Entertainment & Leisure
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COMPANY UPDATE / ESTIMATE CHANGE / RATING CHANGE

Key Metrics

GME - NYSE (as of 9/8/16)		$27.78
Price Target		$33.00
52-Week Range		$24.33 - $47.62
Shares Outstanding (mil)		104
Market Cap. ($mil)		$2,888
3-Mo. Average Daily Volume		2,788,671
Institutional Ownership		99%
Total Debt/Total Capital (7/16)		30%
ROE (TTM ended 7/16)		20%
Book Value/Share (7/16)		$20.68
Price/Book Value		1.3x
Annual Dividend Rate & Yield	$1.48	5.3%
EBITDA Margin (TTM ended 7/16)		9%

EPS FY 1/31* (excludes nonrecurring items)

	2015	Prior 2016E	Curr. 2016E		Prior 2017E	Curr. 2017E
1Q	$0.68		$0.66	A		
2Q	$0.31		$0.27	A		
3Q	$0.54	$0.55	$0.53			
4Q	$2.40	$2.52	$2.51			
Year	$3.90	$4.00	$3.94		$4.10	$4.05
P/E	7.1x		7.1x			6.9x

*Fiscal year ends Saturday closest to January 31 of the following year.
Quarterly EPS figures may not add to annual figure due to rounding and changes in the share count from quarter to quarter.

Revenue ($mm)

	2015	Prior 2016E	Curr. 2016E		Prior 2017E	Curr. 2017E
1Q	$2,061		$1,971	A		
2Q	$1,762		$1,632	A		
3Q	$2,016	$2,095	$2,090			
4Q	$3,525	$3,657	$3,642			
Year	$9,364	$9,355	$9,335		$9,475	$9,450

Company Description: *GameStop Corp. is the world's largest multi-channel videogame retailer. The company sells new and pre-owned software, hardware, and accessories for current gaming systems and the PC. Recent diversification efforts have led to a smartphone/mobile device retail sales & service presence that includes AT&T Mobility/Spring Mobile, Simply Mac, and Cricket stores. GME recently operated 7,520 total stores in 14 countries. This included 3,945 U.S. videogame stores, 2,009 international videogame stores, and 1,566 technology brand stores.*

GameStop Corp.

GME — NYSE — Buy-3

Upgrading Rating to Buy

Investment Highlights

- **We are upgrading our rating on GME to Buy from Neutral and maintaining our Suitability rating of 3.** We feel recent substantial declines in the stock price reflect an overly pessimistic view of the company's near-term outlook. Management has navigated a challenging industry environment in a smart, pro-active manner, in our opinion. This includes maintaining its dominant position as a videogame industry retailer while diversifying the company profile to include higher-growth retail businesses with better growth prospects. Meanwhile, generation and allocation of cash flow are key positive factors, in our view, and could play a positive role in the year ahead.
- **A recent acquisition exemplifies the company's diversification strategy.** On 8/2/16, GME purchased 507 AT&T authorized retail stores, making GME AT&T's largest retail store operator. This addition brought GME's "technology brand" retail store base to 1,566 compared to zero just a few years ago. This includes 1,424 AT&T Mobility/Spring Mobile stores, 72 Simply Mac stores, and 70 Cricket stores. We expect further growth of these businesses through store acquisitions and repurposing of some GameStop stores.
- **Valuation is a major factor in our purchase recommendation.** With the stock down more than 40% from its 52-week high, and down to a much greater extent from the all-time high, valuation levels have dropped to unusually low levels, in our view. We view the current 7.0x multiple on our estimate of expected forward earnings to be quite attractive.
- **Our one year price target is $33 per share.** This is based on what we consider conservative earnings and valuation assumptions. Also, we view dividends as a major component of expected total return. The current dividend, which we believe is well covered by cash flow, currently yields an attractive 5.3%.

Note Important Disclosures on Pages 8-9.
Note Analyst Certification on Page 8.

