the total.

TENNIS COURT SURFACES

There are four main types of courts: clay, hard, grass and carpet/synthetic grass courts. Each playing surface has its own characteristics which affect the playing style of the game.

- 1) Clay Courts - Are made of crushed shale, stone, or brick. Clay courts slow the ball and produce a high bounce when compared to grass or hard courts. This is because clay courts have more grab and when the ball lands there is more friction pushing against the ball's horizontal path, therefore slowing it and creating a higher bounce. For this reason, clay courts take away some advantage of big serves, which makes it hard for serve-based players to dominate on the surface. Clay courts are cheaper to construct than other types of tennis courts, but the maintenance costs of a clay surface are higher than those of hard courts. On a daily basis, clay courts need to be rolled to

preserve flatness and the clay's water content must be balanced via water addition. The courts also need to be swept and the lines cleaned.

Clay courts also need to be “redressed” prior to the start of the tennis season. This requires the addition of clay aggregate material to the existing surface. Therein lies the biggest cost differential between clay and hard courts.

Clay courts are more common in Europe and Latin America than in North America and tend to heavily favor baseline players. Also because a clay court surface has a certain amount of “give”, there is less stress on body joints and is a preferred surface for older players. Currently, over 90% of the top ranked professional tennis players in the world had their base training on clay courts.

- 2) Hard Courts - Are very fast tennis courts, where hard-hitting players have a slight advantage. Hard courts can vary in speed; they are faster than clay but not as fast as grass courts. These courts are considered the most equal for all playing styles. The U.S. Open is played on an acrylic hard court, while the Australian Open is played on a synthetic hard court. The main difference between a synthetic hard court and a true hard court surface is the level of hardness. When the ball bounces on this surface it is faster than all other surfaces if there is not much sand in the top paint. The amount of sand used in the top paint and the size of the sand also determines the speed – more sand means less speed and larger sand particles will slow the speed of play.
- 3) Grass Courts - Real natural grass courts were once among the most common tennis surfaces, but are now rare due to high maintenance costs, as they must be watered and mown often, and take a longer time to dry after rain. The prime example of grass court surfaces is Wimbledon.

Grass court points are usually very quick since fast low bounces keep rallies short, and the serve plays a more important role than on other surfaces.

- 4) Carpet/Synthetic Grass Courts - Carpet is a tennis term for any removable court covering. The carpet is made by combining sand and glue on a substrate. Indoor arenas are a common venue for synthetic type courts.

LUCK COMPANIES (formerly Luck Stone Corporation)

Luck Companies, headquartered in Richmond, Virginia, are one of the largest producers of crushed stone in the U.S. The business was founded by Charles Luck Jr. in 1923 and has thrived under the leadership of three generations of the Luck family for over eight decades. One of the key differentiating points of the Luck Companies is the mission statement which states that “We will ignite human potential around the world and positively impact the lives of others through value based leadership.” Values include integrity, commitment, leadership, and creativity.

Luck Companies operate in four business divisions:

- 1) Construction Aggregates - Operate 15 sites (quarries) in Virginia and North Carolina, which supply crushed stone, sand, and gravel to customers in the mid-Atlantic region.
- 2) Charles Luck Stone Center – There are seven Charles Luck Stone Centers located in Maryland, Virginia, and North Carolina. The centers display natural stone products for both the home building trade and homeowners and consist of a combination of studios, contractor yards, and workshops. Products include distinctive natural stones from around the world for use in countertops, interior surfaces, terraces, and fireplaces.
- 3) Luck Development Partners - This division is responsible for the sales and leasing of corporate real estate assets as well as new project development of three industrial business parks located throughout Virginia.
- 4) HAR-TRU Sports (HTS) - HTS is a major player in the tennis court surfacing and tennis accessory industries. Its core product, sold under the HAR-TRU brand, is an aggregate based material that is used in over 90% of the existing clay courts in the U.S. and 10% on a global basis. In addition, HTS manufactures and distributes a complete line of tennis court accessory products, such as line tapes, rakes and rollers.

