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EDITED TRANSCRIPT

GME - Q1 2014 Gamestop Corp. Earnings Conference Call

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OVERVIEW:

GME reported 1Q14 consolidated global sales of $2.0b and net income of $68m or $0.59 per share. Expects 2Q14 revenues to increase 14-22% and diluted EPS to be $0.12-0.20.

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PRESENTATION

Operator

Good afternoon. Welcome to GameStop Corporation's first quarter 2014 earnings conference call.

(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 use by any other party without the prior written consent of GameStop.

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

Paul Raines - *GameStop Corporation - CEO*

Thank you, operator, and welcome to GameStop's first-quarter earnings call. As is customary on our calls, we start by thanking our Associates around the world for their extraordinary service and commitment to our customers during this quarter. Whether they are at a GameStop, EB Games, or Micromania store, our Kongregate.com, GameStop.com, or by BuyMyTronics.com websites, or our Game Informer Magazine, our employees are the authorities in the video game industry.

In the technology brand space, our Spring Mobile AT&T dealer stores, our Simply Mac Apple dealer stores, and our Cricket prepaid phone stores all lead the way and their respective categories on customer service. Thanks to all of you, and our support center Associates, for another quarter of protecting the family.

Joining me today on our call are Rob Lloyd, Chief Financial Officer; Tony Bartel, President; Mike Hogan; our EVP of Strategic Business; and Matt Hodges, our Vice President of Public and Investor Relations. Mike Mauler, our EVP of International Business, is traveling in Europe today at a business review.

We are pleased with our financial and operational results in the first quarter, and believe that they demonstrate our strategy is working, to maximize our position as the world's largest video game retailer as the video game category enters a growth phase. While at the same time, pursuing and integrating new opportunities in the technology space that are accretive to our top and bottom line.

We delivered our third consecutive quarter of positive comps at 5.8%, with total sales growth of 7%. Margins expanded again by 40 basis points to 31.4%, thanks to strength in pre-owned value gaming and technology brands. This quarter's gross margin rate is a first quarter record high for GameStop. We are excited about our continuing leading share in hardware sales, as we believe that console sales will drive share in the future on software.

On the pre-owned value side, we had strong gross margin performance, with excellent growth, as expected console cycle effect begins to take hold. Our value initiative, while still in the early stage, is succeeding, as we sourced over $20 million in product from publishers and manufacturers to drive value product.

As expected, console software declined year over year, continuing the cycle of prior-gen declines while next-gen software grows aggressively. If you look at the titles we already know about, like Destiny, Assassin's Creed, Call of Duty, Pokemon and Dragon Age, it will be a big second half for software. Add to that the rapid growth in the next-gen install base that will be looking for games to play on their new consoles.

Drilling down on the digital category, we delivered $190 million of digital receipts in the quarter, a growth rate of 9.5%. Digital receipts are becoming a meaningful part of our business, as this quarter's digital receipts equal about one-third of our physical software sales.

The growth of digital gaming is very good for GameStop, and many investors have asked why that would be the case. The reasons are not straightforward, but revolve around our deep knowledge of the gaming consumer. First, digital content, like other entertainment, is sold mostly through a launch process, and is frequently attached to a physical console launch.

If you look at the growth of downloadable content in gaming, most of the growth has come through attached titles in consoles at launch, a process that GameStop effectively invented. Second, gamers use trade credits to buy digital content, just like physical content, and buying games online means giving up trades as a currency, a choice few gamers are willing to make.

Lastly, the in-store environment facilitates the community of gamers in engaging each other and learning about content, and buying from GameStop earns PowerUp Rewards points for the digital purchase. Tony Bartel will give you more color on how GameStop is not only participating in digital sales, but is, in fact, an industry leader in digital growth, with high market share.

On the international front, we had comps of 6.2%, with strong hardware sales in spite of allocated product in some markets. Australia led the way, with 14.3% comps and strong used growth at 11.9%, with strong margins. We continue to see consistent execution on fundamentals in our international business. International multi-channel sales grew 42% in the first quarter, and we continue to see great growth in digital sales across those markets.

Loyalty membership internationally surpassed 9 million members during the quarter, as we launched our program in Sweden, Denmark, Norway and Finland. The winning GameStop formula of a strong in-store and online experience, exclusive product, and buy/sell/trade of games and devices is working.

Many investors have also asked why the mobile category is a good opportunity for GameStop. In our recent Investor Day, we pointed out that our five competencies of real estate, human capital, buy/sell/trade, PowerUp Rewards, and financial strength are transferable to other concepts. We now have proof points from the first quarter.

As an exclusive dealer of AT&T, Apple and Cricket, we bring a higher level of execution to dealer networks that are highly fragmented. Our partners are willing to invest in distribution that elevates performance and customer service levels. The wireless and Apple ecosystems are very large categories, with significant technology innovation that needs distribution through specialty retail channels. We have acquired 12 dealers from

September to April of this year, and have many opportunities. Lastly, as our results from the first quarter demonstrate, these business units are accretive to our margins.

During the first quarter, the technology brands unit reported $60.2 million of sales, and $6 million of operating profit, representing 6% of total operating profit. We added 52 stores during the first quarter, and expect to acquire or build 300 to 400 stores during 2014.

As an example of the value we're creating, let's look at buy/sell/trade of mobile devices. We now have a circle of life in the mobile category that is large and growing. Customers come in to GameStop, Spring, AT&T stores, Simply Mac stores, and Cricket stores, as well as our as BuyMyTronics.com website, and trade their old phones and tablets.

We repair those devices at our refurbishment center, and sell refurbished phones in our GameStop and Cricket stores, and wholesale them through our BuyMyTronics marketplace. As an example, trades received last week at technology brand stores represented over 30% of our total phone trades, while refurbished phones represented 22% of prepaid activations at our Cricket stores for the quarter.