RATING UPGRADE

While we are mindful of the primary challenge facing the company—the videogame industry's growing trend of content being distributed to consumers by digital means—there are enough positive factors to make us confident GameStop Corp. will remain an important industry participant for years to come. Business diversification initiatives add to our favorable view. Ultimately, our Buy rating is based on valuation, and share price weakness has pushed multiples down to excessively low levels, in our view. We believe value investors have an attractive buying opportunity in GME at the current price. The following factors contribute to our current positive view on the stock:

Share price weakness. GME shares are down nearly 20 points, or 42%, from the 52-week high price of $47.62 set in October 2015. During this time frame, the S&P 500 Index has risen roughly 6%. We note the all-time high price of $63.77 was set in late 2007. We believe recent underperformance is likely due to the aforementioned industry trend and GME shares changing hands as the company implements its diversification strategy and as GME moves from a perceived growth stock to a value play. We feel the share price decline has been excessive, given all factors.

New hardware coming. GameStop stores have large market shares for videogame consoles (hardware) and games themselves (software). Importantly, we believe the release calendar over the next 18 months is quite favorable, with several new consoles coming from the major manufacturers and numerous high-profile games we think will become major hits. In fact, there are major new hardware releases planned by Sony, Microsoft, and Nintendo in the coming 18 months or so, including several from Sony just in the next few months. Because physical machines require a purchase from a store (brick & mortar or online), GameStop store traffic could get a boost, including during the all-important holiday shopping season. Also, we note the strong interest hardware and software providers have in GameStop, as they view the company as an important and powerful distribution partner whose employees represent influential salespersons.

Business mix transition. In fiscal 2013, GME ended the year with 6,600 videogame stores and essentially no "technology-based" stores (smartphone and mobile devices retailer and reseller). At 8/1/16, the company operated 5,954 videogame stores and 1,566 technology-based stores. We expect this mix to continue shifting in favor of the technology stores, including more AT&T Mobility/Spring Mobile, Simply Mac, and Cricket Wireless stores. Overall operating margins of the two businesses are similar; in fact, we believe a high volume technology store has higher margins than a high volume videogame store. Furthermore, we believe there will generally be greater demand for mobile devices (new and used) than videogames over the long term. In sum, we view the transition not as an act of desperation, but one based on opportunity and financial returns.

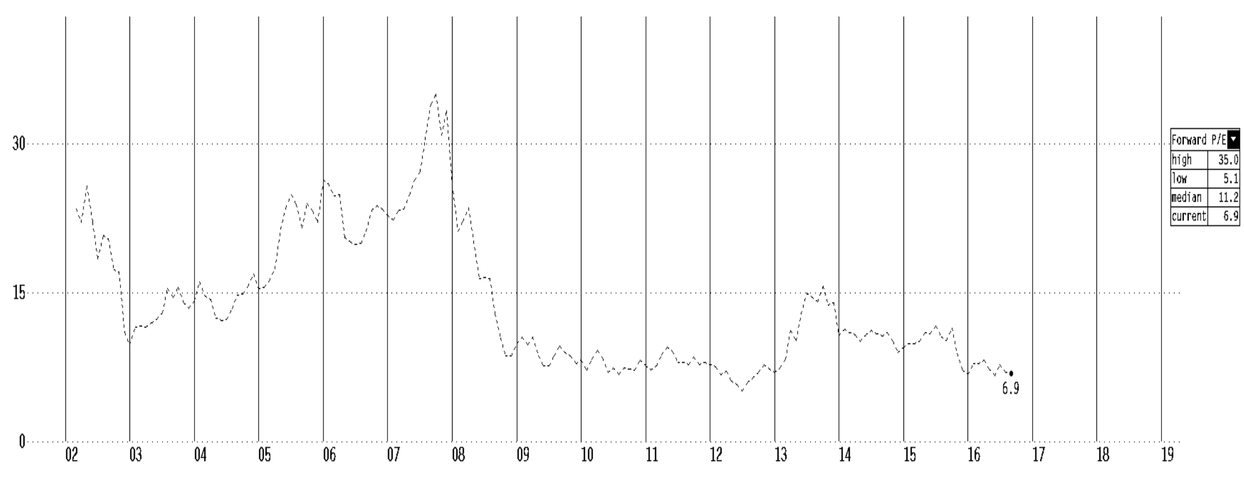
Management. We view GME's management team as a positive investment factor. A sharp management team led by CEO Paul Raines and a forward-thinking Board of Directors led by Chairman Daniel DeMatteo (former CEO of GameStop) have been realistic in assessing the industry and company outlooks and proactive in diversifying the business while keeping shareholder returns as a priority. New businesses such as mobile device retailing and re-selling, collectibles, and videogame self-publishing have helped offset weakness in physical videogame (disc) sales. We believe it is important to note GME is now AT&T's largest authorized retailer with 1,424 AT&T Mobility stores, and we see this number rising in future years. GME's overall profits have held up relatively well in recent years despite the challenging industry environment. Based on our estimate for this year (FY16), compounded annual growth in EPS is 5.6% going back to FY12.

