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GME - Q1 2012 Gamestop Corp. Earnings Conference Call

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PRESENTATION

Operator

Good morning, everyone. Welcome to GameStop Corporation's first-quarter 2012 earnings call. Today's call is being recorded.

At the conclusion of the announcement a question-and-answer session will be conducted electronically. (Operator Instructions)

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

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

Paul Raines - GameStop Corporation - CEO

Good morning and thank you for joining us on the GameStop first-quarter earnings call and update. As we begin our remarks today we would like to, once again, thank all of our GameStop associates worldwide who strive every day to deliver the best customer service and innovation in video gaming.

As you saw in our press release of last Thursday, May 10, our earnings of \$0.54 came in at the higher end of our original guidance, reflecting the margin expansion we are seeing from our pre-owned digital and mobile businesses. These margin-enhancing businesses are filling the profitability gap in this environment of slower physical software and console sales, and the results they are generating are a direct result of the strategic transformation work we have undertaken since 2009.

The first quarter was, however, weaker than we expected on the top line with a negative 12.5% comp, due primarily to the slower new physical software and console sales. It is clear that GameStop, as well as those following our industry, are struggling to forecast software and hardware sales during the late stages of the current console cycle.

Our finance team is, by far, the most knowledgeable and experienced in the console gaming industry but they are facing a different set of variables in this elongated cycle that make it increasingly difficult to predict consumer behaviors. I have asked Rob Lloyd to give you some insight into the



details of how we have prepared a forecast, and you will see we are making some adjustments around comp sales forecasting to provide even more clarity around our assumptions.

From a geographic perspective, Europe was by far our strongest segment with a negative 1% comp, reflecting some of the work we have done on execution as well as a consolidating competitor set. The United States, Australia, and Canada trailed the European segment and Mike Mauler will provide some color on our continued focus on execution and consolidation of the Europe market.

Combined the pre-owned business was flat excluding the impact of foreign exchange. Mike Hogan and his team continue to reinvent the pre-owned video game business through innovative use of PowerUp Rewards, assortment planning, and inventory management. While the growth came in lower than our plan, we are pleased that the pre-owned business showed resilience in a quarter with low customer traffic.

It is also important to note that all major competitors around the world have now either exited or reduced their efforts to enter the pre-owned business. This reduction in competitor focus gives us confidence about the continued success of our pre-owned model going forward.

PowerUp Rewards continues to grow as we reached over 18 million members during the quarter. The program continues to win awards as the most innovative in retail with PowerUp members representing 72% of all sales in the first quarter. PowerUp members transact with GameStop five times more frequently than nonmembers and there are now 300 million games in their collective game library. The average annual spend per member is \$358 and growing.

As we have shared with you, the PowerUp community represents an estimated 35% to 40% of all video game consumption in the United States. In order to help our partners prepare for console launches, we having engaged our PowerUp community in a dialogue around what kind of features they would like to see in their next console.

We have completed a broad survey of gamers between the ages of 13 and 60 who play a minimum of one to four hours per month, and those consumers tell us that they expect a new console and are optimistic that those new consoles will be worth the money spent on them. Those same consumers indicate that their purchase intent around the new console cycle is very sensitive to those consoles providing backward compatibility, ability to play pre-owned and shared games, and the presence of a physical drive. We will share more of the data from our PowerUp community as we go forward.

For a variety of reasons GameStop is better positioned than ever before to be a driver of upcoming console launches. Only in the United States the PowerUp community has an installed base of 24 million consoles in their game libraries. Using an average trade credit of \$75 per console in the game library, there is an estimated \$1.8 billion of currency available to trade towards new console launches.

We are working closely with publishing partners and manufacturers now to create powerful launch promotions that will take advantage of this trade currency to drive their launch, and we are pleased to begin with the Wii U this year. Our partners understand the power of the buy/sell/trade model in launching new consoles, as evidenced by our strong share on all recent hardware launches, including 3DS and Vita, that each had a significant portion of their launch volume at GameStop paid with trade credit.

Our digital businesses grew at 23% continuing strong growth around the world, but overlapping very significant DLC growth during the first quarter of last year. Our PC Digital businesses continue their exciting growth stories with our Kongregate.com platform growing over 50%.

Our PC download business grew over 172% as we added over 1,600 new games to the platform. We also added an exciting relationship with Steam to our portfolio, bringing another leading offering for PC gamers into our stores to purchase digital currency for that large PC platform to add to our Origin and GameStop options. Tony Bartel will provide you more color on our digital businesses.

Our mobile business continues to exceed expectations. During the quarter we expanded the store footprint of our [iDevice] business and trades of those items now represents 8% of trades year to date. We also expanded the tablet business to more stores and added exciting news SKUs from Toshiba, ASUS, and Acer to our assortment.



As we think about the second quarter we are projecting an expanded comp forecast range of negative 11% to negative 5%, reflecting challenges on new software and hardware as well as pre-owned digital and mobile growth. Rob Lloyd will provide greater details on the second quarter and annual forecast.

There is no question that we are at a transition point in console gaming as the current generation of consoles gives way to the new Nintendo Wii U this fall and the next versions of Sony and Microsoft products in the coming years. At the end of this cycle we see pressure on price points for hardware, as consumers seek out newer devices with fresher innovation and features. At the same time, the flexible business model that we have built transitions customers over the higher margin businesses, such as pre-owned video games, digital console and PC content, and the emerging mobile business.

Before I turn the call over to Rob I would like to summarize our view on the business and industry, particularly in light of the extended console cycle as well as opportunities we see for GameStop.