Moving onto multi-channel, our results continue to be impressive, as we grew 103% in sales and 149% in net income in the first quarter. Our mobile app has over four million installs, and those users spend more, trade more and are our most engaged customers.

PowerUp Rewards has nearly 28 million members in the US, with over 37 million worldwide. Mike Hogan will give you more color on our unique approach and strong results in multi-channel and PowerUp Rewards. Capital allocation was consistent and predictable during the quarter, as we paid out $38 million in dividends, and bought back $52 million worth of our shares. Since inception, we have increased our dividend three times, and have bought back over $1.4 billion in shares. We continue to believe in capital discipline.

As we look forward to E3, we believe it will be an exciting show. We expect to hear about great innovations and seeing new IP that will drive our industry for many years to come. As always, thoughtful investors will recognize the strong position that GameStop holds in a growing gaming industry, and the unique model that we have built and are using to expand opportunities to increase shareholder value. I will now turn the call over to Rob Lloyd.

Rob Lloyd - *GameStop Corporation - CFO*

Thank you, Paul. Good afternoon. Let me start by providing some color on our first-quarter results.

As Paul said, we were very pleased with the quarter, particularly with the continued strong demand for new video game consoles, solid pre-owned growth, and meaningful contribution from our technology brands business. Earnings per share grew 28%, to $0.59. Net income to 25%, to $68 million. Technology brands added $60 million in sales, very strong margins, and $6 million in operating earnings to the quarter.

Consolidated global sales were $2 billion, a 7% increase from last year's first quarter, with comps up 5.8%. Our revenue and comp results were in line with our guidance. Comps were positive 5.7% in the US, and as Paul mentioned, positive 6.2% internationally. Of the 7% increase in overall sales, 3% was due to technology brands. Our hardware sales increased 81%, while the US market increased 62%. We were pleased with our sell-through of next-gen hardware during the quarter, and continued to have strong share on the new consoles.

We believe that strong new hardware sales will translate into future positive new software growth. New software sales declined 20.4%, slightly higher than the 18% decrease in the US market. While we achieved our typical launch market share of approximately 60% plus on Titanfall and Infamous Second Son, which were the two major titles released during the quarter, the comparison was against six major titles in the first quarter of last year. Tony will give you added color on how we see sales of titles for the new consoles for the rest of 2014.

Pre-owned sales during the quarter grew 5.3%. Mike Hogan will add more color around the pre-owned and value business. Accessories grew 14.8% on the strength of hardware sales.

Our GAAP digital revenues were flat compared to last year's quarter, at $56 million. Our non-GAAP digital receipts totaled $189.7 million, an increase of 9.5% over the first quarter of 2013. Digital growth was driven by digital currency and strong PC digital sales in our international markets. Mobile and consumer electronics revenues grew to $102.2 million, over 100% growth, and included $60.2 million from technology brands.

The other category declined 19.2% from the first quarter of last year, due to declines in sales of PC entertainment software. Gross margins for the quarter were 31.4%, with a 40 basis point improvement from the prior year quarter. The increase was due to expansion in the pre-owned margin rate, and higher than anticipated margins achieved in our technology brand businesses, due to strong wireless promotions. Gross margins on hardware were 10.2%, software gross margins were 22.7%, and accessory margins were 37.9%, all of which are in line with the guidance we gave on our Investor Day.

Among the highlights during the quarter was the gross margin on pre-owned and value at 49.5%. We recently guided to a new high for this category at 48%. However, for the first quarter, our entry into the value category is just beginning, and had minimal impact. We were able to achieve the 49.5% margin, due to the improvement in margins that comes as consoles age. The PlayStation 4 and Xbox One do not have enough pre-owned volume yet to impact the rate for the pre-owned and value category.

Digital gross margin dollars and rates were both comparable to the prior-year quarter, and were impacted slightly by the mix of underlying products. The gross margin in the mobile and consumer electronics category was 36.2%, with gross profit of $37 million, up from $12.6 million in the first quarter of last year. This was driven by results in the Spring Mobile stores.

Total SG&A expense dollars increased 7.1% compared to Q1 of 2013, due primarily to the addition of technology brands. SG&A held steady as a percent of sales. We leveraged the increase in sales in the video game brand segments, and had this -- and this leverage was offset by the SG&A within tech brands, which runs higher than the video game business as a percentage of sales.

Depreciation and amortization was about 6% less than last year. Operating margin was in line with our guidance range, at 5.3%. Operating margins on technology brands were 10%. As I mentioned earlier, net income grew 25%, and EPS grew 28%, to $0.59.

We ended the quarter with 6,680 stores. 4,215 US video game stores, 2,195 international video game stores, and 270 technology brand stores. We acquired 36 technology brand stores during the quarter, and opened 16 more. We opened 6 video game stores and closed 40 in the US, and opened 5 and closed 18 internationally.

Inventory was up $88 million from the end of the first quarter last year, due to new console inventory and inventory in the technology brand stores. Our AP leverage increased, as the growth in inventory was due largely to new console products.

Now, let's cover our capital allocation for the quarter. As you know, we increased the dividend 20% in March, and used $38 million on dividend payments. As we indicated in the earnings release, our Board of Directors authorized the dividend of $0.33 per share for the second quarter, to be paid on June 17. As we reported, we repurchased just over 1.3 million shares, at an average of $39.28, for a total of $52.2 million.

We have approximately $400 million remaining on our current buyback authorization. Both dividends and buybacks remain an important part of our capital allocation strategy.

Now for the second-quarter outlook. We forecast same-store sales to range from positive 12% to positive 19%. We expect revenues to increase between 14% and 22%. The second quarter is the lowest volume quarter of the year for video games, so the rapidly growing revenues from technology brands will have a larger impact on the gap between comp growth and revenue growth.

