<u>GameStop Corp. (GME)</u>
<u>Baird's 2018 Global Consumer, Technology & Services Conference</u>
June 5, 2018

<< Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Okay. Good morning, everyone. I'm Colin Sebastian, research analyst at Robert Baird. And we're very happy to have with us today GameStop and Chief Operating Officer and Chief Financial Officer, Rob Lloyd. And we also have Mike Loftus and Eric Cerny from Investor Relations. Very happy to have them here as well.

Format will be Q&A as a fireside chat. We also have the ability to e-mail questions, although I'm not sure where the laptop is currently to look at those questions, so perhaps we'll get that and be able to take those questions. E-mail address is on the table in front of you.

So GameStop, as I'm sure most of you know, is the leading specialty retailer of video game merchandise in, not just the U.S., but in Europe, Australia and other markets and with a family of retail brands in technology and collectibles.

With that, Rob, thanks very much for joining us today.

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Thank you, Colin.

<< Colin Sebastian, Analyst, Robert W. Baird & Co.>>

The video game industry is obviously changing. It's becoming more digital, more about recurring transactions, perhaps even subscriptions and cloud gaming and streaming over the future. So I think it would be helpful to understand what GameStop's vision and strategy is for how retail plays a role in that environment for both consumers as well as content creators.

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Sure. GameStop plays a pretty significant role in the evolving world of video gaming as things get more of a digital component to them. At present, probably 45% or so of the video game market would be considered to be digital. In terms of the sales of games, it's probably 30% to 32%, I would guess. I think the stats for 2017 were 30% of the games were downloaded. The incremental component of the total that gets you into the 40s would be things like Colin was talking about.

It's the microtransactions that take place in the online gaming environment, whether it's Xbox LIVE or PlayStation subscriptions, the currency that gets used to download games or play things like Madden Ultimate, FIFA Ultimate Short Cash within Grand Theft Auto; and certainly now, the hottest thing is Fortnite and games like that, sort of a battle royale kind of a game. And GameStop plays in those spaces.

We do over $1 billion a year in sales of digital content to customers, typically enabling them to get into what's happening in the console environment, whether it's selling the Xbox LIVE subscription, selling them the add-on content that would come with a game like Call of Duty, selling them the currency that allows them to conduct transactions in Madden Ultimate Team or Fortnite, for example.

And then we participate in the Fortnite phenomenon. Right now, what's happening is we're selling a lot of accessories, headsets and controllers and things that enable the player to play better. The deal in Fortnite is, is you start out with 100 people. You get knocked off, and you narrow down and the last man standing wins. And the better your headset is, the better you can play the game, at least if you have better skills than I do at that kind of thing. So, we're selling a lot of headsets. We're selling a lot of currency that enable people to get online. And in that overall currency environment, there's probably a $1.7 billion U.S. market for that, and we're probably a quarter of it. So we have substantial share.

And the reason that customers would come into a GameStop environment in order to get digital currency is because they either can't or won't put a credit card online. If they're teenagers, they probably don't have a credit card and mom and dad aren't going to give them the credit card to use. So we facilitate the noncredit card customer to get online. We allow customers to pay for what they want with trades of physical goods. So that ecosystem also facilitates digital as well.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Thanks. And I think, we should note that GameStop is in the midst of a CEO search. And Rob, I think you're a candidate for that position. And I think it might be helpful to understand if – well first, what the criteria the board has in reviewing potential candidates. And also, is that – is the board using that as an opportunity to refresh the strategy? Or is the board very content with the existing strategic vision that you laid out?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

I think the board is pretty focused on the same strategic vision that management has had for the past few months now. We were in a mode, for many years, that we were diversifying the company. And we made a significant investment inside our Technology Brands business, growing that to about 1,400 stores. As well, we invested in the Collectibles space. And at this point, we've shifted that strategy, this goes back four or five months, to where we're focusing on the businesses that we own.

We have three core businesses. The video game space and the video game stores, GameStop, Micromania, EB Games in various markets. We have our Collectibles business, which gets sold through the video game stores, through ThinkGeek.com and in about 100 dedicated Collectible stores. And then we have our Technology Brands business, which consists largely of over 1,300 branded AT&T stores. And our focus has been to make sure we're driving operational excellence inside of each of those concepts. And we're not pursuing the kind of diversification that we had been pursuing for probably late 2013 up through 2017, recognizing the need to improve operations and drive profitability in those businesses we already own.