We remain highly confident in our company's long-term potential, from long-term value in a new console cycle coupled with a resilient pre-owned business and emerging digital and mobile businesses around the world. I would like to note that we recognize there are perceived risks and threats to the business from digital disintermediation, pre-owned competition, and global economic woes.

However, in looking at the history of console gaming and understanding the impact and benefits of the three previous console cycles to GameStop and its predecessor companies, we continue to believe that we are better positioned than ever in our history to leverage a console cycle launch, as well as continue to take advantage of other opportunities in our industry. We encourage everyone to join us at E3 and see for themselves the level of innovation and excitement that is coming in the console industry.

With that said, it is also important to note that our strategic plan, launched in early 2009, envisioned the development of complementary businesses to the new hardware and software businesses that would allow for GameStop to transition to the next generation of consoles under a variety of scenarios. I will now turn the call over to Rob.

Rob Lloyd - GameStop Corporation - CFO

Thanks, Paul. Good morning. Last week following the release of the NPD data we issued a press release pre-announcing that our first-quarter comps were down 12.5% and that our earnings per share were \$0.54. While our comps did not meet our expectations, we continued to outperform the market and achieved our bottom-line forecast as Paul noted.

Today's release provides guidance on the second quarter, which projects a tougher sales environment than we anticipated last quarter. As you know, we are operating in an unprecedented video game market. This console cycle is already two years longer than the last console cycle, and as you can tell from our precision in forecasting sales, this presents some challenges in predicting current consumer demand.

We are not alone in this. Taking the current environment into consideration, we will continue to provide you with quarterly guidance on comps but we are widening the range to reflect the uncertainty in the category. We believe we will continue to operate in this environment of volatility until the next console cycle arrives.

As Paul mentioned earlier, I would like to give you some color on our sales and comp forecasting methodology. Our forecasts are built from the ground up developing estimates of hardware and software for each console and handheld products, and developing estimates of sales for pre-owned, video game accessories, PC software, digital by type, and the mobile business.

We consider the following factors in developing our forecast -- titles that will be launching in the upcoming quarters, reservation patterns for those titles, trends in reservation pick up rate, growth in the installed base, market and market share trends, baseline sales of the software catalog, recent trends in overall sales, previous year and current year holidays, known promotions, and sales history as it affects each these factors on both a macro and micro basis.

The same general process is followed in each country. The challenge, obviously, comes in predicting the impact of consumer at this stage of the cycle on each of these factors. We are confident in our ability to execute on our strategic plans, our ability to deliver the earnings to which we have guided, and our ability to generate strong cash flow and exercise discipline in our use of that cash.

Let me provide some color on our first-quarter results.

Consolidated global sales were down -- were \$2 million, down 12.2% from last year with comps down 12.5%. Comps were down 15% in the US and down 1.1% in Europe. As we said going into the quarter, the new title releases of Mass Effect 3 and Prototype 2 in this quarter would not be enough to overcome the strong titles from the first quarter of last year in which we sold more than 500,000 units of four different titles. As a result, new software sales declined 20% compared to a 29% decrease in the US market.

Overall, we gained 160 basis points of new software share in the quarter. While we were pleased with our share performance on the PS Vita, sales were not enough to overcome the Nintendo 3DS launch from last year. We also outperformed the market in new hardware as our decline of 19% was less than the US market decline of 28%.

As I mentioned, our comps in Europe were down 1.1%. The situation with GAME Group is still very uncertain, and while we can see a positive impact in certain markets in which we compete with GAME, it is difficult to quantify the exact impact their struggles are having or to predict what future operations may look like for GAME from country to country.

Pre-owned sales during the quarter were down 1%. The US was up about 1% and overall we were flat excluding currency, as Paul noted. Given currency impacts and the decline in traffic overall, we take some positives from our results as this category outperformed our new software results by 19%.

Our Digital business increased 23% over the first quarter of last year with strong growth in PC Digital. Our Digital receipts, or non-GAAP revenue, totaled \$118 million with GAAP revenues totaling \$46 million. Tony will share some of our successes on DLC launched during this past quarter.

Consolidated global net earnings were \$72.5 million and diluted earnings per share for the quarter were \$0.54, in line with our guidance range. During the quarter we continued to expand gross margins as we shifted sales towards pre-owned products, grew our digital businesses, and expanded our mobile business. The effect of buybacks during the quarter in excess of those factored into our guidance was less than one-quarter of \$0.01 per share.

Gross margins for the quarter were 30%, up 280 basis points from last year. Margins in the pre-owned business increased 110 basis points during the quarter to 49.1%, due primarily to improvements in margins in most countries. This increase, when coupled with the increase in pre-owned as a percentage of sales, accounted for 200 basis points of the 280 basis point increase in margin overall.

The margin rate in the other category grew 330 basis points from last year and Other as a percentage of sales grew to 15.2% of sales. As a result, the Other category accounted for 110 basis points of the 280 basis point improvement in overall margin rate. The dollar increase in gross profit for the Other category was \$7.6 million, with the growth coming from digital and mobile businesses as well as the sale of products like Skylander toys.

Digital gross margin grew 28% to \$26.6 million and now accounts for over 20% of the Other gross margin dollars. Mobile gross margins were \$4.6 million.

Total SG&A expense dollars declined slightly from last year as we have focused extensively on controlling our SG&A. As we told you in March, we are through with our heaviest investments and, while we will continue to spend wisely to improve our digital, mobile, and loyalty offerings, we are focused on making sure that as we increase gross profit in the future we are positioned to grow operating profit.