We expect diluted earnings per share to range from $0.12 to $0.20. As always, earnings guidance does not include the effect of additional buybacks.

Now, I would like to spend some time discussing how we have modeled the impact of technology brands on the future value of the Company. I discussed this in my remarks on Investor Day last month, but I think it bears repeating today. In order to make sure that our investments in technology brands would drive shareholder returns, we model our future results in two ways: with tech brands and without tech brands. As we have for many years, we have a future forecast for our video game business.

We model what future returns look like for our video games business with various growth and profitability assumptions, and assuming the return of 100% of free cash flow to shareholders. We model future return on invested capital, and as I have mentioned previously, we use a dividend discount model, and a free cash flow to equity model, to inform our buyback decisions. We also model these same things with technology brands in the mix.

In order to give you a sense of the projected impact that technology brands could have, here are some statistics. The present value of our future cash flow streams with technology brands provide a 30% premium over just the video game business.

ROIC with technology brands begins to be accretive this year. The projected premium on ROIC with technology brands rose from approximately 300 basis points in year five to approximately 500 basis points -- sorry, 300 basis points in year three to approximately 500 basis points in year five. Hopefully, this helps with the reasons why we believe investing in technology brands drives shareholders' returns. The contribution from tech brands in the first quarter, at 6% of operating income, should also provide some indication of the potential of this business.

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

Tony Bartel - *GameStop Corporation - President*

Thank you, Rob. As we said at our recent Investor Day, GameStop is laser focused on maximizing this console launch. Our publisher partnerships are stronger than they have ever been, and we are adding proprietary training programs to our unique buy/sell/trade and PowerUp reward programs to offer consumers unprecedented value and gaming insight. In our first full quarter after the launch of both consoles, our optimism about the mid-console demand remains high. And we are well-positioned to take advantage of strong consumer demand.

Our knowledgeable and passionate Associates have the best training in the industry, and are focused on driving meeting market share for hardware, as well as the more profitable software, accessories and digital sales. From an industry perspective, the new console launches are starting off at a faster pace compared to the previous console launch.

According to NPD, the first six months hardware unit sales of the PS4 and Xbox One are 107% higher than the previous generation. New console software unit growth is up 45%. Accessories are flat, and digital sales are fully incremental.

GameStop managed to eclipse that performance with six-month hardware unit sales growth over last generation of 182%. Software unit growth is 113%, and accessories are up 48%. Another way to look at this is to show how much of this first six month growth in the industry GameStop is driving.

In hardware, GameStop is driving nearly 40% of the total dollar growth. In the more profitable software and accessory categories, GameStop is driving 83% and 87% of total dollar growth. So while some of our competitors have been discounting hardware below cost as a loss leader, we continue to execute our buy/sell/trade program to win the share battle, and capture nearly all of the growth in the profitable software and accessory categories.

Our first-quarter software market share on Xbox One and PS4 was 49.1%. Customers understand the value of our buy/sell/trade model, and they are leveraging that to afford the great new games that are being launched. We are seeing strong demand for next-generation games, as each launch in exceeding our expectation in new console game sales.

The upcoming Watch Dogs title by Ubisoft is the latest to have the most pre-orders of a new IP for the next-gen consoles, and we expect that trend to continue with Destiny and other games to be announced at E3. In the first quarter, our software attach rate rose to 4.6 units, and is now 70% higher than the rest of the industry.

Since launch, we've attached 3.6 physical games per console, and this exceeded our competitors' attach rate by 64%, according to NPD. This was slightly less than the games that we attached during the prior generation launch. However, when you add on our digital attach rate of full games, DLC and console network cards, our attach rate per console since launch increases to 4.7, in line with prior generation attach rates, when including our digital attach.

The new consoles are generating an increase in demand for digital downloads, and we are meeting that demand. Our first-quarter digital receipts growth was 9.5% in the first quarter, and represented 9.5% of our total revenue. As a comparison, in the trailing 12 months, we've grown our digital receipts by 8%, which is slightly higher than the non-cap digital revenue reported by our top four publishing partners combined.

As an example, during the recent launch of Titanfall, 15% of the games were delivered digitally. We provide the consumer with choice, and through our close alignment with Microsoft and Sony, our proprietary code delivery technology delivered the seamless experience to the customer. It is important to note that 20% of these digital transactions were paid for with trade credits, which is higher than our physical products, which have a 17% trade payment rate.

Also, over 60% of the digital goods are paid for with some form of payment other than a credit card. As in physical games, we find that discovery, curation, and offline payment options are meeting the consumers' desire to purchase digital games at retail, and we expect this part of our business to continue to grow. As a reminder, non-GAAP digital margins are comparable to software margins.

Kongregate had 115% growth during the quarter, led by both free to play, PC growth and mobile growth. Kongregate has published nine games so far, and has had over 10 million game downloads on the iOS and Android platforms. One of these games, Tyrant Unleashed, reached the status as one of the top 50 grossing games on the iOS platform.

Steam Wallet sales grew 183% globally, as we are now fully rolled out across the world. In PC gaming, we streamlined our PC digital purchase process, both in stores and online. We kicked off our new online process on May 19, and our stores will be fully reset on June 2. As with DLC, PC customers can now get their digital codes delivered seamlessly to their digital lockers from our stores and online.

Turning to our value business, we sourced $20 million of product from publishers and manufacturers to supplement out of stock issues that we had in our pre-owned business. As a reminder, these are incremental purchases that we made from our partners on titles where we have low in-stock positions. We expect this program to continue to ramp throughout the year.

