

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GME - Q1 2013 Gamestop Corp. Earnings Conference Call

EVENT DATE/TIME: MAY 23, 2013 / 3:00PM GMT

OVERVIEW:

GME reported 1Q13 consolidated global sales of \$1.87b, consolidated global net earnings of \$54.6m and diluted EPS of \$0.46. Co. expects 2013 diluted EPS to be \$2.90-3.15 and 2Q13 diluted EPS to be \$0.01-0.07.



CORPORATE PARTICIPANTS

Paul Raines *GameStop Corp. - CEO*

Rob Lloyd *GameStop Corp. - CFO*

Tony Bartel *GameStop Corp. - President*

Mike Mauler *GameStop Corp. - EVP, International*

CONFERENCE CALL PARTICIPANTS

Arvind Bhatia *Sterne, Agee & Leach, Inc. - Analyst*

Mike Olson *Piper Jaffray & Co. - Analyst*

Seth Sigman *Credit Suisse - Analyst*

Edward Williams *BMO Capital Markets - Analyst*

Morley Sankar *Janney Capital Markets - Analyst*

David Magee *SunTrust Robinson Humphrey - Analyst*

Anthony Chukumba *BB&T Capital Markets - Analyst*

Bill Armstrong *CL King & Associates - Analyst*

PRESENTATION

Operator

Good morning and welcome to the GameStop Corporation's first-quarter 2013 earnings conference call. At the conclusion of the announcement, a question-and-answer session will be conducted electronically. (Operator Instructions).

I would like to remind you that this call is covered by the Safe Harbor disclosure contained in GameStop's public documents and is the property of GameStop. It is not for rebroadcast or used by any other party without the prior written consent of GameStop.

At this time, I would like to turn the call over to Paul Raines, Chief Executive Officer of GameStop Corporation. Please go ahead, sir.

Paul Raines - *GameStop Corp. - CEO*

Thank you, operator, and welcome to the first-quarter earnings call for GameStop. As we begin our call, as always, I want to thank our GameStop, EB Games, and Micromania associates around the world for their best-in-class customer service and expertise they provide to our customers.

As we prepare for the upcoming new console launches, we are privileged to define the hybrid retailer for the 21st century.

Joining me today on our call are Rob Lloyd, Chief Financial Officer; Tony Bartel, President; Mike Mauler, Executive Vice President of International; and Matt Hodges, our Vice President of Investor Relations. Mike Hogan, our Executive Vice President of Strategic Business, is out of the country and unable to join us today, but don't despair, we have all the details of his market model with us.

The first quarter played out as expected with sales impacted by a decline in store traffic, which is largely due to the fact we are entering the final phase of the current console cycle. This trend was partially offset by sales of preowned video games and our expanding new digital and mobile businesses. Ongoing strong execution and market share growth allowed us to maximize the console business, and margin expansion and cost controls continue to protect our profitability.



In prior quarters, we have outlined our strategy and provided six indicators of strength that are a hallmark of GameStop's business model. These factors support our future sustainability and include one, increased market share and gross margins; two, deep customer relationships; three, digital businesses; four, mobile and preowned businesses; five, real estate strength; and six, capital discipline. On all of these dimensions, the first quarter confirms that we are on track. We increased our market share again this quarter, and gross margins expanded 100 basis points. That means we have delivered over 400 basis points of margin expansion in four years.

Customer relationships are among the strongest in retail. PowerUp Rewards continues its march onward, reaching 24 million members in the United States and nearly 30 million worldwide. You will hear today how the digital businesses are a diverse portfolio, and they continue to grow well and provide added profitability to GameStop.

Mobile expanded, and preowned video games outgrew the category.

Our real estate portfolio, which we have prudently reduced in the past three years, continues to be among the most flexible and profitable in retail.

And our six indicator of strength is our capital discipline. We have increased our dividend twice since initiating it in early 2012 and are pleased that we have been able to reward our shareholders and expand our investor base through that action. Our buyback continues to be successful, and we bought back \$25 million against our \$400 million authorization this quarter.

As we have said on multiple occasions, we expect to deliver over \$2 billion of capital back to shareholders in the next four years through buybacks and dividends.

We are excited about the console launches arriving in the fall. It is now known publicly that our partners at Sony and Microsoft will be launching massively innovative consoles in time for holiday, and GameStop is right in the middle of that business opportunity. You will hear today that our market share is greater than it has ever been, we have a broader offering of physical and digital products to attach to consoles, and our international operations are far more integrated than ever before in our history. Our vendor relationships are stronger than ever, and GameStop is the defining retailer in the category.

As the category grows at double-digit rates in 2014 and beyond, investors can expect that GameStop will continue to drive great innovation and customer relationships.

With that, I will turn the call over to Rob Lloyd.

Rob Lloyd - GameStop Corp. - CFO

Thank you, Paul. Good morning. I'd like to begin this morning with some clarity around our capital allocation for the quarter. As we reported, we purchased just over 1 million shares at an average of \$25.07 for a total of \$25.5 million. These are the amounts we reported back in March.

We operated under a 10b51 plan throughout the quarter. There has been no change in our philosophy or our long-term intentions regarding share buybacks.

We have \$400 million remaining on our current authorization, and we still intend to return 100% of free cash flow to shareholders. Cash on the balance sheet is ample to continue buying back stock, and we have an unused \$400 million line of credit.

As a reminder, since we began our buyback program in January of 2010, we have repurchased 55 million shares or over 30% of our outstanding shares at an average price of \$20.56, totaling over \$1.1 billion.

Let me provide some color now on our first-quarter results. As we said going into the quarter, we expected the first half of fiscal 2013 to be challenging as this console cycle winds down. Consolidated global sales were \$1.87 billion, down 6.8% from last year with comps down 6.7%. Our revenue and comp results were in line with our expectations. Comps were down 6.9% in the US and down 6.3% internationally. We were pleased

with our sell-through of the new titles during the quarter and the growth in our mobile and digital businesses, but the decline in traffic was as we predicted and was felt the most in hardware sales. Our hardware sales declined 31%, in line with our expectations, while the US market declined 36%.