HAR-TRU SPORTS (HTS)

A) History

Tennis is one of the most popular sports in the world—its players, rules and equipment changing with the times. HTS surfaces are part of that history. During the 1950s, an engineer named Robert Lee began applying his expertise in building materials to the needs of American tennis. He founded a company, Lee Tennis and began manufacturing and distributing the clay aggregate material. The result was a product that standardized and improved clay courts throughout the United States.

Originally, the clay aggregate material used a natural green stone mined in Pennsylvania. When Lee found a second source in Virginia, it encouraged him to expand his business - just in time for the tennis boom of the 1970s. By adding products like sweepers, rollers and drag brushes, Lee Tennis quickly became a one-stop shop for surfacing materials, maintenance equipment, court accessories and court development advice.

When Robert Lee retired in 1997, Lee Tennis was purchased by Luck Stone, a longtime partner and supplier of stone materials. Luck Stone then acquired the manufacturing assets of the original HTS material provider and, finally, bought the HAR-TRU brand in 2000.

B) Organization

HTS is headquartered in Charlottesville, Virginia where the Administrative, Business Development, Marketing/Sales, and Service Solution functions are located (See Exhibit 2). In addition, it has a manufacturing plant and warehouse in Troy, Virginia, approximately 25 miles east of Charlottesville. The plant produces the clay aggregate material and also manufactures/assembles various tennis court equipment, such as rollers, sweepers, and brushes.

C) Manufacturing Plant/Process

The process used to manufacture the clay aggregate product is detailed in Exhibit 3; the crushed green stone that comprises approximately 95% of the material in the product is sourced from Luck Company quarries in Virginia and shipped to the Troy plant in bulk. In essence, HTS controls its supply chain because of the vertical integration opportunity afforded by the Luck Company quarries. The only other component that is added is gypsum at an approximate 5% level.

After the crushed stone and gypsum are mixed, the combined material is packed into 50 or 80 pound bags and in bulk 2,000 pound containers. The bags are used by top dressers and the bulk material by tennis court contractors/installers.

D) Sales Organization / Buy Chain

The sales organization of HTS is detailed in Exhibit 2. Inside sales are done on a regional basis (northeast, southeast and western) with existing and new customers.

All of HTS's product sales go through a wholesale channel comprised of 3 groups.

- 1) Full Service Contractors: Install courts, recondition and maintain courts and resell products/accessories to facilities and homeowners.
- 2) Top Dressers: Individuals or firms that source product from HTS to top dress courts
- 3) Distributors: Firms that distribute both HTS and other manufacturer's products.

Seventy (70) percent of product sales go through full service contractors and top dressers with the remaining 30% through distributors. In total, there are approximately 400 buyers in the above three groups with the top 60 buyers comprising 80% of the total net sells in 2010.

E) Products/Services

HAR-TRU is the world's leading clay court surface, with over 40,000 courts in 23 countries and in 49 U.S. states. New installations and court conversions are quick and relatively cost efficient with maintenance required of 15-30 minutes per day. In addition, HTS surfacing is the most widely used material for top dressing existing clay courts.

In addition to the clay court aggregate material, HTS offers a complete line of tennis court accessory products such as rakes, rollers, sweepers, line tapes, nails and posts.

Several of these products are fully manufactured and/or assembled at the Troy plant. Other products are purchased from outside suppliers and contain the HAR-TRU brand.

Some featured products offered by HTS include:

- 1) European Red Clay - Imported from Europe and can be used for new court construction or top dressing.
- 2) Gator Rakes - A line of fine premium rakes which provide superior leveling and grooming characteristics.
- 3) Tennis Lines for 10 and Under Programs - A set of temporary and permanent lines developed specifically for existing HTS courts.
- 4) Advantage Lighting - A high performance lighting fixture designed to triple light versus competitive tennis lighting systems.
- 5) Irrigation Systems - HTS has partnered with 3 leaders in irrigation technology to offer specialized solutions in irrigation systems.
- 6) ClayTech - Designed for facilities/players who want a clay court surface but not the maintenance. The product is installed directly on top of an existing hard court, provides clay court comfort and is playable in all weather. ClayTech is a European product and HTS is its sole U.S. distributor.
- 7) Tennis Posts/Nets – These products are directly sourced from China and are expected to offer HTS significant growth opportunities in the future.