We are thrilled with the accelerated pace of consumer adoption around the new generation of platforms, and our plan of maximizing share in the profitable software, accessory and digital categories is working. Each new launch is exceeding our expectations, as early adopters are anxious to purchase new IP. We expect E3 to generate a lot of excitement in the gaming community, and we look forward to meeting the strong consumer demand for new innovation.

I'll now turn the call over to Mike Hogan for his comments.

Mike Hogan - *GameStop Corp - EVP of Strategic Business*

Thanks, Tony. I will cover three topics this afternoon. First, an update on the pre-owned business, and our expanding presence in the value category. Second, GameStop's multi-channel business and its contribution to overall company growth. And third, PowerUp Rewards, and particularly impact on accelerating our new businesses.

Pre-owned grew 7% in the US for the first quarter, reflecting the strength of the new console cycle and consumer demand for pre-owned. This is consistent with our full-year 2014 projections, and the historical trend of pre-owned growth, as consumers trade up at the beginning of a new console cycle.

GameStop pre-owned is clearly benefiting from the new console launches. Roughly 30% of our next-generation hardware and software to date has been purchased with the help of trade credits. This is a strong sign that consumers see trades as a way to get the new technology they want, and this provides the inventory to continue to grow the pre-owned business in 2014.

It is worth noting that in our PowerUp consumer research, we continue to see very strong consumer interest for the new consoles, in a majority of members who have yet to purchase their new console. This represents a huge potential wave of trades coming in over the next year or so.

Now, a word on the broader value opportunity in the results to date. We announced this strategy about a month ago at the GameStop Investor Day. As we outlined at that time, GameStop attempts to leverage our core competencies in category knowledge, customer relationships, buy/sell/trade expertise, and refurbishment, to capture broader sales opportunity in pre-owned games, as well an expanded set of technology products.

The results to date have been encouraging. We've seen significant interest from publishers in driving incremental game sales from a select list of high-demand older games. As Paul and Tony mentioned, to date, we have sourced value inventory from several major publishers, totaling over $20 million. In fact, for the first quarter, our external purchases of pre-owned product increased by 52% versus the same period in 2013, and we are in the process of testing additional technology products.

I will now update GameStop's multi-channel business. Multi-channel has a very significant impact on GameStop's total business, with greater than 20 -- greater than 60% of our customers going to GameStop on the web or mobile prior to making their purchase in our stores. For every $1 of online sales, web and mobile influenced greater than $10 of store sales.

In fact, 26% of GameStop.com visitors who do not buy online make a purchase in-store within 48 hours of their online visit here. Multi-channel continues to be a driver of total company performance in Q1, posting 103% growth for the quarter. And GameStop ranks in the top 25 retail websites, in terms of total traffic, according to ComScore.

Leading the growth was our web and store business. When a product is not in stock or not available in a given store, consumers can still purchase the product from that store via GameStop.com, with free home delivery. Web in-store grew plus 414% year over year in Q1.

Our mobile properties grew 53% in traffic, and 36% in revenue, versus prior year. Our mobile app is a key component of multi-channel, with over 4 million installs. Our mobile app users spend 81% more, trade 53% more, and by 79% more pre-owned than the average PowerUp member. These are our most engaged customers.

We continue to invest heavily in mobile, and we are preparing to launch an updated mobile app this summer. We are upgrading the entire customer experience, and adding new functionality in the areas consumers want most. A highlight will be the launch of our trade center, where members can go to learn about trades, look up values, and seek current promotions.

Finally, a quick update on PowerUp Rewards. Our PowerUp Rewards membership continues to grow. Membership is plus 16% year over year, and recently passed the 27 million member mark in the US, and another 9 million internationally. And PowerUp pro-member spend is up 6% year to date.

One area we are particularly excited about is using PowerUp Rewards to help drive some of our new businesses. PowerUp has now grown to the point where it represents much more than just the gaming category. For example, roughly one in four US households has a PowerUp card. And on average, 1 in 12 mobile phone users in the US is a PowerUp member. PowerUp is a key component in our diversification strategy of expansion into technology brands.

Our ability to build and manage relationships with heavy category users gives us a strategic advantage in these new businesses. And that makes PowerUp a key asset. For example, 76% of PowerUp members own a smart phone. And from member profiles, survey and email, we know not only who owns smart phones, but also what specific operating system is used.

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This is just one example of the kinds of data we have that can be used to bring existing PowerUp customers to experience our new technology brands businesses. We've begun this process with new Simply Mac and Cricket stores, and to date, we are able to significantly accelerate the ramp for new stores. For a typical store, we can target between 50,000 and 100,000 high-value customers, and offer them an incentive to visit the new store.

We are continuing to explore new ways to leverage PowerUp Rewards to enhance customer value while [driving] technology brands. I will now turn it back over to Paul.

Paul Raines - *GameStop Corporation - CEO*

Thank you, Mike. And with that, operator, I think we will open it up for question and answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Arvind Bhatia from Sterne Agee.

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

As a first question, I was really intrigued by your comment on Titanfall. I think you mentioned about 15% of your volume was from direct downloads. First, did I hear that correctly? And maybe if you could talk about what sort of market share do you think that was for you? And then also, wanted to see if you could maybe talk a little bit more about your PC digital distribution? We saw the release a couple of days ago. Tony, you mentioned the relaunch. Maybe provide some more color there, please?

Paul Raines - *GameStop Corporation - CEO*

Yes, Tony, he's the guru on this. I would just say, unfortunately, there is no publicly available digital market share. I wish there was. It would make our life a little bit easier, right, Tony? But do you want to fill them in on Titanfall and so [forth]?

Tony Bartel - *GameStop Corporation - President*

Yes, so Titanfall, we basically sold the digital version in two forms. One was packed into the Titanfall Xbox One bundle. And then, at GameStop, we offer customers a specific SKU for the digital -- the full game digital download, using dollars spent on Xbox Live. So that is -- we added those two components of it, and then looked at how many of the games are delivered digitally and that was 15%, which I believe is very much in line with, I think, what EA articulated, in terms of their percent of software that is delivered digitally. So I would say that our digital shares, if that's the case, is very close to our launch share, which as Rob said, generally very high.