Depreciation and amortization was also about 4% less than last year. Operating margins improved slightly from last year due to the improvement in gross margin rate despite the deleveraging associated with negative comps. Total company inventory decreased 14.4% as we continue to focus on disciplined purchasing and inventory management. Turnover was down slightly from last year.



We ended the quarter with 6,614 stores. We opened 18 and closed 87 in the US and opened 24 and closed 24 internationally.

As we indicated in the earnings release, the Board of Directors authorized a dividend of \$0.15 per share for this quarter to be paid on June 12. We repurchased 5.4 million shares in the first quarter at an average price of \$22.70 for a total of \$121.5 million. We have \$455 million remaining on our current buyback authorization.

Since January 2010 our stock and debt buybacks have totaled just under \$1.3 billion. We have repurchased almost 40 million shares at an average price of \$20.70 for a total of over \$823 million.

Now for the second-quarter outlook. We forecast same-store sales to range from down 11% to down 5%. While we have some strong titles during the month of May, like Max Payne 3, Diablo 3, Ghost Recon, we are cautious in our outlook given the overall traffic declines for the category. And we had some titles slip out of the quarter, primarily Guild Wars 2.

We expect diluted earnings per share to range from \$0.10 to \$0.18. We expect the tax rate for the second quarter to be approximately 100 basis points higher than last year when we benefited from the release of accruals for uncertain tax position.

We are revising our full year comparable-store sales guidance to range from down 5% to flat. This change reflects the top-line results of the first quarter, the guidance for the second quarter, and the uncertainty concerning surrounding consumer demand. We are reiterating our previously announced full-year 2012 earnings per share guidance range from \$3.10 to \$3.30.

The second-quarter EPS guidance fits within this range. The second quarter is the smallest quarter of the year and has little weight in terms of the entire year. We have confidence in the back half of the year due to the growth of our initiatives, the launch of the Wii U, and the 53rd week.

Our mobile business is set to ramp based on our existing buildup of inventory, the growth in the number of stores selling iDevices and tablets, and the impact that selling iDevices has on trade volume. We started the quarter with selling iDevices in 460 stores and tablets in 150. We have now rolled iDevices out around the world and have increased the number of stores selling iDevices and tablets, which Tony will talk about.

As you model full-year revenues, keep in mind the effect of the 53rd week on sales. It's estimated to be approximately 1.5% and the growth of revenues, which are not included in our comp calculation, including Kongregate, Impulse, and PowerUp Pro, which are estimated to total 0.5%. Earnings guidance does not include the effect of additional buyback.

Now I will turn it over to Mike for his comments.

Mike Mauler - *GameStop Corporation - EVP, GameStop International*

Thanks, Rob. Good morning, everyone. As Paul mentioned, our European operations had a solid quarter reducing operating losses by [67]% versus Q1 of 2011 to a loss of \$1.1 million. A strong focus on cost control and higher gross margins drove this improvement in operating earnings with the most significant improvements coming from Spain and Northern Europe as the results of their restructuring efforts were realized.

As communicated over the last year, a key component of our international strategy is driving the implementation of best practices across all territories. These efforts generated significant improvements in a number of areas during the quarter.

In Q1 we continued to leverage the technology investments and processes developed in the US to drive growth in our console and PC digital businesses. We went live with Microsoft DLC in Germany and Italy and are continuing that rollout in additional markets. We also entered into new publisher agreements to sell digital goods, such as with Activision Blizzard where we began selling digital copies of Diablo 3 this week in most markets.

I am also pleased to announce that we have signed an agreement with Sony EMEA to begin offering Sony DLC in our international stores during the second quarter. Our efforts to expand refurbishment capabilities and improve inventory management continue to drive growth and profitability.

in our pre-owned business. European pre-owned sales grew 2.3%, excluding FX, and we realized a 100 basis point improvement in pre-owned margin.

Over the last 18 months we have expanded our international e-commerce capabilities, investing in technology and optimizing business processes, which has helped us to continue to achieve strong growth in our international e-commerce sales. During the quarter e-commerce sales increased 30% versus the prior year.

Strong progress continued to be made during the quarter in leveraging our global purchasing power to provide unique and exclusive content to our customers worldwide. Key exclusives included the pre-order of Mass Effect 3 and seven pack the Prototype 2 Blackwatch Collector's edition and the Star Wars Kinect Kit Fisto pre-order exclusive.

As a result of these and future exclusives, we enter Q2 with 53% more reservations than the prior year.

In the first quarter we successfully completed our restructuring in Northern Europe and Spain. In Northern Europe -- the UK, Ireland, and Scandinavia -- we executed the consolidation of all back-office operations to Dublin ahead of schedule. This consolidated operation also includes shared service functions for e-commerce and IT support, creating a center of excellence and reducing operating costs.

The restructuring in the first quarter has helped build a strong foundation for the future, positioning GameStop to continue to increase market share as the competition pulls back or consolidates in key markets.

As mentioned on the last call, in 2012 we focused on three core strategic initiatives. We will continue to expand our console and PC digital businesses by completing our POSA rollout across all territories and by investing in DLC. We are working with our publishing partners to rapidly rollout DLC capabilities in all markets over the next two quarters.

During Q1 we leveraged best practices from the US to launch our mobile businesses in all markets. We are now accepting trades of iDevices in all countries and the volumes are increasing weekly. We have also just recently begun selling gaming tablets in Australia and we will see this product line rollout to other key markets during the year.