New software sales declined only 3.8% compared to a 14.2% decrease in the US market as we outperformed the market on the titles released during the quarter. Overall, we gained 470 basis points of new software share in the quarter.

Preowned sales during the quarter were down 7.5%. Our preowned business outperformed the overall videogame market, which was down over 19% in the US.

The other category increased 14.6% over the first quarter of last year due to growth in our mobile and digital businesses. Our digital business increased 47% over the first quarter of last year. Our digital receipts or non-GAAP revenue totaled \$174 million. GAAP digital revenues grew \$13.3 million to \$56 million. Tony will share some of our digital successes during this past quarter.

Our mobile revenues grew \$34.8 million to \$46.8 million from \$12 million in the first quarter of last year, growth of almost 300%. Our trade traffic continues to accelerate, and we continue the international rollout of stores selling re-commerce products.

Consolidated global net earnings were \$54.6 million, and diluted earnings per share for the quarter were \$0.46, \$0.03 ahead of the high end of our guidance range. The buybacks done during the quarter were completed before we gave guidance and, therefore, did not impact the beat.

Gross margins for the quarter were 31%, up 100 basis points from the prior year quarter with expansion resulting from sales shifting towards our digital and mobile businesses. Digital gross margin dollars grew 58.1% from \$24.7 million last year to \$39 million this quarter. The GAAP margin rate grew from 57.7% to 69.7% due to the growth of digital Game Informer magazine.

Mobile gross margin was 33.8% with gross profit of \$15.8 million, up from \$4.2 million in the first quarter of last year.

Total SG&A expense dollars increased 2% compared to the first quarter of 2012. SG&A increased as a percent of sales due primarily to the decline in revenues. Some of this is also due to timing between the quarters of this year. We continue to focus on controlling costs, and we expect full-year SG&A expense to be flat with fiscal 2012.

Depreciation and amortization was about 6% less than last year.

We ended the quarter with 6,544 stores. We opened nine and closed 105 in the US and opened six and closed 12 internationally. During the quarter, we also completed the acquisition of 44 former game stores in France. Mike Mauler will have more details on this.

Inventory was down slightly, while our AP leverage declined. Within the inventory, we had an increase of 8% in our preowned and recommerce inventory which carry no payables and, therefore, affect our AP leverage.

In addition, Wii U inventory is moving more slowly than anticipated. The timing of new release software also affects our AP leverage, and we are confident we will return to more normalized levels as we move through the year.

As we indicated in the earnings release, our Board of Directors authorized a dividend of \$0.275 per share for this quarter to be paid on June 19.

Now for the second-quarter outlook. We forecast same-store sales to range from down 16% to down 12.5%. Remember that several strong titles released during the second quarter of last year, including Max Payne 3, Diablo III, and Ghost Recon. With very little to compare to that this quarter, we expect diluted earnings per share to range from \$0.01 to \$0.07.

More importantly, we are increasing the lower end of our full-year comparable store sales guidance to now range from negative 5% to positive 1.5%. This reflects the top-line results of the first quarter in the middle of our range and the guidance for the second quarter.

We're also bringing up the bottom of the range of our previously-announced full-year 2013 earnings-per-share guidance. You will recall that our range was \$2.75 to \$3.15, and that the low end of the range assumed one new console. As we now know, there will be two consoles, and given the results of the first quarter, our new range is \$2.90 to \$3.15.

We are still making several important assumptions about each console launch within the guidance because we don't have specific launch dates, quantities, prices, or available software.

The second-quarter EPS guidance fits within this new range. Earnings guidance does not include the effect of additional buybacks.

Now I like to discuss the console gaming market model we introduced in March. If you will recall, Mike Hogan, our EVP of Strategy and Brand Development, introduced the market model on our year-end earnings call. Since sharing the market model on that call, we have been asked to provide more granularity on our assumptions. Today I will discuss some of the methodology behind the model.

Our market model represents a forecast of the North American new console gaming category from 2013 through 2015. Console gaming includes console hardware, console software, and console digital. The primary inputs were developed from top-tier external research, information from videogame publishers and console manufacturers, and our own internal data. External data comes from a total of over 20 sources, including analysts, DFC, NPD, IDG, EA, Activision and many others.

The primary factors driving the model include available new console inventory from launch through 2015; price points; hardware adoption rates relative to the last cycle; software attach rates based on current trends in the last cycle; historical growth curves for console launches; digital content availability, attach rates, and subscription; and projections of future sales of existing consoles.

The primary questions we've been getting surround assumed sell-through, pricing, adoption rates, and software attach rates. Here are some details on these factors.

Inventory. Currently we do not have definitive launch quantities for either system. However, in the model, we've assumed that quantities will be similar to those brought to market in the last console cycle launch.

Price point. We believe that the NextGen systems will have a lower opening price point than they did last cycle, but do not have any specifics to share.

Adoption rate. We know that the growth rates and tie ratios for previous launches and have used those to create model assumptions for the new cycle. During the first full year in the market, Xbox 360 hardware and software sales grew over 60%, and PlayStation 3 hardware and software increased around 30%. The tie ratio of software to hardware in the first full year of sales of the Xbox 360 and the PlayStation 3 was approximately 5 to 1. Current factors were then considered such as consumer interest and purchase intent gathered from ongoing survey work in our first-to-know list for the PlayStation 4 and the newly-created first-to-know list for Xbox 1. All elements were combined to estimate an adoption rate and a tie ratio for the NextGen consoles. The model assumes that adoption rates will range from 80% to 85% of the past cycle and that the attach rate will be approximately 80% of the past cycle.

When we roll all of this information into the model, the numbers indicate 2013 will decline versus 2012, but then in 2014 the launches gain traction, and the category returns to very healthy growth, which extends into 2015.