On the PC digital side, yes, it's like I shared, what we have done is now streamline the process, where we are giving the code delivery, just like we did in DLC. It allows us to offer a refined opportunity for the consumer to get those codes very quickly and easily. They can start their download from their phone. They can -- or they can get the -- sorry, they can get the code in their digital locker, just like with DLC. And we are providing them with a direct access, then, to either Steam or Origin, depending on where they are actually going to play the games. We're making it much easier for them to be able to get the game. And we are doing that online as well as in our stores.

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

Last question for me is, on the new software, as we think about the games that are coming out in the second quarter, as I look back through the second quarter of last year, I think new software sales, I recall, got worse. So in theory, you have slightly easier comparisons. But I know it all depends on titles, et cetera. So I generally wanted to get a sense from you on how you see new software trending, given all the pressure from old generation software and the strength of new-gen? Thanks.

Paul Raines - *GameStop Corporation - CEO*

Okay Rob, you're going to have to read the crystal ball on this one, I guess.

Rob Lloyd - *GameStop Corporation - CFO*

Yes, a couple of things to note about what's coming up in the titles in the second quarter. You've obviously got Watch Dogs; we are very excited about that. That launches on Monday at midnight, and our stores are ready for that. But one of the comparisons you've got to consider here is the fact that there is no NCAA.

Obviously, that's not a worldwide title, but it is impactful in the United States. I think as we look ahead to the title slate in the back half of the year, with Destiny and some of the other things that we know about are coming, and more of which I am sure we are going to hear about at E3. That's where we see a significant opportunity to really drive software for the new consoles.

Paul Raines - *GameStop Corporation - CEO*

It's also important to know, Mark, our [Adolphs] that launches next week, which should be a strong seller for (inaudible), as well.

Rob Lloyd - *GameStop Corporation - CFO*

Okay. Great.

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

Thank you, guys.

Operator

Our next question from Brian Nagel with Oppenheimer.

Brian Nagel - *Oppenheimer & Company - Analyst*

Congratulations on a nice quarter. The question I had -- I also wanted to discuss further downloads. In my job, I get questions all the time from our clients about the risks of downloads to GameStop. So as I listen to your comments today, and the comments you have made before, it sounds to me like you, as a company, view downloads as much more of an opportunity than a risk.

But the question I have is, with that as a backdrop, first off, do you -- as we think about DLC versus full game downloads, is the risk opportunity trade-off different with those two different digital products? And then also, how do we square your comments today, or your thought process toward downloads, with what some of your publishers have said recently about pushing their own download business, and being potentially a large margin driver for them?

Paul Raines - *GameStop Corporation - CEO*

Tony and I are going to -- we will have to tag team this a little bit. Maybe Mike can talk about PowerUp. But I would say that this is why we bring up in our remarks that people call us and ask about digital all the time. And are you scared, and so forth. We've been knocking on doors, creating a technology to sell downloads for a long time.

And publishers, I think, are very interested in a direct business. And if that's a better solution for the consumer, that's what should happen. What we're trying to do is be a better solution for the consumer. But Tony, maybe you ought to talk about how you see DLC versus downloads, and why it's important in our --

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Tony Bartel - *GameStop Corporation - President*

Sure. Like Paul mentioned, Brian, in his comments, downloadable content at DLC is very much a launch event. We see a huge amount of the DLC that we sell identified and discovered at the point of the game -- when customers are purchasing the game at launch events. You have a community of gamers that come together. And in many cases, they don't even know that that DLC exists. And like Paul said, we basically created that business by working first with Activision and sharing that learning throughout the industry and saying, people are willing to invest in downloadable content with the promise of future deliveries of good content.

They're willing to do that at the time of the launch. And so that's what we are very good at, as well as, we create launch events whenever that DLC comes out. The full game download, I see that really as just an option. If the customer wants it, we are going to provided that. And then you have all the benefits that we talked about earlier. You have the buy/sell/trade trade credit that you can provide, you can talk to somebody who is knowledgeable about the game. Mike, anything you want to add about PowerUp Rewards?

Mike Hogan - *GameStop Corp - EVP of Strategic Business*

Yes. I would just say, if you think about the success that we've had to date and through PowerUp, as we -- every time we go out and we talk to consumers who -- why they are buying digital at GameStop, the top three reasons they continue to cite are, they don't necessarily want to pay with credit card online. They want the value, as Tony said, of our buy/sell/trade with trade credits, and they want PowerUp points. And those reasons haven't changed in the last few years. They are still strong.

Paul Raines - *GameStop Corporation - CEO*

And so that's where I know that -- you had mentioned the publishers had been saying they are going direct to customer. And I think we've got a very unique relationship with the customer as a retailer. And that's why, basically, our digital receipts -- our non-GAAP digital receipts are slightly outpacing those of the four top publishers.

Tony Bartel - *GameStop Corporation - President*

And I think, too, Brian, sometimes I think in this digital discussion, we see it as binary. Either you are all physical, or you are all digital. But the truth is, the consumers we deal with are hybrid consumers who have never bought digital, or just began. And we're educating them and teaching them the benefits and the value of all this great digital content our publishers produce.

So our role as a retailer is to be an advocate for that consumer and teach them about this great stuff. And that's the role we want to play. There will be always leading edge adopters, who will only be direct with the publisher, and that's fine. But our consumers are the ones we know through

PowerUp Rewards. So I guess the point we are always trying to make is that digital is a growth business. If you look at our $190 million of digital receipts, we like that business, and we think it's good for GameStop.