Dividends. We view dividends as a significant source of total return potential for GME. GME initiated dividends in 2012 and has raised the rate in each subsequent year. The current annualized rate of $1.48 per share represents a payout ratio of just 38% (based on trailing earnings) and a current yield of 5.3%. Importantly, we consider the dividend sufficiently covered by cash flow. In fact, we believe the quarterly rate is likely to be increased in early 2017.

Cash flow. Strong cash flow generation is another factor in our purchase recommendation. Even with the core videogame business contracting, the company has been able to generate and utilize cash flow in an effective manner in recent years. Core uses include paying interest on the debt, paying taxes, and redeploying a significant amount back into the business through capital expenditures. After those uses, amounts of “free cash flow” then available have been used for debt reduction, acquisitions, and dividends. In FY16, we project free cash flow of over $400 million, after interest payments, taxes, and planned capital expenditures. This would give GME significant amounts available for dividends (we project $155 million in total), share repurchases (we assume $100 million), and other options such as acquisitions, debt reduction or cash build-up.

Valuation. Put simply, we consider GME shares cheap and attractive, with stock valuation being a major factor in our Buy rating. GME is currently trading at 7.1x and 6.9x our FY16 and FY17 EPS estimates, respectively. GME’s median forward multiple over the past five years is 8.9x (with a range of 5x-16x) and over the past fifteen years is 11.2x (with a range of 5x-35x). We attribute the history of relatively low valuations to several factors, including several years of industry sluggishness (2009-2013), concerns about future distribution of videogames (i.e. a threat to GME’s core physical goods business), and uncertainties about diversification attempts (deviating from core competencies).

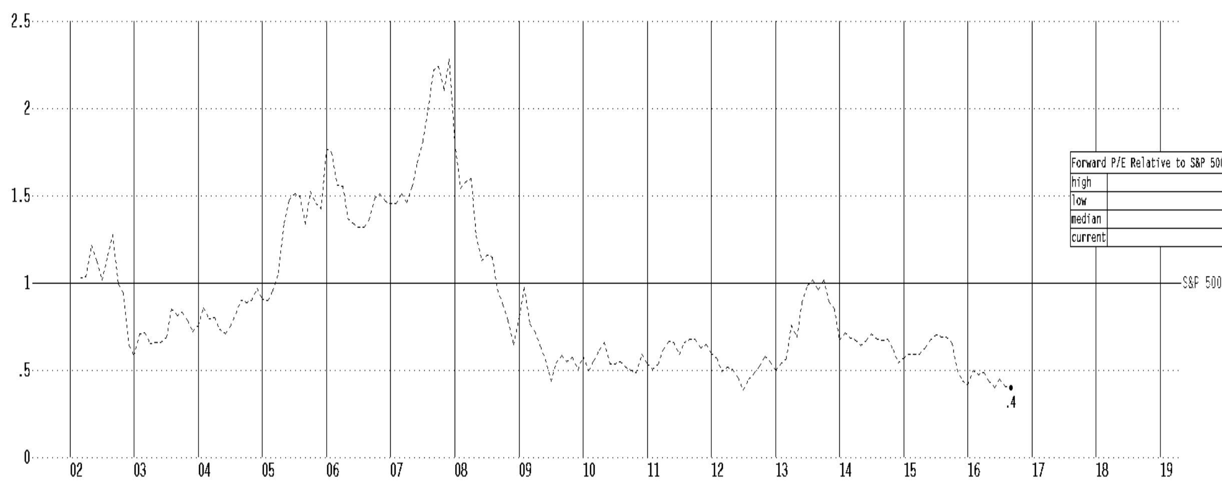
Exhibit 1
GME - Historical Forward P/E Multiples (based on estimated 12-month forward earnings)



Source: Baseline

As noted in Exhibit 2 below, GME's forward valuation relative to the S&P 500 is also well below historical levels, recently trading at just 0.4x that of the major market index. This represents the low mark for this metric over the past fifteen years.