Our model is a market model and does not include any factors relating to marketshare gains we've made since 2005 and 2006. GameStop's hardware and software market share have increased dramatically in the past few years, particularly in PlayStation 3 and Xbox 360. We've driven this marketshare through building loyalty programs with nearly 24 million members in the US and nearly 30 million total globally and by developing our relationships and marketing programs with our publisher and console partners. These factors give us great confidence in our ability to take advantage of growth in the next console cycle.



The other area in which we've been getting investor questions has to do with the outlook for the preowned business in a new console cycle. The primary question is whether we expect the preowned category to grow during the beginning of a new cycle.

We believe there are three factors to consider. First, the introduction of a new console tends to stimulate increased trading as consumers upgrade both their systems and games to the new generation. For example, the Xbox 360 and PS3 were for the most part not backward-compatible. This drove a new cycle of trades. In 2007 the first full year following the introduction of these new consoles, GameStop's preowned business grew over 20%, and in 2008 it grew over 27%.

The second factor is the continued growth of prior generation consoles. History shows that the introduction of a new console is far from the end for the old console. The previous version becomes a value offering and can continue to grow for years.

For example, the PlayStation 3 was introduced in late 2006. At the time, based on NPD figures for the US, the PlayStation 2 installed base was roughly 35 million units. Over the next five years, the PlayStation 2 installed base grew over 30% to nearly 46 million units.

And software for the prior-generation consoles will continue to grow as well. In units, PlayStation 2's software continued to outsell PlayStation 3 software for two years after the PS3 launch. In the same way, we expect the PS3 and 360 to continue to grow, and that, plus the preowned business on the new consoles, will continue to drive preowned.

The third factor is the impact of new software growth on preowned software growth. We know from history that preowned inventory and, therefore, growth tends to lag new software sales. This point is illustrated in a sell-side analysis published in September of 2012. The analysis looked at sales of preowned games relative to the sales of new software. The regression model compared trailing 12-month sales of preowned HD software for Xbox 360 and PlayStation 3 as a function of trailing 12-month sales for new HD software with a 90-day lag. The model accurately predicted preowned HD software sales with a correlation better than 90%.

In summary, historical trends suggest that preowned will benefit significantly from the growth sparked by the new console launches.

Now, I'll turn it over to Tony for his comments.

Tony Bartel - GameStop Corp. - President

Thanks, Rob. This morning I'm going to update you on our digital and mobile growth, as well as share our perspective on the upcoming console launches.

Now that both new consoles have been confirmed for a holiday launch, we can provide more detail on how we are going to maximize the transition to the next generation of gaming. But, first, I will discuss our results.

We are pleased with our digital growth as it continued its strong trend, growing 47.3% over Q1 of last year. Consult digital grew 44%, and PC digital grew 54%. Domestic digital growth was 40%, and international growth was 78%. We are reiterating our 2013 annual digital growth projections of between 25% and 35%.

Today, nearly every significant new videogame is launching with day and date DLC, and our sales associates are doing a great job of pre-selling this content and selling it on the day of launch. A great example is Take-Two's BioShock Infinite where we attached 34% of the 1999 season pass on launch day and drove our average BioShock Infinite ticket to the highest levels that we have ever seen on a launch title.

Our launch plans continue to evolve, and we are now marketing not only DLC but also several new game-related items at the time of launch. Most of these items are in stock and in our stores, but we're also offering items that are centrally located and delivered via our Web-In-Store process. We call this approach franchise marketing. And we are working closely with our publishing partners to ensure that gamers have a full menu of purchase options at each launch beyond just the game and related DLC.



Our PC digital download sales grew 155% in Q1, and we completed our global rollout of our ability to fund steam wallets in all of our stores. Also, Game Informer has now reached 3.3 million digital subscribers.

Kongregate revenues increased 57% over the prior-year quarter, driven by games within game transactions. Kongregate's move into mobile game publishing is off to a good start. Their first published game, Tyrant Unleashed from Synapse Games, is launching in August on both the iOS and Android platforms. Our \$10 million mobile game development fund is generating significant interest, and we will be publishing Mobile Games Monthly after Tyrant's launch.

Our mobile segment had another strong quarter with revenues growing 290% over Q1 to \$47 million at a margin rate of 33.8%. We are on track to achieve our annual guidance of 30% to 40% growth over 2012.

We are leveraging our buy-sell trade model in all US stores and in over 1000 international stores to launch new tablets. And we recently launched new offerings from ASUS and [Suffix].

On preowned consumer electronic devices, our trades continue to grow, and they now represent 8% of all items traded in during the quarter. This is providing us a strong inventory to continue our rapid growth. We are now accepting 560 SKUs for trade as we added Samsung, HTC and Blackberry devices to our trade-in program. And these devices now represent nearly one-third of the total trade-ins of smartphone devices.

Looking forward, we are excited to be in the new console era. The groundwork that we have laid with our publishing partners to deliver global, unique, exclusive content marketed at the critical time of launch by our knowledgeable associates and supported through our various loyalty programs around the world is paying off. Our market share on PS3 and Xbox 360 software is at the record level of 48% for the first quarter of our fiscal year, so we are well-poised for the launch of the new consoles and related software and DLC.

We are also partnering very closely with both Sony and Microsoft to ensure a seamless transition to the next generation. We will be working with all of our platform holder and publishing partners to announce strong trade-in deals, and we will leverage our PowerUp Rewards programs to help customers gain access to and afford the new consoles and games.

Even this far out, there's already strong consumer demand for these consoles. There's a lot of enthusiasm building for the new consoles, and we currently have more than 1.2 million PowerUp Rewards customers who have signed up for the PS4 first-to-know list, and nearly 250,000 PowerUp Reward members have already signed up for the Xbox 1 first-to-know list since the reveal event. We expect to add many more to these lists in the coming weeks as additional information is unveiled.