HTS also offers consulting services (HAR-TRU Consulting) for installing, improving, upgrading and maintaining tennis courts. Specific services include maintenance training and certification, irrigation and lighting design/installation and one day facility visits.

F) Sales Breakout

The breakout of HTS net sales by product segment (clay aggregate material versus accessories) in 2010 was \$5.7b versus \$4.3b. (See Exhibit 4A)

The breakout of net sales of the clay aggregate material by package type is contained in Exhibit 4B. As can be seen, 72% of the material was sold in either the 50 or 80 pound packages versus the bulk 2,000 pound containers. In 2006, only 61% of the material was sold in bags. This indicates more top dressing activity by builders and installers.

The percent breakout of accessory products is contained in Exhibit 4C. Line tapes by far represent the top accessory product sold, accounting for 32% of total net accessory sales.

G) Marketing

The prime marketing objectives are to establish clay courts as the best surface to play on and to create awareness of HTS as the leading clay court brand and supplier of tennis court accessories. To accomplish this, HTS advertises in tennis print media and on cable

T.V. (the Tennis Channel). It also sponsors various tournaments and events. In terms of promotional spending, apparel (hats and shirts) are given away at such events.

HTS also conducts frequent maintenance seminars for its customers and participates in trade shows. A major effort has been to drive consumer traffic to its website and optimizing search capabilities for key products/services.

In 2010, the HTS marketing budget was \$302,000 or 3% of net sales. Almost all of these funds were targeted toward tennis players and the retail market, even though all net sales go through wholesalers. However, HTS does have an accounts manager who calls on the wholesalers and provides educational detail on its products and services.

H) Financials

The financial performance of HTS from fiscal 2000 to fiscal 2010 is summarized in Exhibit 5. Net sales in 2006 peaked at \$12m and have exhibited a steady decline to \$10m in 2010. Some of this decline can be traced to the economic recession during this period.

It is projected that by fiscal 2015, total net sales of the aggregate material will be \$7m versus \$5.7m in 2010. This represents a growth rate of approximately 4% per year. Therefore to achieve the targeted net sales of \$15m in 2015, the accessory business will have to dramatically grow or new sources of growth identified.

In spite of declining net sales, profitability as measured by Direct Cash Contribution (DCC) has increased from 2006, peaking at \$1.89m in 2009 and \$1.36m in 2010. (see Exhibit 5) These increases can be traced to operating efficiencies including headcount reduction, procurement savings and decrease in SG & A costs; also depreciation expense is included in DCC.

Exhibit 6 contains a common sized income statement for the HTS business in fiscal 2010. The statement itemizes cost of goods sold, gross profit, operating expenses, direct operating profit, depreciation and direct cash contribution on a percent basis relative to net sales. Compared to fiscal 2008 and 2009, both cost of goods sold and operating expenses have decreased indicating strong operational control.

WHAT'S NEXT

Randy Futtly knew that the five year strategic plan that he and his staff would present to the senior executives of the Luck Companies in August, 2011 had to address the following issues:

- 1) Can HTS realistically grow from \$10m to \$15m in net sales by 2015 given the low growth projected for its core clay aggregate product?
- 2) Given current organization constraints, does it make sense to seek geographic growth into Western U.S. and into global markets? If yes, what global market(s) should be pursued and what strategy developed/implemented?
- 3) Given the limited marketing budget, how can awareness of the HTS brand be extended beyond clay court surfaces to areas such as accessory equipment and apparel? Also, how can more awareness be created extolling the benefits of playing

on clay court surfaces, i.e. less injuries? Lastly, how should HTS direct its marketing spending in the future?

- 4) Are there opportunities to decrease the cost of clay court installations and maintenance to be more competitive with hard courts?
- 5) Is there a “killer” accessory product that has not yet been developed for use in the tennis industry? The answer to this question would possibly require market research targeted to installers and dressers.
- 6) Can an on-line business model be created / improved to supply individual tennis facilities and players with HTS accessory equipment? This model has been very successful in the yoga industry with startup internet companies supplying equipment / apparel directly to yoga studios and participants.
- 7) Can the clay aggregate material be used in other outdoor sport surfaces?
- 8) How can HTS best exploit the Quick Start Tennis Program for age 10 and under players?