Exhibit 2
GME - Historical Relative Forward P/E Multiples (relative to forward multiples on the S&P 500)



Source: Baseline

Although our main stock valuation focus is on price/earnings multiples, we note a low valuation on an Enterprise Value/EBITDA (earnings before interest, taxes, depreciation & amortization) basis as well. GME's current enterprise value represents just 4.1x our estimate of FY16 EBITDA. This is also below recent historical levels for GME and for the overall market.

Finally, GME is trading at a relatively low price-to-book value multiple of 1.3x. GME's assets include notable amounts of cash, inventory, and property and equipment, including leasehold improvements, fixtures and equipment across its large, well-positioned store base. The stores are leased, mostly under 3-5 year terms with renewal options.

Financial condition. The balance sheet is in good shape, in our view. Cash and equivalents at July 30, 2016 were $289.5 million. The current ratio was 1.59x. There was $926.1 million in total debt, or 30% of total capitalization. This was above the year ago level due mainly to the issuance of senior notes in March 2016. Stockholders' equity was $2.151 billion.

Recent acquisition. On August 2, 2016, the first day of GME's fiscal 3Q, the company announced the acquisition of three AT&T authorized retailers: Cellular World Corp., Midwest Cellular, Inc., and Red Skye Wireless, Inc. This added 507 stores to GME's growing Technology Brands business (a subset of the Mobile & Consumer Electronics reporting segment). The purchase price was $440 million, equating to about $868,000 per store. In 2013, GME entered the mobile space by acquiring Spring Mobile, an AT&T authorized retailer with approximately 90 stores. Today, GME is AT&T's largest authorized retailer with 1,424 AT&T-branded stores. Management stated the Technology Brands business is on track to generate over $85 million in operating profit this fiscal year (FY16) and grow to more than $200 million in FY19. This compares to $27 million last year (FY15).

Earnings outlook. Along with 2Q results, management issued 3Q guidance generally in line with street consensus. Comparable-store sales are projected in a range of -2% to +1%, with diluted EPS of $0.53-$0.58 compared to $0.54 a year ago. Recent street consensus was $0.53. Management maintained its outlook for all of FY16, with non-GAAP EPS expected in the range of $3.90-$4.05. This reflects a notable expected decline in videogame hardware but significant gains in the technology brands and collectibles businesses.

We have updated our earnings model (from our 2Q earnings update report dated 8/26/16) to reflect our latest assumptions on sales and profit margins. We expect continued weakness at the core videogame segments and growth from the technology brands business as management makes strategic decisions related to the company's store base and capital spending. For FY16, we project net sales of $9.335 billion, $20 million below our previous estimate. Our non-GAAP EPS estimate is lowered by $0.06 to $3.94. We have also fine-tuned our FY17 outlook. This includes a $25 million trim to our sales estimate and a $0.05 reduction to our EPS projection.

Opinion. We believe management has thus far navigated challenging industry conditions effectively. The core business is being handled with focus and financial support while the *Spring Mobile*, *Simply Mac,* and *Cricket* stores add diversification, decent margins, and higher growth potential, in our view. Overall cash generation has exceeded cash needs in recent years, which has created a solid balance sheet and the return of cash to shareholders through share repurchases and cash dividends.

We remain mindful of the longer-term outlook for videogame retailing dynamics as it relates to distribution of games/content. However, growth opportunities in the Mobile & Consumer Electronics segment, right-sizing the videogame retailing operation, and implementation of company's buy/sell/trade model applied to mobile devices (smart phones, tablets, etc.) could combine to lead to continued sales and earnings growth for GME.

Our Buy rating on GME reflects the low stock valuation and an attractive dividend that we believe is well supported by cash flow. Despite challenges, we believe EPS can grow modestly in the years ahead. We believe investor expectations are now relatively low and affected by an overall cautious view on videogame consumers' buying habits in a dynamic digital world and risks related to GME's ongoing business transition.

