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GME - Q1 2015 GameStop Corp Earnings Call

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OVERVIEW:

Co. reported 1Q15 YoverY sales growth of 3.2%. Expects 2015 EPS to be $3.63-3.83. Expects 2Q15 revenues to range between decline of 3% to flat YoverY and EPS to be $0.21-0.25.

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PRESENTATION

Operator

Good day and welcome to the GameStop Corporation's first-quarter 2015 earnings conference call. A supplemental slide presentation is available at investor.gamestop.com. 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 use by any other party without the prior written consent of GameStop. At this time, I would like to turn the conference over to Paul Raines, Chief Executive Officer. Please go ahead, sir.

Paul Raines - *GameStop Corporation - CEO*

Thank you very much. Good afternoon and welcome to the GameStop earnings call. We always start our calls the same way, but let me just thank every single associate in our organization for extraordinary service and execution this quarter. This was a great quarter, and GameStop once again demonstrated that we will protect our family of associates, customers and investors going forward.

I want to welcome our cast of characters here today, Tony Bartel, our Chief Operating Officer, Rob Lloyd, our Chief Financial Officer, Mike Mauler, our President of International, Mike Hogan, our Executive Vice President of Strategy and Business Development, Mike Buskey, our President of US Stores, and Matt Hodges, our Vice President of Investor and Public Relations.

Let me say it again, what a quarter. Comps of 8.6%, new software growth of 9.6%, and earnings per share growth of 15%.

Starting with the core, we couldn't be prouder of our associates in stores and SSCs around the world, as GameStop grew market share to record level. The base model of reserving games, providing unique content and trade currency, and delivering midnight launches continues to different us in the market.

Digital growth was also tremendous, at 17.2%, led by DLC, mobile, and steam cards. The big idea of offering every customer add-on digital content for their physical games continues to play well with publishers and gamers around the world. We are also seeing great growth at our Kongregate unit on mobile games and are targeting 12 games for publishing this year.

Preowned business had flattish growth, with a very high margin. As you know, new software took a little longer to grow last year as we overlapped the decline of old gen. A similar phenomenon is happening in our pre-owned business, with next gen pre-owned showing great growth, as old gen declines. We continue to expect mid-single digit growth for the year, excluding currency. And Tony Bartel will share details with you on our core business.

The Technology Brands business continues to make great strides. Jason Ellis and his team are up to 549 stores, and all three divisions continue to receive accolades from AT&T and Apple. We are very important to both AT&T and Apple as an extension of their brands and provider of new services and products. As you know, we are heavily involved in the review of Radio Shack real estate, and we are very active in the M&A markets with dealers across the country.

One of the most gratifying pieces of our success in Tech Brands is that we have accomplished a lot of growth while maintaining a very high rate of quality and a low churn rate. Going back to our earliest conversations with AT&T and Apple, we made a commitment to grow the business, but only while we maintained a very high quality level of service and in-store experience; and we are accomplishing that. Tony will also share with you some color on Tech Brands.

Another piece of the business that is officially launching this year is our Collectibles and Licensed Merchandise category, which gamers refer to as loot. We have learned a great deal about this fast growing, popular consumer segment from our Australian colleagues, who have been piloting the business model for two years. You may have noted that we have rolled Collectible sections in all our stores, with some receiving broader exposures than others.

I have to salute our global merchandising team of Shane Stockwell and Eagan Still in Australia, Michael Vandenberg in Europe, and Bob Puzon in the United States for coming together to make this effort happen so quickly. You will see that we can effectively merchandise video game and popular culture merchandise in our stores, along with game or show launches. Mike Mauler will give you color on Collectibles and License Merchandising, but we expect that business to grow to $500 million within three years, and it is off to a great start.

Our capital allocation strategy remains disciplined. We bought back over $46 million of stock this quarter at about $39 per share and expect to repurchase at least $200 million over the course of FY15. We will also pay a dividend of $1.44 this year, a healthy 3.6% yield before the call started, one of the highest in consumer retail. As you know, we sought some debt last fall to fund our Tech Brands acquisition efforts and our capital formula will remain disciplined and consistent.