As we look to enter the new console cycle, we are confident that we are well-positioned to usher in the exciting new era. From the collaborative partnerships that we have with publishers and platform holders to our strong marketshare driven by PowerUp Rewards and our unparalleled franchise marketing efforts, GameStop is poised to reap the benefits of this tremendous innovation.

While our buy-sell trade model will make us the most affordable place to purchase a new console, our knowledgeable and talented associates will distinguish us from our competition and foster the education and enthusiasm to drive a successful launch.

With that, I will turn the call over to Mike Mauler.

Mike Mauler - GameStop Corp. - EVP, International

Thanks, Tony. Good morning, everyone. In the first quarter, our international same-store sales declined 6.3%, but the results varied by segment with our top-performing segments being Australia and New Zealand, which significantly outperformed the other markets with an 8%'s same-store sales increase and a \$3 million improvement to operating earnings versus prior year. The decline in overall sales was partially offset by a 120-point increase in gross margin percent driven by a 300 basis point improvement in pre-owned margins and continued advancements in our globally-integrated vendor relationships.



GameStop's global merchandising teams, in cooperation with our publishing partners, are now developing franchise marketing plans and exclusive content on key new releases as much as 12 months in advance of the product launches. These stronger and better-coordinated relationships help us bring customers more global exclusives and neat content on new releases than ever before, resulting in improved margins and greater sales on key titles.

Compelling examples include Q1's Gears of War Judgment exclusive market skin from Microsoft and the upcoming Assassin's Creed Black Flag Buccaneer Edition. These exciting offerings are what our customers have come to expect from GameStop.

This global collaboration is also playing a significant role in working with Sony and Microsoft well in advance of the next generation of consoles as we develop powerful launch promotions and rapidly expand our reservation and first-to-know list for the PS4 and Xbox 1.

In the fourth quarter, our investments in technology and improved vendor collaboration increased international digital sales 80% versus Q1 2012 with constant currency. This was driven by strong growth in console DLC, a global partnership with Steam now selling Steam Wallet in all markets, and the initiation of digital Game Informer subscription sales in Italy, Spain, Scandinavia, Germany and Austria.

International e-commerce sales realized their ninth consecutive quarter of double-digit growth and in the first quarter grew 33% over 2012 as we continue to expand our multi-channel sales through improved integration with our stores, investments in technology, and the continued rollout of our loyalty program to new markets.

After launching loyalty programs in Italy, Germany, and Austria in December, we have added over 500,000 members in the first four months. Also, we continue to add new members at a rapid pace in Australia where just recently we added our 2 millionth customer to EB World, which is over 8% of the country's population.

Whether the program is called PowerUp Rewards in the US, MegaCart in France, EB World in Australia, our GameStop+ in Spain, Italy and Germany, GameStop's customer-centric loyalty program is one of the most powerful tools for us to engage the 30 million members worldwide in our multi-channel ecosystem of products and services. This will play a critical role in the success of the next console cycle.

Our focus on expanding new businesses also continued to pay dividends in the first quarter where we realized strong growth in handsets, accessories, and our mobile business. The international mobile category increased Q1 sales 400% versus 2012.

Finally, in the first quarter, we completed the acquisition of 44 stores from our former 165 store competitor, Game, in France, increasing our market share and reducing overall specialty retail square footage in the market by 21%. All 44 stores were rebranded and back up and running in one week and have been exceeding their performance targets.

The significance worldwide transferred transformation of GameStop since the last console launch can be seen in so many areas -- dominant market share in 13 countries; 30 million worldwide loyalty members; strong and growing e-commerce businesses in all major markets; fully-implemented preowned businesses in all markets; and globally-coordinated vendor relationships. These strengths make GameStop well poised to make the upcoming console launches a tremendous success.

And now I will turn it over to Paul for his comments.

Paul Raines - GameStop Corp. - CEO

I believe we are ready for questions, operator.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Arvind Bhatia, Sterne, Agee.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Congratulations on a good quarter.

Paul Raines - *GameStop Corp. - CEO*

Thanks, Arvind.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

I wanted to ask a question on mobile. You are maintaining your full-year guidance, but your first quarter came in stronger it looks like everywhere. Just wondered if you could maybe provide some more color on what is happening on mobile and the incremental success that you might be seeing there?

Paul Raines - *GameStop Corp. - CEO*

Let me say one thing about it, and then Tony could probably take it.

I think that what is interesting, Arvind, as you know, for many years, we have been in the buy-sell-trade business on video games. And we have said for years that, in spite of all our work on marketing and so forth, there's only about 40% trade awareness in consumers. And so every day our biggest mission on buy-sell-trade is to create awareness.

I think what you're starting to see now is this mobile business, which was unknown to us a year and a half ago, is starting to resonate with consumers, and it's a great solution for disposing of your electronic devices.

Tony, do you want to add something to that?

Tony Bartel - *GameStop Corp. - President*

Sure. The only thing that I would add is clearly we were rolling out in Q1 of last year, which is why we had such a significant increase in the first quarter. But we do continue to expect it to be a strong growth driver, and we are confirming our 30% to 40% target, which is a very strong growth for the back half of the year.

Paul Raines - *GameStop Corp. - CEO*

And you know the outlook for launches of electronics, smartphones and tablets for the rest of this year is very, very exciting. The problem is, it's a little unknown when those dates will be and so forth, but we are positioned really to gain a lot of traction with that.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

I want to tie that back into your new console launches. And I think, Tony, you talked about subsidizing these new consoles with trade-in, et cetera. Maybe tie that into the mobile strategy and how maybe you are working with Sony and Microsoft on some of the programs there.

Tony Bartel - *GameStop Corp. - President*

Absolutely. Well, that's absolutely true that we are working with both Microsoft and Sony to make these consoles most affordable. And as I've shared, we will be the retailer where these new consoles and the new games that come along with them will be the most affordable because of our buy-sell-trade strategy.