To address these issues, Fuddy and his staff would have to develop a list of strategic initiatives that HTS would implement on a year by year basis from 2011 to 2015. The implementation plan would detail both financial and human resources necessary to grow to \$15m by 2015, as well as the return on investment expected.

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- 3) Tennis Industry Association – Tennis Participation Study Findings – 2010
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- 5) Racquet Sports Industry – Soft Court Award Winners – May 2011
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- 7) Sports Business Research Network – Tennis – 2010
- 8) Luck Companies Web Site –
- 9) Luck Companies Internal Documents – 2010/2011
- 10) HTS Internal Financial Documents – 2010/2011
- 11) HTS Product Catalogue – 2011

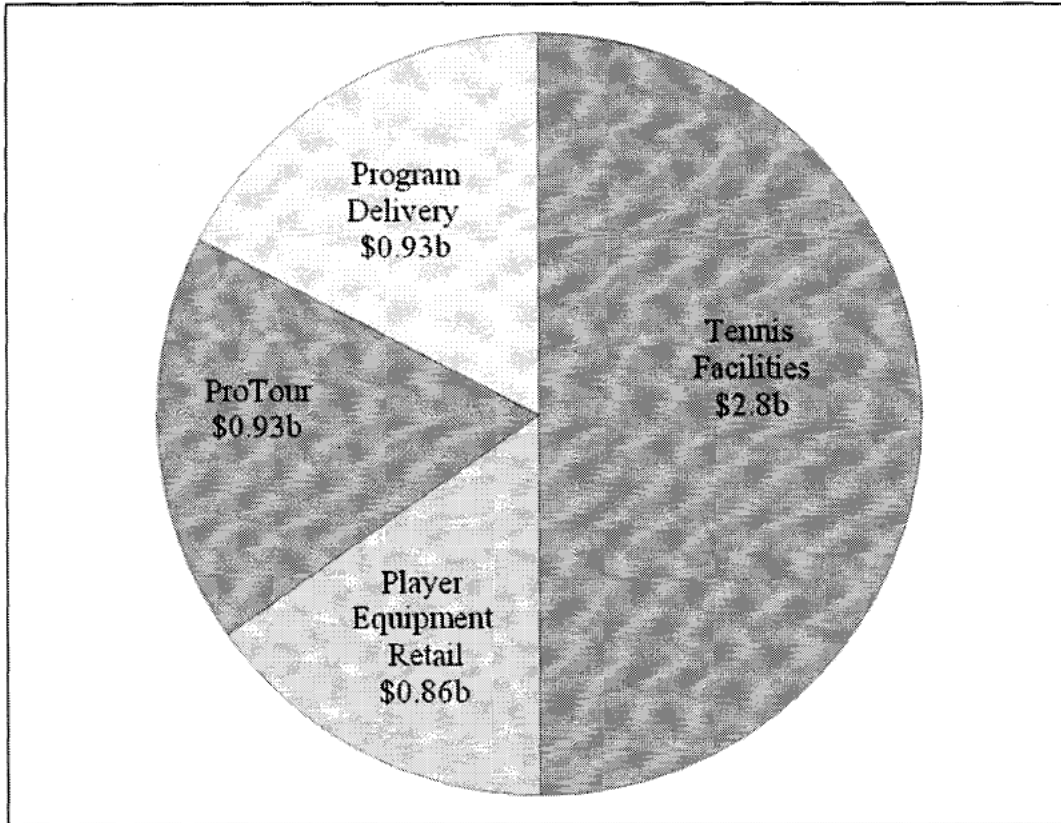
Web Sites

- 1) Tennis Industry Association – www.TennisIndustry.org
- 2) Racquet Sports Industry – www.racquetssportsindustry.com
- 3) Luck Companies – www.luckstone.com
- 4) American Tennis Courts, Inc. – www.AmericanTennisCourtsinc.com
- 5) HAR-TRU Sports - www.hartru.com