Finally, after successful implementations of our loyalty program in Australia, New Zealand, and Spain we will accelerate our loyalty rollout to additional markets during 2012. Implementing a robust loyalty program in these markets is the glue that ties together our brick-and mortar capabilities, services, and digital offering into one cohesive value proposition to our hybrid customers.

Our strong focus on managing the basics of our business and the rapid execution of our strategic transformation is driving profitability, not only during the bottom of the current cycle but will ensure that GameStop is the global leader as we enter the next cycle of Gen 4 consoles. Now I will turn it over to Tony for his comments.

Tony Bartel - GameStop Corporation - President

Thanks, Mike. As Paul and Rob mentioned earlier, our digital receipts grew 23% over last year and are on track to achieve our annual goal of \$675 million. In Q1, console digital grew 17% and PC digital grew 38%. In addition, our mobility efforts are ramping up as scheduled and generated \$12 million of sales during the quarter.

Our DLC business continued to expand as we are educating the publisher base on the power of the GameStop model to drive pre-sales and pre-orders of DLC. As we did with the launch of Activision's Call of Duty ELITE DLC, we are driving well over 50% market share of DLC when it is launched in conjunction with the game. For example, we attached (inaudible) DLC to 42% of the sales of EA's Mass Effect 3. More recently, we attached 46% of the Colossal Mayhem DLC to Activision's Prototype 2.

As expected, we did see a reduction in the sale of specific map packs for the Call of Duty franchise as we accelerated much of those receipts in the last quarter due to our successful launch of Activision's Call of Duty ELITE DLC. We will see a similar impact in the second quarter. In addition, the light Q1 traffic generated lower sales of PSN and Xbox LIVE points cards.

For the back half of the year we expect to see a significant increase in DLC sales as we are seeing more major titles providing sellable DLC content at the time of launch, and we are already offering pre-orders and pre-sales of Activision's Call of Duty ELITE DLC for Black Ops 2 along with an integrated launch campaign. We expect this to provide a significantly higher attach rate of ELITE, resulting in a strong sales lift in our fourth quarter.

We also relaunched our PC digital download business in our stores during the first quarter and we saw significant increases in this business as it grew 172% during the quarter. Since our acquisition a year ago we have increased our catalog to over 1,600 games and we are now selling these games digitally in our US stores. Not only does this allow us to be in stock on all new releases, but it also allows us to provide a rich catalog of favorite games for the PC game enthusiast.

We also started to sell Blizzard's Diablo 3 game digitally this week as a first installment of our digital relationship with Activision Blizzard.

In addition, we recently announced that we partnered with Steam to fund their digital wallet in our stores to customers who prefer to use their platform. We see this as yet another way to tap into the \$1 billion North American PC download business that our market model suggests is growing at 27% annually. These PC enthusiasts will now be able to fund their Steam wallet while experiencing all of the great benefits of GameStop, such as associate knowledge, PowerUp Rewards points, and non-credit card payment sources.

This week's Steam informed the US portion of their 40 million accounts of the GameStop option.

Kongregate continues its transformation, growing in-game transaction revenue by 144% during the quarter and growing total revenue by 50%. Kongregate currently has 136 games in its library that monetize through in-game transactions and another 60 games in the pipeline, so we expect to see the rate of growth accelerate in the back half of the year as these games come online. Traffic, as measured by Google Analytics, increased 22% on Kongregate.com during the quarter.

Game Informer continues to drive both physical and digital transactions. We remain to be fourth-largest physical magazine in the nation with 8 million physical subscribers and 1.5 million digital subscribers. On a weekly basis nearly one-half of our new PowerUp Rewards Pro customers are choosing the digital version of our magazine over the physical version. We are rolling out digital Game Informer in the 14 international countries in which we do business.

Spawn Labs completed its national closed beta achieving all of its objectives and demonstrating its ability to execute ultra-low-latency cloud gaming through six data centers who are associates throughout the nation. We continue to work with our publishing partners to bring a console-based service to market. We have also begun development of a PC-based solution to augment our PC digital service, as well as to provide an expanded cloud gaming offer that takes advantage of our patented virtualization process.

In Mobility, consumer demand for both our tablet offering as well as our pre-owned iDevices has prompted an acceleration of our rollout of these offerings. As Paul mentioned earlier, we recognized \$12 million of revenue in mobility during the first quarter and are on track to achieve our full-year goals. We now sell new Android-based tablets in over 1,600 stores.

As we have shared earlier, our tablets come preinstalled with several high-quality immersive games that utilize a proprietary Bluetooth controller and a copy of digital Game Informer. As previously announced, we will be launching a cross-platform app to discover and purchase a curated list of immersive games later this year.

Our iDevices business is resonating with the consumer and leveraging our trade heritage as trades of iDevices represented over 8% of all trades during the quarter. Trades are ramping up each week and they currently represent over 10% of the trade dollars that we receive each week. We have increased our capacity to test, clear, and repair these devices in our refurbishment center in order to efficiently turn and redistribute the trades that we are receiving.



Based on the increase in trades, we have expanded the number of stores selling iDevices to over 2,200 stores. Sales are steadily ramping as we expand to more stores and we also see a significant lift in trade volume in the stores that are selling iDevices. We are pleased with the trade and sales volumes that we are seeing and expect to hit our full-year projection of \$150 million to \$200 million of mobility revenue this year at a 30% margin.

With that I will turn the call back to the moderator for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Gary Balter, Credit Suisse.