I think the management team, as it's currently constructed, working with the board, reached the conclusion that, that is the right strategy for us. So as the board looks for a new CEO, I think that's going to be a particular focus. And at the same time, we're wanting to want to make sure that we're maximizing the opportunities that are going on inside video games, including things in the digital arena. But I don't anticipate that there'd be a significant shift in the strategy as we go forward.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

So maybe help us out a little bit with some of the changes to the GameStop stores themselves, given the changing mix of content, given some of the diversification that's already taken place in terms of bringing Collectibles in, for example. What is – what does the GameStop store of the future look like?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Sure. I think one of the things that we need to focus on from an operational perspective, as I talked about in terms of maximizing profitability, is that as we've brought the Collectibles into the video game stores, we haven't done it in a very clean and customer-friendly way. The space tends to get very crowded, and I think we've lost touch with our customer a little bit. So we have a lot of work going on right now to understand what the customer behaviors are. I think we have a pretty good handle on the core gamer that wants to buy Call of Duty on the day that it comes out, and it comes in our store, goes to the counter and immediately asks for whatever console copy of Call of Duty that they want.

Where we're lacking is appealing to the more casual gamer that wants to shop the store, see what sort of pre-owned deals there might be, what new games might be on sale; and certainly, the moms and families and making our stores attractive for them. So there's a lot of work going on around customer segmentation, understanding those customer behaviors better so that we can design a shopping environment that will appeal to the kinds of customers that we need to broaden our base and broaden the awareness of our trade-in programs, for example.

So it's a little early to say what the store of the future might look like, but we're focused pretty heavily on cleaning up the appearance of our stores, decluttering them a bit and making sure that as we design something, it's with the customer now, three, five years in the future in mind. And making sure that where we can, we're creating the kind of experience that the customer wants to go to the store to get. That might include things like, in certain stores in a market, some sort of eSports-related venue, very small, small tournament kind of a thing; and making sure that we've got the products in the store that appeal to the gamer who wants to play like the eSports celebrities, that are starting to gain more attention, are playing. So a lot of testing and a lot of work going on in the stores to make sure that we're creating that right experience.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

And maybe sticking with the theme of the stores. What is your view on the optimal store count and the geographical footprint of GameStop stores, both domestically as well as globally?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Yes. I think that for those of you who that have followed GameStop, you know that we've closed probably 1,000 or more stores in the past few years as we focused on optimizing that store portfolio. We keep our leases exceedingly flexible. Our average remaining lease term in our video game store base is under two years. That allows us to close stores as customer shopping patterns change, as we see the economics of the store needing to – requiring closure. We use our loyalty programs to help us close stores in a way that transfers sales to other nearby stores. And in so doing, we've actually, each year, closed stores that are profitable in order to optimize that portfolio.

Historically, what we've done across the last few years is we'll go up to about $50,000 in store profit and still consider a store for closure, and in doing so, use the loyalty program to transfer the customer to another nearby store. If we can transfer 30% of the sales of a closing store, we can increase the combined profits of that profitable store that's closing plus that nearby recipient by 30%. As we've gotten further and further into this, and again, closed probably close to, I don't know, 15%, 18% of the store base over the years, we've seen that we've sort of gotten the low-hanging fruit and you got to get up to about $75,000 in profitability now to keep that number of store closures in the 2% to 3% range. That stopped making sense to us. Doesn't make sense to close a store that's making $75,000. Our stores only cost $100,000 to $125,000 to build.