Exhibit 1 – Breakout Total Tennis Economy (U.S.) – 2010*

Segment Breakout by Dollars

Total Revenue - \$5.7b



Segment	Dollars	% Change (2009 to 2010)
Tennis Facilities	\$2.8b	+5%
Program Delivery	\$0.93b	+5%
ProTour	\$0.93b	+2%
Player Equipment Retail	\$0.86b	-9%

* Source – Tennis Industry Association

Exhibit 2 – HAR-TRU Sports Organizational Chart
June 15, 2011

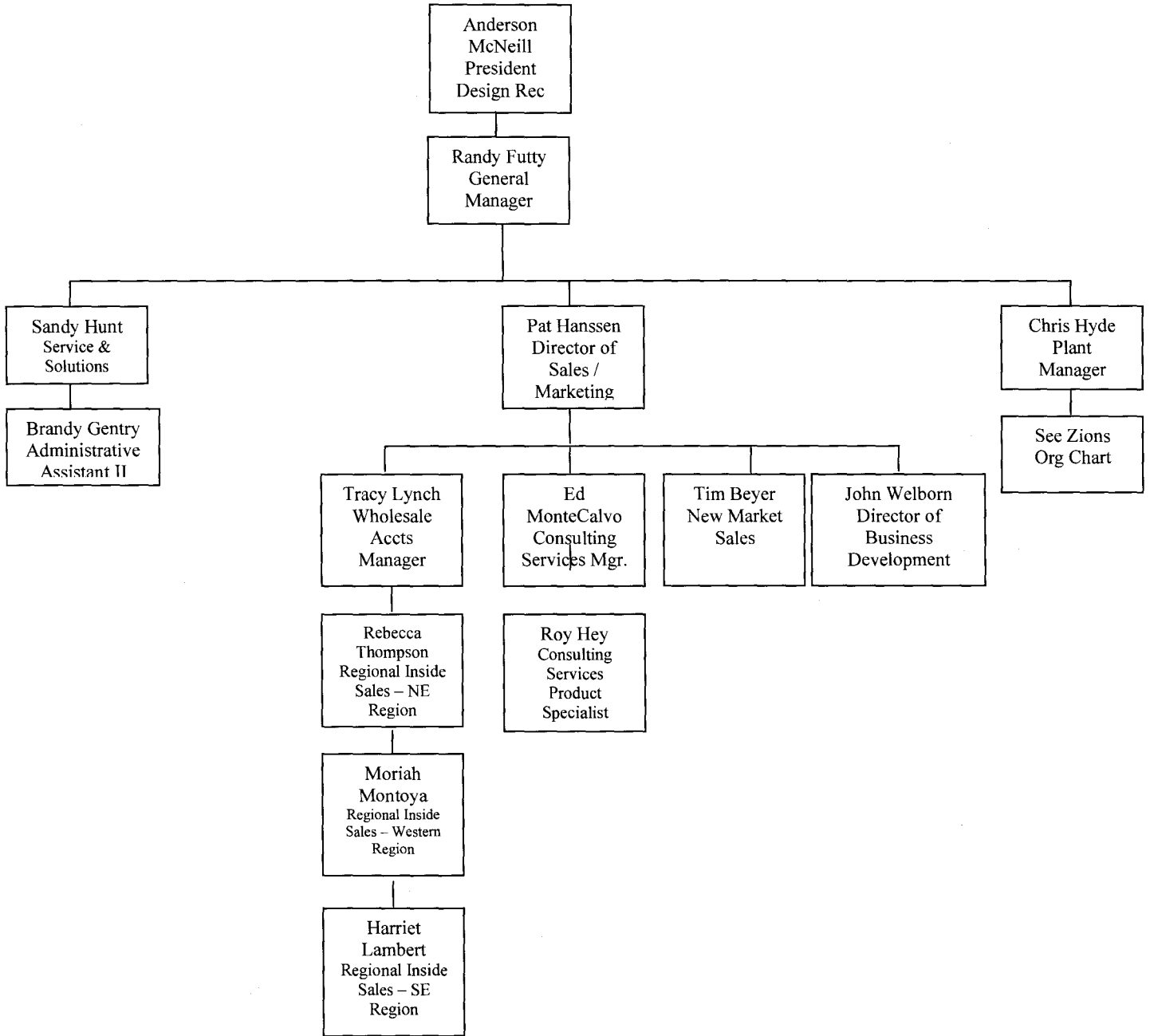


Exhibit 3 – Manufacturing Process for HTS Clay Aggregate Material

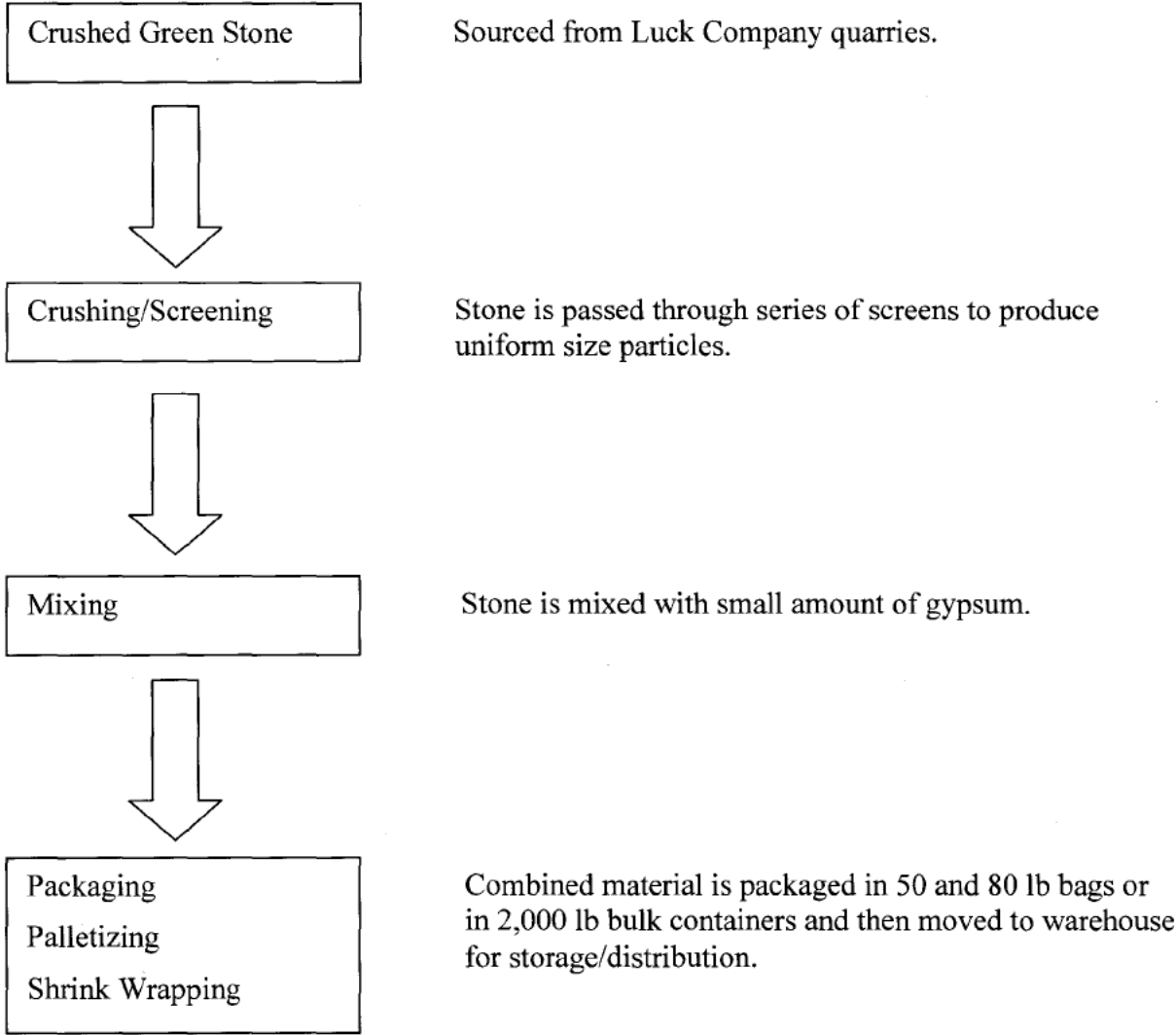


Exhibit 4A – HTS Net Sales Breakout by Division

2010 – Total Net Sales \$10m

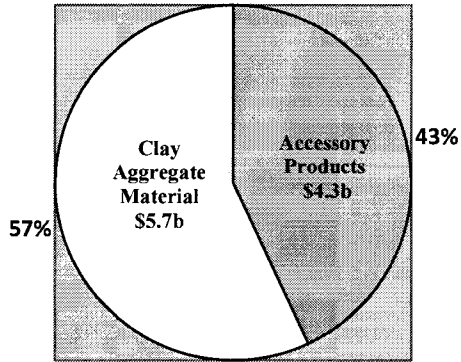


Exhibit 4B – Clay Aggregate Material Breakout by Package Type

2010 – Total Net Sales \$5.7b