Our one year price target is $33 per share. This is based on our estimate of forward EPS of $4.00 one year from now and an assumed P/E multiple of just over 8x. This represents some multiple expansion from the current depressed level of roughly 7x, but still well below historical averages and current market, sector, and industry levels. Total return potential based on the current price and our target is approximately 24%, including quarterly dividends.

Suitability. Our Suitability rating on GME is 3 (on a 1-to-4 scale with 1=most conservative and 4=most aggressive). This reflects generally stable earnings at this time, yet concerns about ongoing changes in consumer buying behavior, the related impact on future store traffic trends, and a growing reliance on non-core operations. Our rating also reflects the company's solid balance sheet, recent diversification of revenue streams, generation of free cash flow, and effective utilization of that cash flow.

Risks. Competitive entry in the used game business and digital downloading of content by consumers have been common concerns among investors in the past. While new entry in the used game business in the past raised some concern among investors, we note GME's dominant share of the business. We feel GME can benefit from competitive advantages such as those related to inventory, pricing acumen, and employee expertise. To date, management has not seen an adverse impact from competitive entry into the used game business.

Digital downloading is likely to continue growing each year, in our view. GME has been active in developing revenue streams associated with that trend while it maintains a large share of the declining physical goods market. GME and the industry's major game publishers continue to work together to develop the retailer's role in the marketing and selling of both physical and digital content. We envision GameStop's expanding website, large store base (including in-store kiosks for digital sales), and sales associates playing a role in the company's digital distribution efforts.

Planned declines in the company's sizable videogame retailing store base with a concurrent increase in the smartphone/mobile device retailing business represents a change in focus for GME. There is no assurance that the company's acumen in the former will transfer to the latter, though we note results to date from this strategy have generally been favorable.

Other risk factors associated with investments in GameStop include changes or delays in publishers' release schedules; relationships with publishers, distributors, and hardware manufacturers; lease terms for stores; cyclicality of industry sales; macroeconomic risk; dependence on holiday sales; ability to negotiate and integrate acquisitions; and geopolitical risks to international operations.

Exhibit 3

GAAP-based Consolidated Statements of Income (figures in millions except per share data and percentages)