So we're – probably have fewer stores that we're going to close on an annual basis as we go forward and make sure that we're picking them for the right opportunities. At the same time, as we look at the business in the future, we'll take our long-term projections for the business sort of a worst-case, likely case, best-case scenario, and we push those down through the store base as we model on a store-by-store basis. So that we can identify, based upon whatever those worst-case trends are, at what point in time stores would be ripe for closure. That allows us to keep those leases very flexible and make sure that we're able to react when we need to.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Thank you. We know how important the preowned business is to the GameStop model, the success of the model to date certainly. Doesn't it get harder to grow or even stabilize this category when the mix of software sales continue to shift towards digital downloads and the number of games being published is continuing to decline? At least those published for traditional distribution. And how do you manage that trend?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

That is a challenge. So fewer games sold every year means there's fewer available to be traded in. Statistically, it's about half the games that gets sold in North America get traded in, in a

GameStop store. So we understand that there's a core consumer that needs to trade games in order to buy more games. So that sort of forms a baseline for the business. And what we've seen is that the business has shifted from something that was predominantly preowned software with – preowned software still being the majority, but preowned hardware and preowned accessories growing in the mix of the overall preowned business.

So our efforts are focused on a couple of things: Making sure that we can drive those preowned hardware and accessories sides of the equation, and making sure that we are increasing the awareness on the part of the consumer that we take trades. That's pretty well known if you look at our PowerUp Rewards members and those that are most engaged in the program. They understand about the trade business. They don't all participate, but probably a majority do. But then, as you drift further away from that core gamer and you get to the more casual gamer and then you get to the non-PowerUp Rewards member, that awareness level goes down.

So a lot of our efforts this year in terms of our work around the customer and understanding the customer behaviors is also focused on making sure that we can deliver a trade message to that customer to: One, increase the awareness that we actually take trades; and two, educate on the value of trading in games, particularly for those moms and families, and how you can use the trade-in program as a way to educate children on sort of the value of a dollar, if you will.

So those are our efforts there.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

There's some speculation in the market that – and this is looking out a couple of years, but – that the next consoles from Sony and Microsoft might be more focused on digital or streaming as distribution. Would that affect your approach to the preowned market or the way that the stores are managed in terms of product mix overall? Or how would that potentially impact that view?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

We've seen that the consoles be pretty focused on the digital side of the equation since they were introduced in 2013, and then that's how you've reached sort of the growth in digital penetration to the point where 30% or so of the games are downloaded. It would surprise me greatly if the next generation of consoles did not have a physical component to them because physical is still the majority of the market and because it still is very difficult in many parts of the country to download a game. But obviously, if that were the case, we would still continue to participate in the preowned, the sales of consoles new and then the preowned market. What's probably not known greatly because we don't tend to disclose the numbers at this detailed a level, but the prior generation of preowned consoles and software is still a significant component of what it is that we sell.

So if we were to move into the PlayStation 5 and Xbox Two generation, we'll still have sales of Xbox One, PlayStation 4 and related software for many years to come.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Okay. Switching gears a bit, you talked about this on the earnings call related to changes in the AT&T, the tech brands relationship and strategy. I guess, what makes that agreement still attractive for GameStop? And what changes do you expect to be able to affect from that relationship going forward?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

We continue to work with AT&T on the nature of the compensation and how they compensate us for the transactions that take place in stores. Fundamentally, it's a solid partnership and it's one that AT&T would like to see us grow. What they're interested in is healthy competition with Verizon and T-Mobile. And to do that, they recognize the need to have storefronts for the consumer. The challenge in our case is that when they change how we get compensated, I think it's difficult for them to model through what impact that's going to have on their authorized retail base. We are the largest authorized retailer for AT&T. We're the only one of any of the carriers that is an authorized retailer that's also a public company.

So, AT&T is kind of getting used to the environment in which we need to talk about results that impact their business. So what we've tried to do is go to AT&T and educate them on what impact the compensation changes they did last year had on our individual store profitability. And they want us to grow. They understand that at this stage of the game, it's difficult for us to make that store base investable. It doesn't make sense for us to continue opening stores in the economics that we're operating in.