Guidance for the second quarter is for flat to mid-teens growth, and we increased our annual guidance by the share count reduction achieved through the shares repurchased during the first quarter. We learned in our investor survey that setting achievable targets is important to you and expect to continue doing. Rob Lloyd will give you more color on our results and expectations.

It is interesting. When we first started talking about driving a high rate of internal change here at GameStop a few years ago, we had no idea how rapidly our external space would change. The good news is that we have persevered and today find ourselves with an abundance of good business opportunities, as we build a portfolio of specialty retail brands that make your favorite technologies affordable and simple.

Here are a few key strategy points to remember about GameStop. We will continue to innovate and expand share in our growing video game business, and publishers of all kinds are participating in that process. We created a digital process for selling DLC, steam cards, full game downloads, Kongregate mobile publishing, and many others. We will continue to create and innovate in the digital category to serve our customers.

PowerUp rewards is a foundational backbone to the business, at 40 million members. Technology Brands is a strong partnership with AT&T and Apple, and we can continue to be successful only to the extent that we serve their needs. New categories, like Collectibles and others upcoming, will continue. We are very active in the M&A space, as we continue to diversify the Company; and our capital allocation will continue to be disciplined.

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

Rob Lloyd - *GameStop Corporation - CFO*

Thank you, Paul. Good afternoon, everyone. I'd like to start today by covering the results of the quarter. We had a fantastic quarter. Here are the highlights.

Overall results exceeded our expectations in terms of revenue growth, same store sales, operating margin, net income and EPS. Sales increased 3.2% in the quarter, driven by next gen software growth. Comparable store sales increased 8.6%, exceeding the high end of our guidance range by over 300 basis points. Gross margins declined 40 basis points on the strength of 10% new software growth and the resulting shift in sales mix.

SG&A as a percentage of sales was 23.3%, down from 24.1% in the prior year quarter due to leveraging the sales growth. Operating earnings increased 17% for the quarter on the strength of our sales results. Interest expense increase $4.8 million, due to the $350 million in debt outstanding. Net income increased 8.5% and EPS increased 15.3%. Foreign currency moves cost nearly $100 million in sales, but had minimal impact on EPS.

Now let's look at sales and margin during the quarter for some of the categories. Hardware sales increased 40 basis points in the quarter, but increased 5.1% excluding FX, because of strong demand for the PlayStation 4 and hand-held units. Software sales grew 9.6%, or 15.8% excluding FX, driven by our market leading position on strong new titles, such as Mortal Kombat X, Battlefield Hardline, and Dying Light.

Pre-owned revenue was down 3.4%, but actually increased 0.8% excluding FX. At 49.1%, pre-owned margin rates for the quarter were 140 basis points higher than Q4 and comparable to the prior year quarter. Digital receipts on a non-GAAP basis grew 17.2%, or 23.3% excluding FX, to over $220 million for the quarter. As we said in the release, growth was led by sales of DLC for Evolve and Mortal Kombat.

GAAP digital revenues declined 18% year-over-year, due to FX impact and because we now account for Kongregate on a commission basis compared to a gross receipt basis in Q1 of last year. Mobile revenues increased 33.9%, which was attributed to the 70% growth in our Technology Brands revenues. Mobile margins for the quarter increased due to margins improvement in Technology Brands, from 36.2% in Q1 last year to 39.8%.

Tech Brands revenues totaled $102.2 million, up 70% from the first quarter of last year; and we ended the quarter with 549 Spring Mobile and Simply Mac stores. Tech Brands' operating income was $3.1 million, which was down from $6 million a year ago due to added infrastructure costs of approximately $4 million to prepare for opening roughly 200 new stores over this coming summer.