Seth Sigman - Credit Suisse - Analyst

Hey, guys, good morning. This is Seth. I guess to kick it off a question on the next generation of consoles. I realize you discussed this on the last call, but over the last few weeks we have heard a lot from the publisher community about this topic. I think it would be great to just get your updated views on the console cycle.

Paul Raines - GameStop Corporation - CEO

Thanks, Seth. This is Paul. I will start it off and then I will ask Tony to give us some color.

Interesting stuff going on with the console cycle. We have been spending a fair amount of time with Nintendo, of course, because they are going to be the first out of the gate and we are excited about what they are going to show at E3. Lots of plans around that.

As I mentioned in the remarks, we have a very significant opportunity in launching that Wii U console given the amount of consoles that are currently out there in the PowerUp Rewards community. It's over \$1 billion anyway you model it to apply towards that.

So we think there will be new features that are very exciting. I have followed closely the EA remarks, and I think Ubisoft had a great call this week where they talked about some of the social features and matching that they will be able to do with the tethered tablet and so forth. But a lot of excitement.

Our job, I think, Seth, is to make sure that we leverage those advantages that we have. We are better positioned than ever in our history to launch these consoles because we have an enormous community now in PowerUp Rewards that would love to bring their old console in to buy a new console.

Tony, any remarks on the publishers or anything else?

Tony Bartel - GameStop Corporation - President

Sure, a few things that I would say. The first out of the gate from a platform holder standpoint will be the Wii U, so we have worked very closely with Nintendo to have a full launch plan.

It's an integrated launch plan and it will obviously start as soon as they announce some details of that, which we will hear at E3. Then we will start our launch plan flowing. As Paul talked about, it will have a very large dose of PowerUp Rewards and the trade credit component that he talked about.



All of the publishers that we are talking about now --clearly, we are talking with them about the rest of the year because there are some exciting titles coming out. But every one of the publishers we are talking about is already investing in Gen 4 consoles and we see that everywhere that we go, so we share a lot of excitement and we see Wii U as just the kick off to the next cycle.

Seth Sigman - *Credit Suisse - Analyst*

All right, thanks. Then as you look at the guidance for the remainder of the year, obviously the business is very dependent on the holiday. But can you maybe just drill down on Q4 and what some of the key industry and GameStop specific drivers are that you expect to lead to better results over the holiday? Thanks.

Rob Lloyd - *GameStop Corporation - CFO*

Well, Wii U is important to Q4, obviously. We have another Call of Duty title coming. We have seen growth in Call of Duty year over year for several years running. There is no reason to expect that to be any different. We are seeing -- we expect Halo 4 in the fourth quarter; we expect that to be big as well.

Obviously, we are ramping our mobile business as Tony talked about, expanding the number of stores that are selling and expanding it around the world. And we have a growth plan for that that is modeled out basically week by week through the year, and we will execute against that plan.

And then not to be overlooked in the fourth quarter is the impact of the 53rd week of sales. As you can imagine, you pay rent once a month; in some countries you pay people once a month; you pay them twice a month in the US. You get some leverage with that extra week of sales included in the numbers.

Tony Bartel - *GameStop Corporation - President*

One thing to add, Seth, is I think for investors -- and this is the case on the mobile business where I think the customers are ahead of the investors. When you think about GameStop, the reason we are in this mobile businesses because we had a lot of customer demand to accept trades.

The reason we acquired BuyMyTronics is we watch what is happening in our stores and we have only just begun. As we watch it, we have modeled out what this will look like ramping through holiday. We feel very good about the target we have laid out there that will play a big role in the fourth quarter.

So I think when you think about our fourth quarter this mobile business, in addition to all of the other things going on in console, will be very important.

Operator

Colin Sebastian, Robert W. Baird.

Colin Sebastian - *Robert W. Baird - Analyst*

Great. I have a couple of questions as well. I guess first off was wondering if you could somehow clarify for us how much of the impact on sales overall are secular in nature versus cyclical. Obviously in different parts of the business you are seeing the impact on both sides of that.

Then, secondly, in terms of the used sales decline, obviously the used margins were the highest in more than three years, which is very positive, but is there an opportunity, perhaps in the margin, to be a little more promotional there on pricing to drive more store traffic and sales? And I guess



related to that given where the cycle is long in the tooth, should we expect ongoing declines in used software really until the next boxes are launched? Thanks.

Paul Raines - GameStop Corporation - CEO

As far as the secular versus cyclical, maybe -- Rob, I don't know what you want to -- how you want to start that off. Maybe give some color on what you seen going on with the consoles.

Some of this is tied up a little bit with the difficulty in forecasting what is happening between hardware and software, and then we can talk about used, maybe, after that.

Rob Lloyd - GameStop Corporation - CFO

Sure. I think as we look at this, Colin, there is some element of what is going on in the market that, as many of you have expressed and as we read about as well and as you guys do, it shifts to other forms of gaming, whether that is on smartphones or tablets and other social sites. But a fundamental piece of it for us is where we are in the console cycle and in essence how to measure that consumer demand for these products until we get to that next console cycle.

Obviously the console cycle will start with the Wii U in the fall, but we will be anxiously looking forward to what the next products are from Sony and Microsoft as well. It's difficult to separate what is cyclical versus what is secular within that. And so our attempt is to try and understand the whole and, as we said earlier, the challenges in predicting consumer demand.

Paul Raines - GameStop Corporation - CEO

I think we are all in that boat a little bit. When I listen to our partners discuss their forecast, there is a little bit of all of us wanting to see where that is going to shake out.