Just to remind everyone, we have over \$1 billion worth of trade credits that come in every single year. 70% of those get applied back into new games. And just to put that into perspective, about 17% of all new games and digital content that is sold at GameStop is funded by trade credits. So these are an incredible source of funding of currency that helps to sell new games, and that is why you see our market share go up 470 basis points -- that, combined with the loyalty program, as well.

In addition to the \$1 billion of trade credits that we get from games, we also now are starting to generate over \$100 million of trade credits that comes in from these mobile devices or from tablets and MP3 players and smartphones. That's a whole other source of currency that we have unlocked just as we are coming into this new generation.

Paul Raines - *GameStop Corp. - CEO*

The interesting thing, Arvind, and you know this, because you followed us quite a bit, but I think we have said on a couple of calls ago, there are 24 million consoles in our PowerUp Rewards members' homes in the United States. So if you think about those 24 million consoles and you can model a trade price on those -- whatever trade price you want to put on them, \$50, \$70, \$100 -- if you model that, you see that the amount of trade currency that Tony is talking about is far bigger than anybody's marketing budget.

Tony Bartel - *GameStop Corp. - President*

Right.

Paul Raines - *GameStop Corp. - CEO*

So the question we always put out to publishers and manufacturers and console makers, and now smartphone and tablet manufactures is, how much of that trade currency do you want for your device? Because if you will support it in all kinds of different ways, we can activate that currency.

So it's pretty exciting to think about a console launch. There's never been this much trade currency available.

Tony Bartel - *GameStop Corp. - President*

And so we are working very closely with not only the platform holders, but all the publishers as well to make sure that there is a seamless transfer to the next generation.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Great. Thanks, guys, and good luck.

Tony Bartel - *GameStop Corp. - President*

Thank you.

Operator

Mike Olson, Piper Jaffray.

Mike Olson - *Piper Jaffray & Co. - Analyst*

Somewhat along those lines, is there anything you can tell us about how you anticipate buying, selling, and playing used games will or will not change with the Xbox 1?

Maybe said another way, at this point, do you anticipate a change in how gamers will be able to interact with used games on the Xbox 1 versus how gamers are able to buy, sell, and play used games today?

Paul Raines - *GameStop Corp. - CEO*

Yes, Tony can answer that.

Tony Bartel - *GameStop Corp. - President*

Mike, I figured that question would come up. Definitely Xbox has said that they do support the trade-in resale games at retail and that they want to handle communication from this point forward on that.

I think what's important to note is that all three of the platforms that have launched, all three of the consoles that were launched have now come back and they say, I realize the value of the buy-sell-trade model, and they have built that into their new consoles moving forward.

So we anticipate that we are going to be able to leverage that likely leverage it on the consoles today, to make not only those consoles but the new games, the new DLC, all these other ancillary products that we sell, more affordable by running the buy-sell-trading model in the future.

Paul Raines - *GameStop Corp. - CEO*

Here ahead of E3, Mike, it's a tight communications process, but what's exciting to us is we are a different Company than we were on the last console launch. And our ability to bring that \$1 billion of trade credits in in lots and lots of new and unique ways is pretty compelling.

Tony Bartel - *GameStop Corp. - President*

Clearly platform holders understand the value of that \$1 billion-plus worth of trade credits, and they have enabled that in all three of the new platforms that have launched.

Paul Raines - *GameStop Corp. - CEO*

But other than that, Microsoft owns communication.

Mike Olson - *Piper Jaffray & Co. - Analyst*

Okay. That's helpful. And if I might sneak in one more, you gave some interesting data on how the used market will continue to grow as we move through the NextGen transition. And along those lines, you are probably approaching, I guess, a tidal wave of used hardware and software coming later this year as gamers sell used to apply to NextGen. Logistically, how do you guys deal with that? Is there an uptick in expenses related to this as far as increasing headcount or other resources that you need, or what's been your experience in the past with these cycles?

Paul Raines - *GameStop Corp. - CEO*

Rob will give you some inventory remarks on that, but I will tell you, we like the word tidal wave of inventory, right, Tony? It seems to be a good word?

Tony Bartel - *GameStop Corp. - President*

Yes, we have a very flexible labor model to deal with that.

Paul Raines - *GameStop Corp. - CEO*

Yes, we have, Mike, and I think you've been there, I'm not sure. We have a 200,000-square-foot facility here in Grapevine. It's very -- we are very different on this. We have over 1000 employees who work in our refurbishment. It's a very high-tech center, so we have a lot of capacity to process and refurbish technology products, and that's one of the things that makes us unique.

But Rob, you want to talk about inventory and how you see it and expenses around this?

Rob Lloyd - *GameStop Corp. - CFO*

Sure. As Paul said, we've got the refurb capability to deal with this. We've been through a couple of console cycles with some pretty extensive refurb capacity, so we are used to that. As Tony said, we've got a flexible model in the store to deal with it. So we are anxious for those days to get here, frankly.

Paul Raines - *GameStop Corp. - CEO*

Rob shared with you some pretty compelling data. The inventory growth that this console cycle will bring -- the fact that it correlates highly, it creates awareness between new software and pre-owned. And this is all in our DNA, and we've done it many times before. So it's an exciting -- it's a nice opportunity. And there are no other retailers on the planet who are prepared for this kind of opportunity.

Mike Olson - *Piper Jaffray & Co. - Analyst*

All right. Thank you.

Tony Bartel - *GameStop Corp. - President*

Thanks, Mike.



Operator

Seth Sigman, Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

First, a question on the Wii U. Paul, there are some quotes out there from you today saying basically lets not write these guys off just yet. I mean what are your updated thoughts on the Wii U? Is there anything in the pipeline that you think will really start to stimulate demand for that console?

Paul Raines - *GameStop Corp. - CEO*

Yes, thanks, Seth. I think what I've said about Wii U is there is a tendency in the business to move on to the next hot thing, and we certainly seem to have a wealth of hot things coming. But my point here is there is a very large installed base of Nintendo consumers and gamers out there. We know them very well. We see their transactions in store every day. And while the Wii U has tailed off, as we've said on previous calls, I still play Mario, and there's still activity around him. I believe our partners at Nintendo have lots of innovation and creative content that will be coming in the future in the market.