The number of store openings in the next three months is four times the highest number of stores we had opened in any previous quarter, and we needed to hire and train store personnel and field management in order to ensure successful openings. These added infrastructure costs will also impact the second quarter.

Some other data points are as follows. We closed a net of 40 video game stores around the world. We acquired or opened a net of 65 Technology Brands stores. In the quarter, we repurchased $46.4 million in stock, or 1.19 million shares at an average price of $39.03, and we paid the first quarter dividend at $0.36 per share.

Now I'd like to discuss second quarter guidance. As stated in our earning release, we expect same store sales to be flat to positive 3% and revenues to range from a decline of 3% to flat year-over-year. Changes in foreign currency rates are expected to negatively impact revenue by approximately $100 million when compared to the second quarter of last year.

We expect monthly software results from NPD to vary dramatically during the second quarter. The industry and GameStop will be comping Mario Cart 8 and Watchdogs in May. On the other hand, Batman Arkham Knight in June does not have a significant comparison from last year. There are no major titles expected in July to compare to the last of us from next gen from last July.

Due to our over indexing in market share on new titles, we are expecting new software revenues to be down in the second quarter as the two biggest titles, Bewitcher 3 and Batman Arkham Knight, are not expected to sell through as many units as the two biggest titles of Q2 2014, Watchdogs and Mario Cart 8. According to NPD, in the US, nearly 3 million units of Watchdogs and Mario Cart were sold in the second quarter last year. Our share of that helped drive a 16% increase in new software and 22% comps for us in the second quarter of 2014.

Despite this decline, we still expect higher operating earnings compared to the prior year quarter, due to the strength in other areas of our business. We are guiding EPS for our second quarter to range from $0.21 to $0.25 per share. We are expecting a 37% tax rate for the quarter, which is higher than we had in the second quarter of last year, and we will have approximately $0.03 per share in interest expense.

You should model 108 million shares outstanding for the second quarter and 108.2 million shares outstanding for the full year, based on buyback through the end of the first quarter. After considering buybacks we've completed thus far, we are raising our full-year guidance from a range of $3.60 to $3.80 per share to a higher range of $3.63 to $3.83 per share.

I will now turn it over to Tony for his comments.

Tony Bartel - *GameStop Corporation - COO*

Thanks, Rob.

As Rob and Paul have already shared, Q1 was a strong quarter for GameStop and showed the power of our diversification efforts. We achieved record Q1 market share, gained share in digital, met our pre-owned expectations and grew Technology Brands, all while maintaining high customer satisfaction levels.

We remain focused on being the premier video game destination, and we drove 360 basis points of total video game market share growth during the quarter. We increased our Xbox One and PS4 software share by 420 basis points, to 54%, and our new gen hardware share by 260 basis points, to 38.5%. On a combined basis, GameStop sold 46% of all Xbox One and PS4 hardware and software combined during the quarter, up 610 basis points from last year.

We continue to gain share in a new cycle that is significantly outpacing previous launches. The month of April was even more impressive than the quarter, as we captured 47.6% of all software sold. We sold 57% of all Xbox One and PS4 software during the month and nearly half of all the new gen hardware and software combined.

A promotion that we recently ran shows the power of our unique value proposition. During the month of April, we partnered with Microsoft to run a promotion where customers could buy a new Xbox One console for $275 with the trade-in of either a PS3 or an Xbox 360 console. We nearly doubled our Xbox One market share during the month; but more importantly, GameStop drove two-thirds of the 63% industry growth that Xbox One experienced during the month. We are providing unprecedented value that is fueling this cycle's growth.

We also gained share in digital receipts, as we grew 17.2% after the impact of FX, to outpace the aggregate growth of our top four publishing partners. In the US, we grew 22.7% and we grew international 24.9%, excluding FX. GameStop's full game AAA downloads more than tripled and our downloadable content increased by 83% during the quarter.

Based on information from DFC Intelligence, full game AAA digital down holds represented 3% of the total software market in the first quarter and that specific segment was 40% smaller than the downloadable content category. Indy games and catalog games are bigger than both of these categories combined, and we are developing plans that we will share on future calls to increase our share in this important category.