One thing we know, though, is if you look at the history, and if you spend time looking at previous console cycles, this behavior is not dissimilar from previous console cycles. We see a decline in innovation; we see price point pressure on hardware. We actually see contraction in all of the companies' valuations who are in the sector and then you get the big pop with the new innovation. So I would agree with Rob.

That's talk about the pre-owned a little bit because I think that is a good question as well. There is no question that we are improving margins in that business. And when you ask about growth versus promotion, one thing to keep in mind is A) we still see growth in the pre-owned business for 2012. I think we laid out, Rob, in our guidance mid-single-digit growth in the guidance. We are still looking at growth, we feel good about that.

We also have seen gross profit growth in this quarter and we will see it in other quarters, so we don't believe that the pre-owned business is in a long-term decline. We do know that traffic declines put pressure on that.

The other point I would make is don't forget that we have categorized it as mobile, but we have now added another engine of growth to our pre-owned business in that we have a pre-owned re-commerce business inside our stores. Tony, anything you want to share?

Tony Bartel - GameStop Corporation - President

Well, I was going to actually -- definitely the re-commerce business is working and accelerating on that, and we are going to expand that dramatically throughout the rest of the year. And that will, obviously, provide a lot of the Q4 impact that Rob talked about earlier.



The other thing I was going to address on the secular versus the cyclical comment was I think sometimes that there is a tendency to divorce the DLC part of the business from the packaged goods side. Actually we are seeing tremendous growth in the DLC side of the business, which we are driving a lot of that growth. And so sometimes people will only look at that packaged goods side where when you combine those two it's a significantly different picture.

Colin Sebastian - *Robert W. Baird - Analyst*

Okay, thanks for the color.

Operator

Anthony Chukumba, BB&T Capital Markets.

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

Good morning. Had a question on mobile. Basically, you did \$12 million in Q1; you are saying you can do \$150 million to \$200 million. And certainly part of that is going to be expanding to other doors.

But I think I would be more comfortable if I just had some -- a little bit more color just in terms of what you are assuming in mobile in terms to get you to the \$150 million to \$200 million. Obviously part of it's expanding doors, but I am sure you are also assuming a ramp up in terms of trade ins and also sales per door. So if you could just give us a little color that would be helpful, thanks.

Rob Lloyd - *GameStop Corporation - CFO*

Anthony, I might need to get back to you on that with some of the details, but we talked about it in March on our first-quarter call and we talked about it in terms of the number of trades, the number of sales per store that we have got to generate. Again, I don't have those notes with me right now, but really it's the ramping of the stores coupled with that model for trades and sales per store that helps us get confidence.

It's the ramping of the stores that are selling tablets and then we talked about the international rollout of trades and then sales coming on the heel of trades. Again, you got to build up the inventory; you got to put it through refurbishment. Then you can put it out to stores and start to sell it.

So I can get back to you or have Matt get back to you with our detailed assumptions around the sales and trades by region.

Paul Raines - *GameStop Corporation - CEO*

We put out a model there; I think we put out a light version of the model for competitive reasons back in March. But I think that the key things to look at is to verify for yourself if you think our assumptions are aggressive. We don't think they are.

The wild card here is international. We like where we are at in the US. Don't forget that ByMyTronics is adding inventory now in a way we have never had, but, Mike, you want to talk about the international rollout as well?

Mike Mauler - *GameStop Corporation - EVP, GameStop International*

We did. We had a very fast implementation of (inaudible) trades starting about a month-and-a-half ago. That is now fully implemented in all countries, but we really haven't started to sell the product yet. As Rob mentioned, you have to build the inventory, then you have to refurbish it and repackage it.



So in our first-quarter numbers there are really no international sales of iDevices yet and that will ramp up throughout the year.

Tony Bartel - *GameStop Corporation - President*

What we are looking for is to get -- we talked about last time that we talked at our year-end we talked about moving from three trades per store per week to seven trades per store per week for iDevices. And we are well on the way to achieving that.

Again, what that allows us to do is roll out to more stores. We have been very aggressive on our roll out which gives us a lot of confidence for our Q4. Really the balance of the year, but specifically in Q4 that we will have a very good sales ramp.

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

Okay. Just one related follow-up. You mentioned that sales were on plan so it sounds like you are happy with how sales came out. How about from gross margin? I know you are targeting about a 30% gross margin and I was just wondering if that was on plan, a little bit better, a little bit worse in the first quarter.

Rob Lloyd - *GameStop Corporation - CFO*

Well, I gave you the margin number at \$4.6 million. We talked about \$12 million in sales. I think the actual was like \$12.5 million so the margin rate at that is about 36.6% I think. It's running ahead of the 30% that we had talked about.

We are not selling tablets in as many stores as we are selling iDevices in. The iDevices have a better margin; the tablet is more of a hardware-like margin. So at this stage of the game we are ahead of that margin plan and while we are not -- we are pleased with it but we are not necessarily banking on it holding at 36%-plus for the rest of the year.

Paul Raines - *GameStop Corporation - CEO*

I think, Anthony, one on other thing on this is you will get a good feel from stores now. If you go out and look at where we are at in stores we are in a much broader footprint, as Tony mentioned earlier. And I think this business, which has been a little bit of a pilot for us, I would say guys, for about the last six to eight months since we launched it, it's now going very broad and you will get a good feel for our execution out there in our stores.

Tony Bartel - *GameStop Corporation - President*

Over two-thirds of our US stores currently have either iDevices or tablets or both.

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

Okay, that is helpful. Thank you.