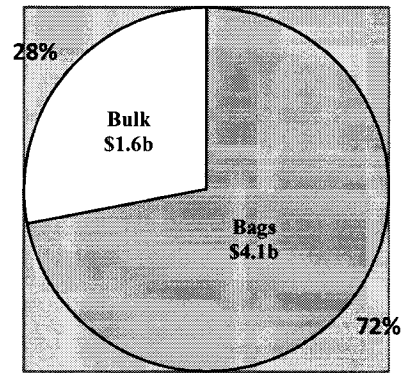


Exhibit 4C – Percent Breakout of Accessory Products

2010 – Total Net Sales \$4.3b

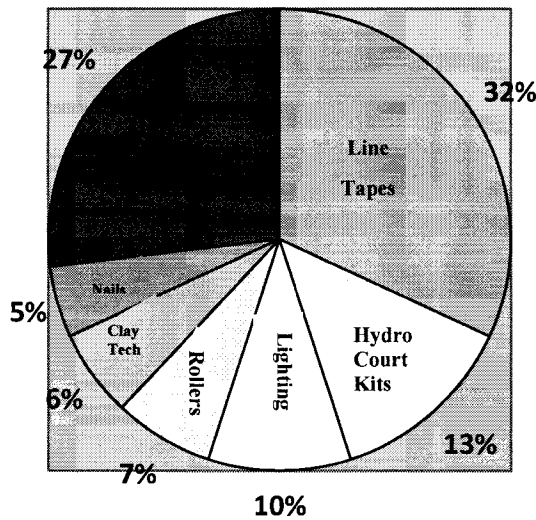


Exhibit 5 – HAR-TRU Sports Financial Performance

Fiscal 2000 – 2010 *

(\$ millions)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Net Sales	\$ 8.9	\$ 8.9	\$ 9.5	\$ 9.3	\$ 9.9	\$11.5	\$12.0	\$11.7	\$11.6	\$10.2	\$10.0
Total DCC**	\$0.22	\$(0.80)	\$1.10	\$1.22	\$1.07	\$1.33	\$ 1.16	\$ 0.91	\$ 1.13	\$ 1.89	\$ 1.36
Investment***	\$7.01	\$7.36	\$7.36	\$8.02	\$7.87	\$7.84	\$8.29	\$10.02	\$10.85	\$11.30	\$10.31
DROCE****	3.1%	10.9%	15.0%	15.2%	13.6%	17.0%	14.0%	9.1%	10.4%	16.7%	13.2%

* Fiscal Year ends on October 31.

** DCC = Direct Cash Contribution – Direct Cash Contribution is calculated by subtracting cost of goods sold and operating expenses from net sales and adding back depreciation.

*** Investment = Capital expenditures made; aggregated and depreciated on yearly basis.

**** DROCE = Direct Cash Return on Capital Investment = $\frac{\text{DCC}}{\text{Investment}}$

Exhibit 6 – Common Sized Income Statement for HAR-TRU Sports

Fiscal 2010 Actual Dollars

	Dollars	Percent
Net Sales	9,956,666	100
Cost of Goods Sold	5,270,650	52.9
Gross Profit	4,686,007	47.1
Operating Expenses	3,785,010*	38.0
Direct Operating Profit	816,807	8.2
Depreciation	543,816	5.5
Direct Cash Contribution	1,363,116	13.6

* Includes marketing expense of \$302,603.00
3% of net sales