Other than that, I have to let them handle that. But my point on that is that Nintendo is a very successful franchise. And I think a lot of the folks who want to write them off, right, Tony, it's really not going away any time soon.

Tony Bartel - *GameStop Corp. - President*

I see that they are going -- I'm sure that they are going to come out with their powerful IP. I have no doubt. They haven't announced a lot of that, but there's no doubt that they will.

I also know that there is an awareness opportunity to talk about the very unique and innovative game plan on the game pad. So those two things I'm sure will happen later on this year if Nintendo does what they do so well.

Seth Sigman - *Credit Suisse - Analyst*

Got it. Okay. And Rob, on the full-year guidance, you took up the low end by \$0.15. Can you just elaborate on what the assumptions were that may have changed at the low end?

Rob Lloyd - *GameStop Corp. - CFO*

Well, primarily it is the results of the first quarter. So some beat of the \$0.46 over what we gave is a first-quarter low end, and then it's firm knowledge around the second console.

Going into the release back in March, obviously, as a partner to Microsoft, we had some information that we weren't able to share. And so we had to provide the wide range that we did with knowledge of the one console that was out there. And then the high end of the range, obviously, we talked about if there is a second than the \$3.15.

So that's really it. It is the results from Q1 and the certain knowledge that a second console is coming.



Seth Sigman - *Credit Suisse - Analyst*

Got it. Okay. And one more for you, Rob, a question on SG&A. It looks like it was a little bit higher this quarter, up \$9 million versus last year, despite lower sales and fewer stores. I mean what drove that increase? And I know you are planning for flat for the year, but can you maybe walk us through how you get there? Thanks.

Rob Lloyd - *GameStop Corp. - CFO*

The timing of expenses throughout the year can vary from year to year and the timing of marketing programs and things like that. So there really isn't too much to be read into that. I think the guidance that we gave that we expect it to be flat year over year is what you should rely on as you're working your models.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thanks and good luck.

Paul Raines - *GameStop Corp. - CEO*

Thanks, Seth.

Operator

Edward Williams, BMO Capital Markets.

Edward Williams - *BMO Capital Markets - Analyst*

A couple of questions. Mike, if we can go into the international markets in a little bit of detail. What I am curious about is the differences that you are really seeing with regards to the adoption of used now and digital. You articulated some of it in your prepared remarks, but if you can go a little bit deeper into how that shopper is engaging with GameStop's products on the digital side, as well as on the used side?

Paul Raines - *GameStop Corp. - CEO*

Ready, Mike?

Mike Mauler - *GameStop Corp. - EVP, International*

Okay, sure. Yes, I think we are starting to see, we've talked on a few other calls that in some of the major initiatives rolling it out internationally for complexity and other reasons followed the US by about six months. And so I think we are really starting to see that pick up now with consumers are internationally engaged with digital. I think the implementation of our loyalty programs as that rolls out helps with that.

So we saw in digital sales increase in the first quarter, like I said, 80%, and we are just rolling out Steam Wallet now where we had that in the US last year. So there's a variety of initiatives that are driving those high numbers.

From a used perspective, you know, Paul mentioned refurbishment. At the beginning of the last console cycle, our refurbishment capabilities internationally were very, very limited. And now you can see in the markets the capabilities are really the same in the US. And that has driven the margin improvements so that now US used margin -- or excuse me, international used margin is very similar to the US. We've got the refurbishment capabilities, and the penetration is very similar, as well. So we are in a much different place than we were six, seven years ago.



Paul Raines - *GameStop Corp. - CEO*

I think, Ed, if you listen to our remarks, we have been trying to signal that we are more globally integrated than in previous cycles. And the reason we like making that point is a lot of hard work has gone on around the world, both here and around the world, to take the innovation we've created here and roll it out or learn from the innovation in the international markets and bring it here. And I think the international team here gets a lot of credit with our technology and merchandising teams here for that. There is no other retailer, I think. Maybe the food guys, but I don't know of another retailer that has leveraged best practices in the way that we are doing. And, of course, the macro issues around the cycle have masked it, but the fact that Mike and I can go to -- we were in Italy in February, and we can see digital content represented in a way that is similar to what we do in the US. And we can go to our publishers and negotiate global exclusives around BioShock -- it's very powerful for us. And I think that as you think about the next cycle, it's really an interesting thing of what we can leverage.

By the way, digital content sounds cooler in Italy -- [continue digitale] sounds better, right, than digital content. But it exists around the world at GameStop. And I think it is an unusual situation that we're in where we can leverage those practices.

Mike Mauler - *GameStop Corp. - EVP, International*

You know, Australia is a great example of that where they follow the US by about a year on their loyalty program, and within a year and a few months, they managed to sign up 2 million customers that are just as passionate as the customers here and just into digital and just into buying recommerce. And that is 8% of the Australian population. And as we continue to roll out these programs, we will see similar results, I think, in some of the other markets.

Edward Williams - *BMO Capital Markets - Analyst*

Okay. Great. Thank you.

Operator

Tony Wible, Janney Capital Markets.

Morley Sankar - *Janney Capital Markets - Analyst*

It is actually Morley Sankar in for Tony. I had two questions, one that is going back to the Xbox 1 review and one on used.

In terms of the Xbox, it raised obviously a number of questions on what they are planning in terms of daily Internet connection and the scenarios on how they support used. And you've made some comments on that as well already. And I was wondering whether you had had a chance to see any of the early reactions from some of your customers on these controversial points and how you think those will impact the cycle and GameStop?

Paul Raines - *GameStop Corp. - CEO*

Thank you. That is obviously lots of excitement, right? Tony could tell you the excitement around the first-to-know is awesome. Other than excitement and commentary from the community, we get lots of commentary, but really we have to let our partners lead on that, right, Tony?