Paul Raines - *GameStop Corporation - CEO*

And we are going to continue to knock on doors. We still think there's consumer friction in the digital process, even at GameStop, and we are going to continue to work with Sony and Microsoft to knock off as much of that friction as we can.

Brian Nagel - *Oppenheimer & Company - Analyst*

And so maybe just to follow up that, and more of a qualitative question. Are you seeing it as -- you are very connected with your consumers, and particularly those in the PowerUp Rewards program. As you are communicating with these customers, are you seeing it becoming more difficult to say, keep customers away from full game downloads outside the GameStop ecosystem? Or is it too difficult to tell?

Paul Raines - *GameStop Corporation - CEO*

I don't think so. We see growth in all the PowerUp metrics and all the digital metrics.

Tony Bartel - *GameStop Corporation - President*

First of all, it's not a goal of ours to keep them (multiple speakers) --

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Paul Raines - *GameStop Corporation - CEO*

We are not in it to keep people away from publisher business. We actually want people to buy more of publishers' great digital content. That's a good thing for this industry. This industry needs innovation.

Tony Bartel - *GameStop Corporation - President*

And going back to Arvind's question, that's basically the PC digital streamline. And it's making it easier to direct those customers back to the publisher websites, so that they can get on the games they want. They still have a value to buy at GameStop. We just wanted to make it easier, especially online, where we had friction in the process, where we streamlined it.

Paul Raines - *GameStop Corporation - CEO*

And I think, if you go and try to download some full games today, I think you'll see that the role we play in discovery and making it a friendlier experience in allowing you to -- and subsidizing the purchase with $1 billion of trade credits, and then making it fun with PowerUp. All that stuff has tremendous value, and that is the role we play. That's the role a retailer should play.

Brian Nagel - *Oppenheimer & Company - Analyst*

And just one more quick one, if I could, as a follow up. How should we think about the recent price actions on Xbox One? Is there any read-through to demand for that device? Or (inaudible)?

Paul Raines - *GameStop Corporation - CEO*

I definitely think we are already seeing, in our stores with our reservation program, as well as the dialogue through PowerUp Rewards, that there's a stronger demand as a result of the price drop. I'm not sure what it's going to do on comps, as you weigh the mix towards the lower price SKU and lower price point. But I -- the good news for us is, it sells more units. We will sell a lot more units, because we are -- like we shared earlier, we are driving a lot of the growth, and that means that we will just -- there will be more units out there to put software on.

Brian Nagel - *Oppenheimer & Company - Analyst*

Thanks for all the color. I appreciate it.

Operator

Seth Sigman with Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

A couple questions about your tech brands business. First, for Rob, on the wireless economics. I think you pointed to a 10% operating margin for that business. Is that a four-wall number, or does that fully allocate any other corporate costs associated with the initiative? And then related, you commented on higher margins than expected. Any more color on that would be helpful, and how to think about that going forward? Thanks.

Paul Raines - *GameStop Corporation - CEO*

Yes, Rob, that's your -- the only thing I would say, Seth, before Rob gives, is remember that we're talking but tech brands as a portfolio of different concepts and formats. So all of the color we give around that is an aggregated color. That's important, because A, they are small and not super-material yet. B, we have partners who would prefer that we not drill down on individual economics.

Seth Sigman - *Credit Suisse - Analyst*

Fair enough.

Rob Lloyd - *GameStop Corporation - CFO*

I guess looking at the results that we saw, there are various promotional programs that run, particularly on the wireless side of the tech brands businesses, that can have an impact on top line revenues, margin rates, et cetera, on a quarter by quarter periodic basis, as the primary wireless carrier there comes up with new programs. And so, in particular, there is a promotion running with a new methodology around wireless postpaid, and that's been very successful for us.

The demand for that has been very high. I don't want to say too much about that. But to your question about the operating margin percentage, that includes the overhead cost associated with running the business. That is not a four-wall contribution number.

Seth Sigman - *Credit Suisse - Analyst*

Okay. That's helpful. And then just one other question that still comes up on the tech brands business, is just the rationale behind being exclusive with AT&T and Apple. Questions come up, and as these stores start rolling out, and ahead of certain product launches, any new thoughts on, or anything else you can help us understand the rationale behind that?

Paul Raines - *GameStop Corporation - CEO*

Absolutely, Seth. It's a great question. I think what comes up a lot, to us -- and maybe Mike Hogan can help me on this a little bit, because he's helping on the roll-up of this fragmented dealer base. But what comes up a lot with us is, how can you be successful when other competitors have multi-carrier relationships, and are not performing well? And I would tell you, we made a strategic decision to be an exclusive partner of these two companies of AT&T and Apple. We chose carefully; we studied the market. But when you are exclusive, a lot of things happen.

Number one, we are able to focus on one, companies' pricing programs, promotions and products. And so we have a level of knowledge in our Spring and Cricket stores that's really deep, compared to some of our competitors, and our Simply Mac stores, because we only sell one company's product. The second thing is, we are eligible for subsidy and promotional activity that others can't get. At the same time, and then I'll ask Mike, maybe, to talk about how he sees the dealer base. The other thing that you have to remember is, we also become a distribution channel for new innovation.

So if you think about our Spring Mobile stores, about a half of them sell Digital Life, which is the AT&T home security product, very successful product. And about a third of them sell U-Verse. The reason all of them don't is because it's not available in every geography. But we are not just a phone store, but we sell digital devices. Jason Ellis and Brett Bradshaw and our team at Spring, as well as Steve Bain and our team at Simply Mac, they are selling new and cutting edge innovations that these manufacturers are producing.