As we noted in our fourth quarter release, we are seeing far fewer digital tokens packed into hardware, and we do not expect significant digital pack-ins for the balance of the year. Kongregate continued to expand its mobile publishing efforts, increasing mobile revenue by 37% during the quarter and exceeding 40 million mobile game installs life to date. We are on track to launch 12 games this year.

Turning to pre-owned sales, our growth of 0.8% excluding FX met our expectations, as our pre-owned sales have a higher mix of declining prior gen software than our new business has. As you can see on slide 7 in the supplemental data provided on our website, our pre-owned business is outpacing our new business in both software categories, new gen and prior gen, besting new gen growth by 31 points and prior gen decline by 38 points.

However, because we still have a higher mix of prior gen, our overall pre-owned growth is 13 points behind our new software growth. As our new gen pre-owned inventory continues to build, we expect our full-year pre-owned growth rate to be mid single digits.

Finally, our Technology Brands division continues to expand. Our end of quarter store count of 549 stores is more than double our count at the end of Q1, 2014. As Rob indicated, we're investing for significant growth over the summer, where we plan to open approximately 200 stores. These stores are a combination of Radio Shack conversions, GameStop conversions, and white space stores. In addition, we continue to be active in the acquisition market.

Technology Brands stores that have been open more than a year are growing earnings at a strong double-digit pace, and this gives us confidence to continue to invest in this fast growth concept. We are currently the largest and fastest growing Apple authorized reseller, the second largest and fastest growing AT&T authorized dealer, and a top five Cricket dealer.

As impressive as that growth is, what is even more impressive is our ability to quickly ramp these businesses while still maintaining a high level of customer service. We are the most productive dealer in the AT&T network and remain in the top tier of all Apple authorized resellers. Our churn is down and the Next program is driving traffic growth. The strength of our relationship with AT&T and Apple has allowed us to quickly become large national dealers in their respective networks, as we continue to expand our retail footprint in a high service manner.

These relationships also provide us with new opportunities to drive even greater growth. Our AT&T stores are ready to sell future AT&T products and services, and we are also assessing our GameStop stores for these services, as well. And over 50% of the traffic that we receive at our Simply Mac locations are for high margin Apple certified services that we offer for all Apple products, regardless of where they were purchased. We are on track to open between 450 to 550 Technology Brands stores this year and grow our annual profits in this segment between 30% and 40%.

And now I would like to turn the call over to Mike Mauler to discuss another exciting new growth opportunity.

Mike Mauler - *GameStop Corporation - President, International*

Thanks, Tony. Good afternoon, everyone.

GameStop's International businesses had a solid first quarter, exceeding expectations with a 6.9% same store sales increase, record market share, and a significant improvement in operating earnings over Q1 2014. We have now entered our third consecutive year of positive same store sales growth.

Along with growth in the pre-owned and digital categories, one significant global driver of GameStop's same store sales and profitability increase during the quarter was the expansion of our Licensed Merchandise and Collectibles category, or what our customers like to call loot. Driven by exciting new products, such as Zelda Monopoly, Game of Thrones Top Vinyls, and Mind Craft Lego, this is our fastest growing global category during the quarter and was accretive to our overall margin rate.

As we have mentioned on previous calls, over the last several years GameStop has focused on expanding its franchise marketing efforts, especially around the launch of major new releases. The global focus on selling related products that tie to software IPs, such as Call of Duty, Batman or Pokemon, has helped increased the sales and gross margin per customer transaction and has also been met with enthusiastic demand from our customers, extending the consumer's experience with the brand they love.

Driven by the high demand for these types of products and feedback from our customers through PowerUp rewards, our team in Australia piloted expanding the range of loot in all locations to include other gaming and pop culture related products, such as cards, board games, T-shirts and exclusive collectibles related to popular games, movies and TV shows. With dedicated in-store sections and an expanded assortment, sales and margin have increased rapidly.