Tony Bartel - GameStop Corp. - President

Sure. Microsoft is leading the publication. There are lots of rumors out there. I think the most important factor is that nearly 250,000 people have just signed up within not even 48 hours for the first-to-know list. So I think there's tremendous demand. And I have no doubt that we're obviously going to -- we already have millions on these lists. And I have no doubt that they are just going to continue to grow.

I, for one, am very interested in what they are going to say at E3 because I think that the gaming-centric portion of the Xbox 1 is going to be released.

Paul Raines - GameStop Corp. - CEO

The cool thing for us is that we are an advocate for the gaming community. We've got 30 million gamers around the world who are connected to us in a real tangible way, and we are all about gaming. The Xbox 1 is massively innovative. It's good to be exciting. So we are excited about it.

Tony Bartel - GameStop Corp. - President

And just for instance, we announced our PowerUp Rewards customers before they even knew about the PS4 and the Xbox 1. We said, what interest level do you have in purchasing? Over 50% of these people said, I want to buy one without even knowing what was out there. So we anticipate that there will be tremendous consumer demand as more and more details are available.

Paul Raines - GameStop Corp. - CEO

Yes, I think it is going to be an exciting process.

Morley Sankar - Janney Capital Markets - Analyst

Great. And just following up on used, obviously that's been a huge driver for the success at GameStop. Are you concerned about new or, I guess, recurring entrants into that space, and I'm particularly talking about Best Buy who seemed to hint that they would enter into things like refurbishment, as well as part of their new strategy under their new CEO?

Paul Raines - GameStop Corp. - CEO

Yes, we followed those announcements of our competitors. It's very interesting. This is not the first time we faced competitors in the buy-sell-trade business. I mean I can remember many, many announcements before in a variety of ways and formats and approaches.

I think the point that I made on a few calls ago was that there is a few things about this business you have to understand. A), it is far more complex than anyone understands; B), GameStop is a far more challenging competitor than we get credit for.

So I would say we follow events closely. We are continuously investing in buy-sell-trade, all the barriers to entry like pawnshop laws, and we are building our ecosystem bigger than it has ever been. So we are clear that we have to earn the right with our consumers every day, but we have a massive advantage in this business that people will see.

Morley Sankar - Janney Capital Markets - Analyst

Great. Thank you.

Operator

David Magee, SunTrust.

David Magee - *SunTrust Robinson Humphrey - Analyst*

A couple of questions. One, the figure you had referenced earlier about the adoption rate that you anticipate for the new consoles, you said 80% to 85%. I'm curious what period of time are you thinking about there?

Paul Raines - *GameStop Corp. - CEO*

Rob?

Rob Lloyd - *GameStop Corp. - CFO*

Well, that would be during that 2014, 2015 -- well, late 2013, 2014, 2015 timeframe.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Okay. And then on the used business, what is your assumption that you baked in as far as the margins over the balance of the year?

Rob Lloyd - *GameStop Corp. - CFO*

Pre-owned videogame business, so not talking about the recommerced side of the mobile business, you can expect that to continue in the range of the 46% to 49% that we've talked about for a year now.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Okay. Then lastly, given the growth that you are anticipating with the business sector over the next few years, does that warrant any more stores domestically to handle that business?

Paul Raines - *GameStop Corp. - CEO*

That is a big question, David, we debate around here a lot. I think real estate -- we've called out real estate strength as one of our great strengths. We're very fortunate. Our founders built a Company that was extremely flexible, and I think they did that because they had seen inflexible real estate in the past. So we've said before, we have huge flexibility in our real estate.

One of the big debates we have around here is, how much business can we do in these stores in a new console cycle? On the one hand, PowerUp Rewards has allowed us to consolidate in a very unique way, and we've shared that with you -- 40% to 60% of the transfers gets you 20% to 30% store contribution growth. So we can continue to do that, and we can continue to consolidate.

We are also selling digital content and mobile content that doesn't require as much space. At the same time, we want to maintain our dominance. So I think the question around real estate, we will stick with our guidance of a net 2% decline, but we are looking hard at real estate.

We are also looking hard at different formats. It's not clear that we require the same kind of format in the future, so we are always experimenting and testing new ideas.

Rob, do you want to talk about real estate a little bit?

Rob Lloyd - *GameStop Corp. - CFO*

Just to say that we continue to remain focused on what the appropriate size of our real estate portfolio is and making sure that we are maximizing the profitability coming out of that. We think we are in great shape for the console launches. We have been able to continue to increase market share. But one of the questions that we have when we look at closing stores is, how much of that share we are willing to give up? Obviously, net-net, we've gained share during the past three years, and we've closed over 500 stores, I think it is. So we continue to remain focused on it and will in the future.

Paul Raines - *GameStop Corp. - CEO*

One thing we should discuss, guys, I'm not sure we've given it enough time, and I will let Tony take you through it. But we have created something we call Web-in-store. And I know a lot of retailers have Web-in-store, but the really unique thing we have is our stores are small. Our service level is very high, and our gaming consumer really likes the related merchandise.

But Tony, why don't you share some thoughts on Web-in-store, because that's another factor in this, David, in terms of how many stores?

Tony Bartel - *GameStop Corp. - President*

Sure. The beauty of Web-In-Store is that we don't have that inventory in our store, but we actually either have it centralized or, in many cases, we actually just drop shipment from another vendor and never actually take possession of it.

So what we are learning to do is being able, like I talked about in the franchise marketing effort, is we can market things that are too big for our stores, that are very unique. It helps our inventory position because we don't have to send it out in the US to 4400 stores. We can keep it centrally located, and we can get it to the customer very, very quickly.

So our associates are incredible salespeople, and now they have a whole another weapon at their disposal. We can represent it in our stores, but then deliver it to the customer. It also helps from an inventory perspective if we are light on inventory, particularly, say, in our preowned segment where we have, let's say, that we have a game that's really hot in the preowned segment, it allows us to be able to keep that centrally and deliver it to the customers who want it on a store-by-store basis.