So we've made some progress with respect to compensation changes that will come in across this year, some of which are changing the way we get paid on transactions, some of which assist in markets where we've had high growth and operate in – with a higher cost structure and some of which are designed to provide incentive for us to continue to open stores. We've yet to sort of hit that decision point. And as I said, we want to make sure the base economics of the stores that we operate are where we need them to be before we'll open more.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Turning to capital allocation. This is something that you and the other – and the board and the management team have focused on quite a bit over the years. But at this point, how are you prioritizing capital allocation? And given where the share price is trading, does that affect the dynamic between share repurchases or dividends or other uses of capital?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

The first and foremost use of the capital over the past few years has been the dividend, which uses about $155 million or so of our free cash flow right now. So the board has prioritized that. The board continues to evaluate other avenues for returning cash to shareholders and managing the balance sheet of the business. We announced in March that we would be refinancing our 2019 senior notes and we will be reducing the – as we've refinanced those, we'll take out about $75 million of the principal. So, reduce the debt load on the balance sheet. So between looking at the debt structure and share buybacks, the board continues to evaluate what that right use of free cash flow is.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

So, turning now to a couple of questions. First one is related to a letter received from an activist investor, whether this has created any internal discussions on strategic alternatives or other priorities.

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

We received the letter. We communicated back to Tiger, is the name of the firm, that we received it. The nature of the things that were called for in the letter are things that we're constantly looking at in the business. Some of them had to do with operational things, like cost control and reduction, and then some of it had to do with capital allocation and strategic alternatives. And those are the kinds of things that we discuss with the board routinely.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Second question is you mentioned on your earnings call that accessory sales were up on higher headset sales. Can you say how much headset sales were up specifically? And do you also plan to add more shelf space to headsets in Q4 for the holidays?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

I don't have the numbers that we haven't disclosed them at that level with respect to headsets, but the growth has been very strong inside the accessory category. I think the category itself went up 13%. Inside accessories, we would have headsets and controllers and memory and VR and other things.

So changing mix there, but clearly, the driver, with very strong growth, was the headset category, and that led the overall to a 13% increase. I think one of the things we're looking at there is whether there are particular types of headsets that we should be carrying that we might not. We carry a pretty good selection of them.

And then we're looking in some markets, we're testing kind of a – sort of an eSports section in the store that would highlight the kinds of products that you would see the higher-end gamers using in order to provide that product selection to the customer. So it might change what we carry at the holiday, but I don't have any specifics on that at this time.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

You mentioned the eSports test a couple of times. Is – what is the monetization strategy around that? Is that generating store traffic? Is there a fee to participate in eSports tournaments? Or are – I'll leave that open to you.

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Well, obviously, if we were to roll out a section in-store that provided the kind of equipment that eSports players are using available for sale to the customer, then that would be product sales and associated margin. In terms of how we would monetize things that we might do on a local level for eSports, tough to say at this stage, but there's a lot of things that we're looking at. I'd say there's a lot going on in the eSports category, and it's easy to see how a company like Activision has been able to monetize that when it gets down to the retailer level, it's a little more challenging to figure out exactly how you play in that space. But we have a number of conversations and things that we're looking at as ways to do that.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

What are the key drive titles for later this year? And which games are you most enthusiastic about?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

I think we're excited to see a Red Dead Redemption for the first time in eight years. Take-Two, when they come out with their games every few years, like Red Dead and Grand Theft, tend to hit home runs. So we're excited about that. This is the Black Ops year for Call of Duty. Those Black Ops years tend to be very strong, so I think we're excited about that one as well. Battlefield 5. And then new titles coming from Nintendo as well. So there's a lot on the titles slate in the back half to be excited about.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Are you playing Fortnite, Rob?

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

I have not played Fortnite, no. One of my colleagues has been downloading it. He says there's a counter that ticks down how many bodies are left. I've asked him he's gotten below 99 bodies left when he gets knocked out. And I don't think he's out of the 90s yet, so.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

Out of curiosity, how many in the audience are playing or have played Fortnite, or a family member who plays Fortnite? Okay. About a third of the audience. Not bad. Well, unless there are any other questions, which I don't see here at this moment. We'll wrap it up there. Rob, thank you very much.

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Thank you.

<<Colin Sebastian, Analyst, Robert W. Baird & Co.>>

I believe there is a break-out session for those that do want to ask further questions of the team. And certainly, feel free to reach out to me as well. The break-out is in the Rockefeller Suite. Next, coming up in this room is Robert Half. In the Grand Ballroom A is Nielsen Holdings. Grand Ballroom B is Whirlpool. And in the Empire ballroom B is Deluxe Corporation. Thanks very much.

<<Rob Lloyd, Chief Operating Officer and Chief Financial Officer>>

Thank you.