That's unlikely to happen if we were a multi-carrier. So in our world, we think exclusivity is far more productive for GameStop. And by the way, we also are a very productive channel for these companies, and we are one of the last large distributed, high performing speciality retail channels in the world. So that was a good reason. Mike, maybe you ought to talk about the benefits you get on the fragmented dealer base, and so forth.

Mike Hogan - *GameStop Corp - EVP of Strategic Business*

Sure. So I think Paul highlighted the customer experience and the AT&T relationship. I think if you look at the base of stores today, it tends -- the dealer base is fairly fragmented today. There is a lot of small operators.

And I think we see, certainly, an opportunity there to begin to consolidate some of that in a way that increases store productivity pretty significantly, and delivers a much better and much more uniform customer experience. So we think there's a real opportunity to improve the customer experience across that. And then I think to Paul's point, between that and the opportunity to then begin selling an expanded array of products, there's just huge upside potential for us, here.

Seth Sigman - *Credit Suisse - Analyst*

All right. Thanks for the color. And then just one follow-up. Is there way to think about the store growth for that business, over the next couple of quarters? I knew you said 300 to 400 for the year. But just the cadence of that?

Paul Raines - *GameStop Corporation - CEO*

It's tough to say, Rob. We've got a lot of roll-up -- a lot of opportunistic activity, as well as organic. A lot of acquisition and organic.

Rob Lloyd - *GameStop Corporation - CFO*

The timing and the size of individual acquisitions is not necessarily something that we can talk a lot about right now, and becomes more difficult to predict the further you get away from today. I would say the way to probably think about it would be somewhat linear, for the remainder of the year. We said 300 to 400 for the year; we did 50 in the first quarter. So I would start to think about it that way.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thanks, guys.

Operator

(Operator Instructions)

Sean McGowan with Needham and Company.

Paul Raines - *GameStop Corporation - CEO*

Operator, I don't think he's there. Let's move to the next one.

Sean McGowan - *Needham & Company - Analyst*

I apologize for that. Very interested in the connection of the spend, relative to the cost of some of these new consoles. Now that you've seen that price move by Microsoft, have you seen any lift, just since that's been announced? And generally, what you are seeing about, after that initial purchase, is there a little bit of a delay in when they buy additional peripherals or software? Or is it happening pretty quickly? Thank you.

Paul Raines - *GameStop Corporation - CEO*

Tony, you want to take that one?

Tony Bartel - *GameStop Corporation - President*

Sure. We haven't seen the impact of the price drop, obviously. It goes live the second week of June. But people -- obviously, there's been more traffic into our stores as a result, as people come in to reserve it. And so we are excited about the reserves that we are seeing on that. And actually we have seen a slight uptick in the sale of Xbox One, as well.

And so in terms of the purchase behavior, I would say that it's probably more launch-driven at this point. So for instance, next week, where we have Watch Dogs launching, that is a very -- we're very pleased with the pre-orders. They have exceeded our expectations. And we are -- so what we see is, when there's innovation like that, that's where we really see a lot of traffic in our stores. So clearly, as the install base grows, you are just going to see that expand.

Paul Raines - *GameStop Corporation - CEO*

One of the things that interesting to me, Sean, is Tony keeps talking about the digital attach rate. Our attach rates are pretty healthy. But we are increasingly, share of wallet is going into a digital attach. And that's going to change the economics, because that's a no inventory attach that we are selling fairly well with these consoles.

Tony Bartel - *GameStop Corporation - President*

And so those of you who were at the midnight launch or go to even reserve Watch Dogs at this point at a GameStop are going to be presented with the opportunity to understand, discover and even pre-order the digital season pass that goes along with that.

Paul Raines - *GameStop Corporation - CEO*

So you've already seen, then, some impact of that reduction without the connect, so that's encouraging. It's not even in effect yet, but you have already seen some impact.

Tony Bartel - *GameStop Corporation - President*

Yes, just with increased traffic as people come in to talk.

Sean McGowan - *Needham & Company - Analyst*

Okay. Thank you very much.

Operator

Curtis Nagel with Bank of America.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Just a quick one on used sales. Were certainly the best, I think, in a long while, and I was wondering what drove that? Was it primarily value? And then, I was just curious on what is driving such strong productivity, in terms of your mobile users?

Paul Raines - *GameStop Corporation - CEO*

I don't know. It's a little early on used. Rob, you want to take the used question? Certainly, Curtis, the only thing I would say is, remember that there is a predicted console effect that happens in the pre-owned business that we've seen a couple times before. So traffic-wise, you are going to start to see that. But Rob, any commentary on value versus regular pre-owned product?

Rob Lloyd - *GameStop Corporation - CFO*

Value was minimal. Again, we started the program, we announced it in late March. And I've been working with the publishers, and the guys talked about the volume of product we were able to source in the quarter that will go into -- get on our shelves, and be available for sale. But in terms of getting that out into the chain, not much impact on the sale in the first quarter.

Really, what we're seeing is the impact of all the activity leading up to and through the launches and the holiday season, as people bring in their old systems and games to trade toward new consoles. And that inventory availability, and that's what Paul is talking about, in terms of the cycle effect on pre-owned, as well as new consoles. You'd expect that to continue.

Paul Raines - *GameStop Corporation - CEO*

One thing, Curtis, to keep in mind is -- and you've studied this. But we have tried to make our universe of trade currency bigger over the past few years. And so today, we span from phone stores to Apple stores to video games stores. You can trade almost all of the products at all of our formats and websites, and buy those products at a lot of our websites and format. So as that universe of currencies expand, it's a tail wind for the category. Rob, as far as the productivity of the mobile, the technology brands units?

Rob Lloyd - *GameStop Corporation - CFO*

Were you asking about the technology brands units? Or were you asking about the mobile app?

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Your mobile users on the app.

Paul Raines - *GameStop Corporation - CEO*

Mike?