Paul Raines - *GameStop Corp. - CEO*

And Mike is working on figuring out how to do that around the world. And I think this time next year, we are going to be talking a lot about Web-in-store.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Great. Thanks, guys, and good luck.

Paul Raines - *GameStop Corp. - CEO*

Thank you, David.



Tony Bartel - GameStop Corp. - President

Thanks, David.

Operator

And we have time for two more questions. Anthony Chukumba, BB&T Capital Markets.

Anthony Chukumba - BB&T Capital Markets - Analyst

I had two questions on the Xbox 1. I will just start with my first one. It seems like just based on the reveal that Microsoft is really envisioning it as more than just a gaming console, but also like call it a living room entertainment hub. How do you think about that as an opportunity or maybe potentially a threat for GameStop, given the fact that they are emphasizing more of the living room integration features?

Paul Raines - GameStop Corp. - CEO

Anthony, I will start this off, and the guys can kick in.

First of all, I would say for GameStop, we don't look at anything as a threat. Everything is an opportunity. We've been told there are so many threats in our lives in the past few years, I think we would be -- if we worried about threats, we would be in trouble. We turn everything into an opportunity.

So one thing I will say on the Xbox 1 -- and I will let these guys add to that -- is we have in the past sold media property, right? Digital content. We've sold movies in our stores digitally. It's not been a frequent idea, but it certainly could be.

Consumers see our store as an entertainment destination, and our technology that we use for DLC, right, Tony, can be used for lots of other stuff?

Tony Bartel - GameStop Corp. - President

Absolutely. And I would say that we love complexity because we are the only people who are able to go in with our associates and the training that we do, we are the only people that can go in and sort out that complexity.

So what I see is tremendous power in both of these consoles in the PS4 and the Xbox 1. And it's going to take a very educated sales associate to help the consumer differentiate between the two. But there are definitely distinct differences, and our folks are very uniquely positioned. And we will provide them with the best training in the industry to be able to help the consumer with that decision.

And like Paul said, a lot of it is about getting people to know -- it's about discoverability. And what we can do in our stores now is digital content can be easily discovered, as we have shown in our sell of DLC.

So we will actually work with Microsoft and we will work with Sony as they come out with, I guess, what you would call non-gaming entertainment properties -- we will be selling those in our store.

Paul Raines - GameStop Corp. - CEO

And our PowerUp community around the world will participate in it.



Tony Bartel - GameStop Corp. - President

And people will pay for it with the trade currency --

Paul Raines - GameStop Corp. - CEO

Yes.

Tony Bartel - GameStop Corp. - President

So it is -- we love the complexity.

Anthony Chukumba - BB&T Capital Markets - Analyst

Got it. That's helpful.

And then second related question, so I guess that the Xbox 1 is not going to be backward compatible. I mean how do you think about that, once again, as is it an opportunity? Is it a threat? I mean how do you think about that, particularly given that it looks like the PlayStation 4 will be backward compatible?

Paul Raines - GameStop Corp. - CEO

I think we've got a -- the manufacturers have answered these questions. I think if you listen to Rob's remarks on the pre-owned business, we are doing a lot of modeling around pre-owned and historical. I think that the viability of the prior consoles continuing into the future is pretty exciting, right, Rob? I mean the numbers would tell you that there's a huge installed base, and we can continue selling pre-owned inventory and games for those old devices. So I think it's an opportunity -- fair to say, guys?

Rob Lloyd - GameStop Corp. - CFO

Yes, definitely. If you think back to the PlayStation 3, the first version was backward compatible. The Xbox 360 came out with backward compatibility for certain of the bigger blockbuster games. But that is about it. So it was limited. And the behavior we saw out of the consumers at that time was that many of them just want to take everything they had and go ahead and trade it in. They are ready to move on and play the new games on the new consoles.

And so we expect that behavior to continue. We would expect this to drive a lot of trade and volume, and we are very excited about the opportunity that gives us to sell the new products, as well.

Paul Raines - GameStop Corp. - CEO

And what we will also have then is you will see a wave of old PS3s coming in as customers trade those in for the new console. We refurbish those old PS3s, and we allow a whole new set of customers right now that can't afford a new PS3 to be able to buy the refurbished PS3. And now you have more customers out there buying software.

Rob Lloyd - GameStop Corp. - CFO

That's right. That is exactly right.



Anthony Chukumba - *BB&T Capital Markets - Analyst*

Okay. That's very helpful. Thank you.

Paul Raines - *GameStop Corp. - CEO*

Thank you, Anthony.

Operator

Bill Armstrong, CL King and Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Some more on the Xbox 1. It sounds like Microsoft might have some features that would allow them to charge customers who are using used games on the box. If that were the case, how would that affect your business in terms of how you price on the buy- and sell-side of used games, your margins and any implications for volume of used games?

Paul Raines - *GameStop Corp. - CEO*

Boy, that's a big question. Bill, we have got to let Microsoft take the lead, so we are not really going to delve into that. We have a long history of selling used games in all kinds of ways, and we will be very successful on taking \$1 billion of trade currency. E3 is coming up, and I think everybody has got to let Microsoft lead the communication on that.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. Fair enough.

Paul Raines - *GameStop Corp. - CEO*

Okay. I think we are at the end. So thanks, everyone, for being on the call. I think you can tell these are exciting times for GameStop. We've had some challenging times in this category, and we are really excited about what is about to happen in this business. We know that we have a lot of work to do, particularly in the second quarter. We have a lot of work to do between now and the console launches at holiday where we believe we will use our buy-sell-trade credits of the 24 million consoles that are in homes today to drive unparalleled market share and excitement with our gaming community. We will continue to grow new businesses and control costs to position us throughout the summer.

We look forward to seeing all of you at E3 and to bringing console innovation to the gaming community. Thank you very much.

Operator

And that concludes today's teleconference. Thank you for your participation.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2013, Thomson Reuters. All Rights Reserved.