	2013	2014	1Q	2Q	3Q	4Q	2015	1Q	2Q	*3QE*	*4QE*	*2016E*	*2017E*
Net Sales	$9,039.5	$9,296.0	$2,060.6	$1,761.9	$2,016.3	$3,525.0	$9,363.8	$1,971.5	$1,631.8	*$2,090.0*	*$3,642.0*	*$9,335.3*	*$9,450.0*
Cost of Sales	6,378.4	6,520.1	1,421.6	1,181.4	1,360.7	2,481.8	6,445.5	1,296.0	1,014.1	*1,375.0*	*2,519.5*	*6,204.6*	*6,256.0*
Gross Profit	2,661.1	2,775.9	639.0	580.5	655.6	1,043.2	2,918.3	675.5	617.7	*715.0*	*1,122.5*	*3,130.7*	*3,194.0*
Asset Impairment	0.0	2.2	0.0	0.3	0.3	4.0	4.6	0.0	0.0	*0.0*	*0.0*	*0.0*	*0.0*
SG&A Exp.	1,892.4	2,001.0	479.3	490.5	525.2	613.9	2,108.9	520.8	518.4	*571.2*	*658.5*	*2,268.9*	*2,317.0*
EBITDA	768.7	772.7	159.7	89.7	130.1	425.3	804.8	154.7	99.3	*143.8*	*464.0*	*861.8*	*877.0*
Deprec. & Amort.	166.5	154.4	35.8	38.0	39.4	43.4	156.6	40.7	41.0	*43.0*	*45.0*	*169.7*	*175.0*
Operating Income	602.2	618.3	123.9	51.7	90.7	381.9	648.2	114.0	58.3	*100.8*	*419.0*	*692.1*	*702.0*
Interest Inc. & Other (Exp.), net	4.7	10.0	5.4	5.6	6.5	5.5	23.0	10.8	13.6	*15.0*	*15.3*	*54.7*	*55.0*
Income Before Taxes	597.5	608.3	118.5	46.1	84.2	376.4	625.2	103.2	44.7	*85.8*	*403.7*	*637.4*	*647.0*
Provision for Taxes	241.4	215.2	44.7	20.8	28.3	128.6	222.4	37.4	16.8	*31.3*	*147.4*	*232.9*	*236.2*
Net Income, GAAP	356.1	393.1	73.8	25.3	55.9	247.8	402.8	65.8	27.9	*54.5*	*256.3*	*404.5*	*410.8*
Non-GAAP Adjustments	0.0	(0.7)	0.0	7.8	1.2	3.8	12.8	2.6	0.0	*0.0*	*0.0*	*2.6*	*0.0*
Net Income, Adjusted (exclud. nonrecurring items)	$356.1	$392.4	$73.8	$33.1	$57.1	$251.6	$415.6	$68.4	$27.9	*$54.5*	*$256.3*	*$407.1*	*$410.8*
Diluted EPS, Adjusted	**$3.01**	**$3.47**	**$0.68**	**$0.31**	**$0.54**	**$2.40**	**$3.90**	**$0.66**	**$0.27**	***$0.53***	***$2.51***	***$3.94***	***$4.05***
Wtd. Diluted Shares Outst.	118.4	113.2	108.4	107.2	106.1	105.0	106.7	104.2	104.3	*103.2*	*102.1*	*103.5*	*101.5*
As a % of Net Sales													
Gross Profit	29.44%	29.86%	31.01%	32.95%	32.52%	29.59%	31.17%	34.26%	37.85%	*34.21%*	*30.82%*	*33.54%*	*33.80%*
SG&A Exp.	20.93%	21.53%	23.26%	27.84%	26.05%	17.42%	22.52%	26.42%	31.77%	*27.33%*	*18.08%*	*24.30%*	*24.52%*
EBITDA	8.50%	8.31%	7.75%	5.09%	6.45%	12.07%	8.59%	7.85%	6.09%	*6.88%*	*12.74%*	*9.23%*	*9.28%*
Operating Income	6.66%	6.65%	6.01%	2.93%	4.50%	10.83%	6.92%	5.78%	3.57%	*4.82%*	*11.50%*	*7.41%*	*7.43%*
Net Income, Adjusted	3.94%	4.22%	3.58%	1.88%	2.83%	7.14%	4.44%	3.47%	1.71%	*2.61%*	*7.04%*	*4.36%*	*4.35%*
Tax Rate	40.40%	35.38%	37.72%	45.12%	33.61%	34.17%	35.57%	36.24%	37.58%	*36.50%*	*36.50%*	*36.53%*	*36.50%*
Yr-Over-Yr Growth Rates:													
Net Sales		2.8%					0.7%	(4.3%)	(7.4%)	*3.7%*	*3.3%*	*(0.3%)*	*1.2%*
Gross Profit		4.3%					5.1%	5.7%	6.4%	*9.1%*	*7.6%*	*7.3%*	*2.0%*
SG&A Exp.		5.7%					5.4%	8.7%	5.7%	*8.8%*	*7.3%*	*7.6%*	*2.1%*
EBITDA		0.5%					4.2%	(3.1%)	10.7%	*10.5%*	*9.1%*	*7.1%*	*1.8%*
Net Income, Adjusted		10.2%					5.9%	(7.3%)	(15.7%)	*(4.6%)*	*1.9%*	*(2.0%)*	*0.9%*
Diluted EPS, Adjusted		15.3%					12.4%	(3.6%)	(13.4%)	*(1.9%)*	*4.8%*	*1.0%*	*2.9%*
Store Count:													
Videogame Stores, period end		6,211					6,064					5,850	5,700
Yr-over-yr store count % chg.		(5.9%)					(2.4%)					(3.5%)	(2.6%)
Comparable-store sales % chg.		3.4%					4.3%					(3.0%)	(1.0%)
Tech-based stores, period end		484					1,036					1,650	1,800

Source: GameStop Corp. and Hilliard Lyons estimates

Note: Fiscal year ends on Saturday closest to January 31

Additional information is available upon request.

Prices of other stocks mentioned:
Apple Inc. - AAPL - $105.52 - Buy
AT&T Inc. - T - $41.19 - Buy
Sony - SNE - $33.12
Microsoft - MSFT - $57.43 - Neutral
Nintendo - NTDOY - $33.875

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	37	31%	14%	86%
Hold/Neutral	70	59%	3%	97%
Sell	12	10%	0%	100%

As of 8 August 2016

Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

Other Disclosures

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