Finally, due to the success of our in-store loot expansion in Australia, we have also been testing over the past nine months a stand-alone retail contest called Zing Pop Culture, which is devoted to this category. The initial pilots have been successful and it ended the quarter with six stores.

Based on this success and key learnings, our merchant teams worldwide coordinated their efforts for the initial launch of this product category in all 6,100 stores in the US and Europe during the first quarter. As sales have continued to climb on these new products, we are increasing the space devoted to the category in all markets. This second wave of expansion will be completed by the end of the second quarter.

The expansion of this category has been met with very enthusiastic demand from our store associates and customers, and we expect continued strong sales growth in 2015, driven by many outstanding entertainment launches, such as the recent release of The Avengers Age of Ultron, Pixels, Hunger Game, and the upcoming Star Wars Episode 7, The Force Awakens, which is experiencing very strong pre-orders.

In North America, the entertainment collectible and licensed merchandising category that we are competing in is approximately $11 billion annually and is very fragmented. We are excited by this opportunity to drive continued same store sales growth and increasing relevance with our customers, and we expect this category to grow to a $500 million business globally for us over the next three years.

And now I will turn it over to Paul.

Paul Raines - *GameStop Corporation - CEO*

Thank you, Mike. And with that, I think we'll open it up for Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Mike Olson, Piper Jaffray.

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

When you talk about the third-party data that suggests only 3% of games purchased were full game downloads, can you just describe how that's different than maybe what the publishers are talking about with 15% to 20% of software sold as full game downloads? Do publisher numbers include PC or other categories, and the third-party data only includes console, or what else would describe that?

Paul Raines - *GameStop Corporation - CEO*

Sure. Tony, you want to talk about that?

Tony Bartel - *GameStop Corporation - COO*

Sure. I think what I've heard the publishers say typically is they'll describe that their attach rate on a game for a specific time frame. What DFC Intelligence does is actually talk to consumers about where they actually spent their dollars. So it's a much broader perspective, and they break it down into categories of saying they spent this much into the AAA digital downloads, this much into downloadable content, this much into the

Indy games and so forth. So we believe it's a much more accurate metric. So I think what you're hearing on the 15%, 20%, as I've been listening, is that typically responds to a game for a specific time frame, generally around the launch periods.

Paul Raines - *GameStop Corporation - CEO*

But, you know, Mike, this is an obscure area, so you've got to be careful. We're reporting on industry data. Our publishing partners report on their own data. So somewhere in between, we'll see what the truth is. All we can do is go by what the industry data is, the third-party data.

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

Okay. And then for pre-owned, you're essentially saying that similar to new software sales growth last year being delayed by legacy gen decline, it's kind of the same now with pre-owned legacy gen essentially bogging that down and you expect that it will kind of tick up later in the year. Is that the right way to read that?

Rob Lloyd - *GameStop Corporation - CFO*

Yes, Mike, that is exactly the right way to read it. Typically, you'll have about a six-month lag in that time frame is what we historically see. So we fully expect for the pre-owned growth rates to eventually exceed the new growth rates in the back half of the year.

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

Great. Thanks very much.

Paul Raines - *GameStop Corporation - CEO*

Thank you.

Operator

Arvind Bhatia, Sterne Agee.

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

Thank you. And I'd like to add my congratulations, guys, on the quarter. I wanted to spend just a quick second on the Technology Brands, if I could. I know that you mentioned the operating income was down in the quarter, but I still wonder if the Tech Brands outperformed overall versus your expectations this quarter. That's one.

And then going back to Mike's question on downloads for a second, whether it's 3% or 15%, I guess the trend is that increasingly more games are going towards that format. And I just would love to hear your latest thoughts on some of the efforts that you guys are looking forward to putting in to gain market share in that and how we can kind of look back at DLC and your success there. So, thank you.

Paul Raines - *GameStop Corporation - CEO*

Rob, why don't you start us off on Tech Brands. Did they outperform versus our expectations?