Mike Hogan - *GameStop Corp - EVP of Strategic Business*

Your question is about the increased spend?

Paul Raines - *GameStop Corporation - CEO*

Are they still production?

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Why they are so productive versus -- I'm assuming they are much higher than your average customer.

Mike Hogan - *GameStop Corp - EVP of Strategic Business*

I think it's -- I guess I would say it's analogous to how PowerUp Pro members are more engaged, and spend more with us. They -- we give them more opportunities for engagement (inaudible) to the GameStop ecosystem. I think we said that they buy 79% more pre-owned than the average, but they also trade 53% more. One of the things that you see, for example, we know, as we release the new app, we know that the engaged user is using the app. We know that they want to do things like, for example, find a trade value.

We're making it easier and easier for them to do that. And as we do that, they're more likely to come and, say, look up the trade value. That obviously provides a much greater value for them, and that's more reason to come in. So it's basically because they're deeper -- we are giving them more ways to get more deeply involved in the GameStop ecosystem, through information to reservations, through trade credits, through the ability to buy online, the ability to buy in-store.

Rob Lloyd - *GameStop Corporation - CFO*

It's anecdotal, but if you are a mobile app user, when I open up my mobile app, it -- Mike has it, and his team have created in a way that it presents all of your game libraries to you pretty overtly. And we haven't talked about the game library in a while. How many games are in the game library? (multiple speakers) 538 million games, Curtis, in the game library. Remember, when we started, we talked about this, it was the few hundred thousand. There's that many games in the game library. And when you open up your mobile app, it shows it all to you. So I think the data says that it's heavy. I just -- anecdotally, go use our mobile app, and it presents to you just a lot of currency.

Mike Hogan - *GameStop Corp - EVP of Strategic Business*

When we have that information, we can recommend the games you are most likely to like. We can tell you what your credit balance is that you haven't spent with us, and we can make you special offers to trade in games that we know you have towards games that you want.

Paul Raines - *GameStop Corporation - CEO*

And if you own an iPhone, maybe we can tell and give you some ideas on --

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Mike Hogan - *GameStop Corp - EVP of Strategic Business*

Tell that as well.

Paul Raines - *GameStop Corporation - CEO*

On training classes and launches.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Go to Simply Mac, right? (multiple speakers)

Paul Raines - *GameStop Corporation - CEO*

Or trade value and Spring Mobile. So that's the idea of the ecosystem.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Got it. Thank you very much. That's very helpful.

Operator

Tony Wible with Janney Capital Markets.

Tony Wible - *Janney Montgomery Scott - Analyst*

A lot to like to chat about. I will try to be disciplined and keep it two, but probably less obvious things. So the first thing is on AT&T and its proposed merger with DirecTV. Is there any reason to think that you would not benefit from having what will be DirecTV integration into the AT&T life ecosystem? And then the second thing, and this was a pretty big week for broadband.

The FCC put out new open internet proposals, and Comcast is saying that with usage-based billing, they're going to move out of test mode. What is your sense on the awareness of this big change in how people are paying for internet access and data? It seems like it would really affect video games, given that the FCC is making it pretty clear that that onus will be shifted to the consumer.

Paul Raines - *GameStop Corporation - CEO*

Tony, on DirecTV, we want to not comment on anything like that, because it's a transaction that's been rumored, and hasn't closed, and all of that. And our partners wouldn't want us to wade into that. But what I will repeat is that one of the great virtues of exclusivity -- and we talked about this extensively when we started down this path. But our team at Spring mobile would tell you if they were here that when you're good at selling products for a big partner, they bring you new products to sell.

And so we are very proud of the fact that our performance, net promoter scores, are at the highest levels at AT&T and the dealer network. And we do a great job on their extended strategic products and Digital Life and so forth. So a scenario where we could add to our assortment is likely. And so we want to be there, and be -- stand for excellence in the dealer network, so that we can participate. As far as broadband, that's a pretty controversial subject.

Awareness, guys, of the consumer? Don't know. Certainly, we have a high degree of awareness of how much broadband speed is available. We model it, and we understand how many downloads are really happening, and the challenges with that. But I can't say -- we don't really have an official position on that game. Faster speeds is always better, I would say, I think, in a digital economy, but that's about it.

Tony Wible - *Janney Montgomery Scott - Analyst*

It seems like we're moving to a world where the consumer would have to pay for every gigabyte they consume. And to then -- have a game like Titanfall is, and is only going to get bigger. I'm just curious have many publishers you think are aware of that dynamic? Also, if you can provide an update on Walmart? And what are your latest thoughts on their foray into the used category?

Paul Raines - *GameStop Corporation - CEO*

Tony, most publishers are aware of the cost of this, if it happens?

Tony Wible - *Janney Montgomery Scott - Analyst*

Yes, I think most publishers are aware of all the net neutrality and all the usage-based billing that they have. So I think that they are aware of that. I'm not -- I think they're, like all of us, waiting to see what happens.

Paul Raines - *GameStop Corporation - CEO*

As far as competitors entering the used space, we are in Texas. I'll have to say, it's not our first rodeo. Maybe that would be a good analogy. We have not seen any impact from competitors entering the used space. I would encourage you to go do some trades at all of our competitors. Because I think all of them are in the trade business. Mike, fair to say at this point? But we have a deep knowledge of how execution looks in all those competitors. And we have not had any impact from them.

Tony Wible - *Janney Montgomery Scott - Analyst*

Great. Thank you.

Paul Raines - *GameStop Corporation - CEO*

Okay. I think that is the last question. Thank you very much for joining us in this new time. Please feel free to give Matt Hodges any feedback in terms of the calendar, but we hope that this is a better way to carry out this call. Thanks for your support of GameStop, and good afternoon or good evening.

Operator

That does conclude our conference for today. Thank you for your participation.