Operator

Brian Karimzad, Goldman Sachs.



Brian Karimzad - *Goldman Sachs - Analyst*

Just continuing on the used iDevice business, so in your guidance for the mobile sales any sense on the mix of that that you are banking on from international? Then can you also give us a sense for what is the time period that you build inventory and kind of how long does it take once you have built that inventory before you refurbish that kind of first group of devices and start putting them out in the stores? And then I have a follow up for you.

Paul Raines - *GameStop Corporation - CEO*

Why don't we let Rob start with the assumptions around international and what you think our expectations are there?

Rob Lloyd - *GameStop Corporation - CFO*

Well, internationally we are, call it, six to eight months behind where the US is, so it is not a significant component of our planning for the year. We are pleased that the business is out there, but at this point I am not ready to talk about what that split might look like between the US and international.

Paul Raines - *GameStop Corporation - CEO*

In terms of the time, we got to be careful here because the competitors -- this is one we are fairly disruptive to this channel now. I think Rob or Tony have said on previous calls the one difference on this is that all of the devices are coming back here to Grapevine, to our high-tech facility. But other than that I am not sure there is much we want to disclose, right, guys?

Unidentified Company Representative

Right.

Brian Karimzad - *Goldman Sachs - Analyst*

Okay. And then to clarify, just on the traditional use business, you are still expecting mid single-digit growth for that in your outlook today?

Paul Raines - *GameStop Corporation - CEO*

Yes. Rob, do you want to address sort of what the components of what we have talked about?

Rob Lloyd - *GameStop Corporation - CFO*

Yes. Sorry, I was making some notes. We did talk about in the call in March mid single-digit on the used side where we are still projecting growth in used for the year. I think that is about all I am willing to disclose about it at this stage.

Brian Karimzad - *Goldman Sachs - Analyst*

Okay. So not necessarily the same mid single-digit as we kind of back things out from the reduction in the same-store sale guide?

Rob Lloyd - *GameStop Corporation - CFO*

That is fair to say.

Brian Karimzad - *Goldman Sachs - Analyst*

Okay, that is helpful. Then for the Wii U launch, I understand that you do a lot of work on historic cycles and understand that the behavior ahead of this cycle seems similar to the past. But are you guys banking on similar behavior when they launch, given that the innovation on some of these may not be quite what it was six or seven years ago?

Paul Raines - *GameStop Corporation - CEO*

Yes, that is an interesting point. As far as the innovation on them, there is really not a lot known publicly about them. We certainly like what we see, and I will let Tony talk about his visits with publishers.

Are we banking on it? Our model is not -- and I will let Rob talk about what is in our model. We certainly don't even -- it's only launching in the fall of this year so we don't have anywhere close to a full year so we can't bank on a lot of the launch volume.

But as far as innovation, I mentioned earlier that we are talking to the PowerUp Rewards community about what they expect in a new console and there is a lot of innovation expected by consumers. So we suspect that our partners will be creating a lot of innovation.

Tony, do you want to talk about gameplay publishers, that kind of thing?

Tony Bartel - *GameStop Corporation - President*

I can't say a whole lot, because of the restrictions that we have, I can just say that -- I think what you will experience at E3, some of which we have seen, I think will be a very positive experience on the Wii U. And I think I should hold my comments to that until after E3.

Paul Raines - *GameStop Corporation - CEO*

The other thing about the historical, if you do the research on the historical console launches, you can imagine GameStop, we have people here who have been -- we have a museum downstairs that every console ever made. We have got merchants and buyers who saw every console launch.

One of the other things that comes out of the history is the new consoles are always dismissed as not being innovative, and expectations are always very low and there is always --. So this is a little bit of what you see in previous console launches.

Tony Bartel - *GameStop Corporation - President*

I will say we are seeing a high level of innovation.

Brian Karimzad - *Goldman Sachs - Analyst*

Okay. But, Rob, when you are making our plan for like a Wii U in the fall you are not banking on what happened in 2006?

Rob Lloyd - *GameStop Corporation - CFO*

I think what we are doing is looking at the history that Nintendo has in terms of delivering launch date quantities and quantities in the couple of months following the launch so that we can model what we think is going to happen in fiscal 2012 conservatively based upon where we know the cycle is, what we believe the technology is, and what we know our share of launches to be. It's important to our quarter, but we are certainly cognizant of what is going on in the industry and what typically happens with a Nintendo launch.

Brian Karimzad - *Goldman Sachs - Analyst*

All right, fair enough. Thank you.

Operator

Edward Williams, BMO Capital Markets.

Edward Williams - *BMO Capital Markets - Analyst*

Couple of quick questions looking at the current quarter. Obviously, it's a wide range of guidance. What are the key levers that are pushing you towards the low end of that guidance?

Rob Lloyd - *GameStop Corporation - CFO*

Ed, this is Rob. I think that as we frame the guidance we looked at where the traffic levels were in the first quarter. There was some things that drove traffic in February, primarily IRS refund checks that kind of ran their course. We looked at traffic pre- and post-Easter. We have looked at traffic thus far in May and we have considered what typically would happen in the summertime when school lets out and how that impacts traffic.

From there we built what you would typically expect any company to build, which is sort of an expected case, a worst case, and a best case. I think for us the news that we might hear at E3 -- we are not sure what that news is, but E3 can be an impetus for things.

Paul Raines - *GameStop Corporation - CEO*

Ed, the thing that we have talked about is that it's important to share with you the challenges we are seeing, the variables that go into their forecast, and just be transparent about that. Some of this is harder to predict than it has been, so that is all of what is going into this.