Rob Lloyd - *GameStop Corporation - CFO*

I would say that they performed at our expectations. We knew we were going to need to invest in the infrastructure in order to support the level of store openings that we've got going on. And so that was sort of baked into our thinking about their performance during the quarter. I'd say they hit that.

We are still tremendously pleased with performance on new stores and performance on acquisitions that exceed our targeted IRR. I think there's still a slide in the deck that you can find on our website about that. And so the individual store contributions that we're seeing, the performance against those IRRs, as Tony mentioned in his remarks, warrant additional investment.

Paul Raines - *GameStop Corporation - CEO*

Let me get this started, Tony. The thing on the downloads, Arvind, I know it's been controversial, but if you look at the numbers that we have, it says that full game downloads, we sell full game downloads. It's a pretty good experience, low volume, 40% smaller, I think, Tony, than DLC. We would love to sell more full game downloads. The consumer is just not ready for it, right, Tony?

Tony Bartel - *GameStop Corporation - COO*

Absolutely. So Arvind, I'll go back to your comments on downloadable content, where we had a 41% market share in the first quarter. And obviously what we do there, we do a great job of helping people discover that content, because it's great content but not a lot of people know about it. And then as we've talked about before, a lot of that content is actually purchased with trade credits at our stores, so we make it affordable.

I think the same model applies to the digital full game downloads, as well. And so we'll continue to help people discover the full game downloads. And we really are very customer centric on this. If they want to buy digital, we sell them digital. If they want to buy physical and get the residual benefits of being able to use it for a trade credit, we're going to sell them physical. Like I shared, though, we have some exciting things planned that we will share in the future about what is a bigger category, which is indie and catalog games, and that's a much bigger category than both DLC and full game AAA downloads combined.

Paul Raines - *GameStop Corporation - CEO*

I think if you do the research, right, guys, DFC would tell us that indie and catalog are fairly significant compared to -- Rob, you want to mention something on other forms of media?

Rob Lloyd - *GameStop Corporation - CFO*

Yes. Tony mentioned that what we're trying to do is give the customer what they want, whether that's digital and physical. And so we spent some time in the past few months, and we've talked to many of you about this, studying other forms of media and what the customer adoption has been in term of digital versus physical. On the book side of the business, somewhere between 25%, 27% of the book business is now digital. The remainder, obviously, would be physical; and that industry has reached an equilibrium in terms of digital versus physical. Movies, I think, are around 42%, based upon some data that was put together for us by Tony Wible. And then the music industry is in the mid-40s, in terms of a physical and digital split.

So the way that we approach this is in thinking about our business, we have the most expensive form of media, we have the most established second-hand market. There's a little bit of one for books. There really isn't for music or movies anymore. Customers know that their games are worth \$20 to \$25. And our form of media is also the most difficult to download. So as you think about where the consumer might go, it just doesn't seem logical to us that they would extend digital adoption past the point of any of those other forms of media.

Tony Bartel - *GameStop Corporation - COO*

But if they do, we can sell them that download and it'll be a good experience like anything else.

Paul Raines - *GameStop Corporation - CEO*

Absolutely.

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

That sounds right, but just one more second here. When you started DLC, it started off, if I remember correctly, a little bit slow and then it took you guys a little bit of time to convince all the other players, console companies and the publishers, and then you really took off. Are we kind of in that stage now where there are negotiations going on, and is there any hurdles on that front that once you clear those, then this can take off for you, as well?

Paul Raines - *GameStop Corporation - CEO*

Tony, let me say, there's negotiations going on all the time everywhere on everything. So that's not unusual. But I think you have to look at this and say, DLC were smaller file sizes. That's why we chose that business to go after as aggressively as we did. I think, Tony, the bigger file sizes, it's still going to be tougher to get there. Now they will sell some, and they'll give them away free and they'll do advance downloads and so forth, but it's going to be hard to build that business under the current technological infrastructure. That will change, though.