Edward Williams - *BMO Capital Markets - Analyst*

As you have looked to the second half of the year obviously the Wii U can be a catalyst, Halo 4 can be a catalyst -- all of which are presumably Q4. How does Q3 shake out? What are the drivers that kick in for Q3 that can affect traffic?

Paul Raines - *GameStop Corporation - CEO*

In terms of titles, you have got Madden that typically is there, FIFA. Assassin's Creed, as I understand it is in October. We expect big things from this Assassin's Creed. There is a number of other titles there as well. Tony, do you have any --?



Tony Bartel - GameStop Corporation - President

Resident Evil should be good as well. I think that we are seeing from a title perspective that it should be good.

Again, I think some of that is going to be clarified at E3. Certainly -- we do not have any knowledge of this, but certainly any pricing action on the hardware would be advantageous as well. We don't know, again, what is going to be announced at E3 but that would clearly be a catalyst for movement in the marketplace.

Edward Williams - BMO Capital Markets - Analyst

Okay. And then just one question to follow-up on pricing. In the conversations that you are having with your customer base, how critical is price to the success of the new hardware consoles?

Paul Raines - GameStop Corporation - CEO

Well, we have discussed price and that is part of our survey panel. I want to save some of that; we are going to release some of this stuff post E3.

But I would say the comment about -- the first comment I said that consumers are expecting a console and they will expect that they will be worth what they pay for them. We anticipate a high level of innovation in the devices, but we also anticipate that to command higher price points they will have to be sensitive to those things consumers told us are important to them -- backwards compatibility, pre-owned games, etc.

So while we don't want to share a lot of the data on price points, we will be sharing it with our partners. But we do know that there is an expectation around innovation and use of the device for multi-uses.

Edward Williams - BMO Capital Markets - Analyst

Okay, great. Thank you.

Operator

David Magee, SunTrust Robinson Humphrey.

David Magee - SunTrust Robinson Humphrey - Analyst

Hi, guys, thanks. Couple of questions. One is on the May numbers, just sort of hypothetically, given that we have got better titles, we are still expecting the software to be down though, right, for the sector year over year. Is that because the backlist would be more than offsetting that better title list year to year?

Tony Bartel - GameStop Corporation - President

You are you talking about the May NPD numbers?

David Magee - SunTrust Robinson Humphrey - Analyst

Yes, May NPD or just the sector trends. I mean even with better titles I guess I am just trying to get a sense for what that means in terms of what we might see there.



Tony Bartel - *GameStop Corporation - President*

David, I am hesitant to predict what NPD might look like but I will point out that Diablo 3 is a PC title and would not be in the in NPD software numbers then.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Okay. Secondly, Rob, what have you built in at all in terms of ASP changes in the second half of the year? Is there the thought that you could see additional price cuts on the hardware or the software side?

Rob Lloyd - *GameStop Corporation - CFO*

As Tony mentioned, hardware cuts have the potential to drive things but we are not necessarily at liberty to say all of what we might know about that. But to the extent we don't know of a price cut, we are not certain of a price cut coming, we don't build it into our forecast.

David Magee - *SunTrust Robinson Humphrey - Analyst*

So it's not in the forecast, okay. Lastly, you mentioned consolidation benefits overseas. Are there any thoughts that you could have some here at some point, given that the other players in the business here domestically must be really hurting with your trends?

Paul Raines - *GameStop Corporation - CEO*

Certainly we see what is happening in the channel, we know that some of our competitors are closing, big-box stores. We certainly have seen people exiting, as I mentioned, the pre-owned business.

We think that is positive for GameStop. Tony, you want to talk about what you hear from publishers in terms of volumes of orders, that kind of thing?

Tony Bartel - *GameStop Corporation - President*

Sure. You can just look at the share gains that we continue to pick up month after month as we continue to report here. But essentially we are becoming more and more important each and every day as our competitors order less and less and deemphasize this category to a certain extent. Some get out entirely.

But what it allows us to do is work very closely, again executing what we call our circle of life, which is having pre-order exclusives and having pre-orders and using our trade credits to fund this. So I think all it does is bring people closer into our model and allow us to tighter integrate with the publishers, which is exactly what you are seeing. Using PowerUp Rewards has been a tremendous weapon for us to use with a lot of our publishing partners, because they love the stealthy element of it where we can put out very unique and differentiated deals and they are very nonpublic.

Paul Raines - *GameStop Corporation - CEO*

One other thing we may say, Mike Mauler, maybe you want to comment on square footage that you are seeing around the world? It's a little early, but your thoughts on that.

Mike Mauler - *GameStop Corporation - EVP, GameStop International*

There is a number of different markets where there has been competitors that have closed stores, reduced the square footage in those markets. We have all read about some of the issues that GAME Group has had. However, I will say that at this point they haven't closed any stores outside of the UK. They did enter administration on Monday in Australia.

We are also seeing, as Tony mentioned, internationally some of the big boxes that have experimented in used or expanded the category when it was hot they have started to pull back. In some cases, actually just get out of the business all together. So while it's hard to predict for this year in terms of the impact, we expect at this point that trend to continue.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Great, thanks. Good luck.

Paul Raines - *GameStop Corporation - CEO*

Thank you, Dave. So with that we will wrap up the call. Thanks very much for your time and attention in support of GameStop. We look forward to seeing all of you at E3 and talk to you soon. Thanks.

Operator

Again, that does conclude today's conference. We thank everyone again for their participation.

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