Tony Bartel - *GameStop Corporation - COO*

I agree.

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

Thanks, guys. Thanks for the color.

Operator

Brian Nagel, Oppenheimer

Brian Nagel - *Oppenheimer & Co. - Analyst*

A question I think someone already addressed, used, I wanted to jump back on that topic, and you spent a lot of time talking in your prepared comments, too. But just so we understand, as we look at the results, if you look at the sales results in that category. (Indiscernible) As we look at it right now in Q1, is it more a function of supply or demand? I think I heard you say that to a certain extent, the consumer is switching now to the new gen games. And there isn't the number of titles in your used business. Is it more of a supply or demand issue at this point? And I'll follow up with some questions.

Tony Bartel - *GameStop Corporation - COO*

It is definitely a supply issue. As we get the inventory in, we're turning it very quickly on the Xbox One and PS4, and we're turning it at normal rates on the PS3 and Xbox 360. So it's purely an issue of supply.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Is that consistent then with the past several cycles, the timing of this?

Tony Bartel - *GameStop Corporation - COO*

It is absolutely consistent. The only difference is that if you recall in the last cycle, we didn't have a significant decline in the previous generation, so that's the only thing that's different. But in terms of the inventory and supply position, this is very similar to what happened in the last cycle.

Paul Raines - *GameStop Corporation - CEO*

And if you recall, when we quoted the last cycle, we never quoted it specifically as a model. We said the last cycles demonstrated historical growth. I think we probably all missed the decline of current gen being as fast and as aggressive as it has been. And I guess that's everybody's myth. But if you look at this growth Tony has here, 148% on the next gen inventory, that's pretty strong.

Brian Nagel - *Oppenheimer & Co. - Analyst*

In the last call on used, the conversation I have a lot with our clients is, as we talk about DLC and these games kind of multiplex, are you seeing a tendency for your customers or gamers to hold onto games longer, or that may be -- if that's happening, that's slowing the rate of those games come into you used inventory?

Tony Bartel - *GameStop Corporation - COO*

No, we're not seeing that. Actually, what we see is that when great games come out, or when new games come out on PS4 and Xbox One, you see a lot of trades coming in towards those games. Actually, what we're seeing is what happens with DLC is a fascinating thing, but you'll see people that will buy a game, they'll bring it back in, and then they'll buy it pre-owned again when the next iteration of DLC comes out. So we actually have a very high pre-owned game attach rate to downloadable content when it gets launched. So you definitely have people bringing games back in as currency for the next new game that they want, and then buying that game pre-owned when the DLC comes out

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Paul Raines - *GameStop Corporation - CEO*

Remember that we go way back on this. But I remember -- remember, Tony, the early discussion with publishers was they didn't want to sell DLC, because it would cheapen the content of the game. There's a lot of publishers who missed the original wave of DLC. I would say Activision was an early leader on DLC. And one of the reasons is, they weren't afraid of it. And I think now, every title comes out and has (Inaudible) attached to it. And I think that to the degree that you see more of that, I think it will help drive the DLC rate.

That's why we say, the full game downloads is an interesting business, but it's not nearly the potential business that the DLC business is.

Brian Nagel - *Oppenheimer & Co. - Analyst*

That's very helpful. Thank you. Congrats again.

Operator

Tony Wible, Janney Capital Markets.

Tony Wible - *Janney Montgomery Scott - Analyst*

Thanks. And I'll say congratulations, too. You guys really do deserve a great quarter.

Paul Raines - *GameStop Corporation - CEO*

Thank you, Tony.

Tony Wible - *Janney Montgomery Scott - Analyst*

Quick question. You guys provide a lot of qualitative comments around the second quarter pipeline. Can you guys talk about the third quarter and the title that you see out there and the comps that you have versus last year? And is there a chance -- or do you guys feel like there's a chance at E3 that we could see some titles that kind of fall into the third quarter to kind of fill the void with some of those comps?

And then also, I was hoping on the mobile side of the business, can you guys just give us a sense for what your same store sales is? I know it's been a little bit more than a year now that you guys have had these stores. Any kind of trends that are starting to show up there? Thanks.

Tony Bartel - *GameStop Corporation - COO*

Well, in terms of titles -- and what you're going to see on E3, obviously, we'll talk more about the back half of the year, when we can come back in and talk about that. But you've got some big games that have been announced already. And obviously, we can't talk about the ones that haven't been announced. You've got Madden and FIFA which are coming out. And then you've got, later on in the year, you've got Halo 5 and Call of Duty. You've got Guitar Hero that is now coming out, as well.

So I think there's going to be a lot of game play at E3. And we're excited to have others see what we've seen already, which is fantastic innovation amongst these games. I think the other thing that is going to take a lot of space and time at E3 is virtual reality. I think that's going to be something that a lot of people spend a lot of time on there.

Tony Wible - *Janney Montgomery Scott - Analyst*

Do you see a chance, though, that something could get slated as soon as third quarter if it's announced at E3?

Tony Bartel - *GameStop Corporation - COO*

New idea you mean, or -- Nothing that I can comment on, at this point.

Tony Wible - *Janney Montgomery Scott - Analyst*

Okay. Got it.

Paul Raines - *GameStop Corporation - CEO*

Mobile business, I think we're limited in our agreements with AT&T and Apple to talk about specifics around comp growth. So Rob, anything you want to add to that, same store sales, group profits, that kind of thing, but anything else?

Rob Lloyd - *GameStop Corporation - CFO*

What I'll add, Tony, is that our mobile store, wireless stores, are not included in our comp base. And as we got into this business as a public company, we looked at the only other public company that operates wireless retail as a reseller for the carriers, and comps are not an element of revenue measurement, in that the same store sales are highly dependent upon the types of programs that the carriers are running at any given point in time. For example, we've talked about next (Inaudible) had a dramatic impact on sales dollars, but not necessarily gross profit dollars.

So our guys who've been running the business -- Jason Ellis, who Paul has mentioned, has been doing this for about 14, 15 years -- and the focus that they put on each store is what the gross profit per opportunity or customer that you sign up is, as well as what the gross profit volume is for the store on a month-over-month and year-over-year kind of a basis. And so we've been very pleased with the profitability and productivity that Jason and his team have been able to drive in our stores, in term of that gross profit per door, is what they call it.

Tony Wible - *Janney Montgomery Scott - Analyst*

Got it. And was your comment about used for the growth of the year including FX, or was that without FX consideration?

Rob Lloyd - *GameStop Corporation - CFO*

I think it was after.

Tony Wible - *Janney Montgomery Scott - Analyst*

Okay. Thank you.

Operator

David Magee, SunTrust.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Hello, guys. Congrats on a good quarter.

Paul Raines - *GameStop Corporation - CEO*

Thank you, David.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Just a couple of questions. One is, did you comment about the value piece of the pre-owned business and the performance of that?

Rob Lloyd - *GameStop Corporation - CFO*

No, we did not. We generated $32.5 million of value product this quarter, which was up from $20 million last quarter, so about a 65% growth value product.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Is that year-over-year?

Rob Lloyd - *GameStop Corporation - CFO*

Year-over-year, yes.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Okay. And then how important are some of the product movements within the Tech Brands? I'm thinking specifically about getting allocation of the iPhone or the tablet business being down for other retailers? How important are those trends to the performance you're seeing at Tech Brands overall?

Paul Raines - *GameStop Corporation - CEO*

They're fairly important.

Tony Bartel - *GameStop Corporation - COO*

Yes, very important, the allocation of product and the availability of product is very important. Now what is nice is we can do direct fulfillment in our AT&T stores, which means that every AT&T store, whether it's corporate owned or whether it's a dealer store, has the same opportunity. Given the fact that our stores are the most productive in the entire dealer infrastructure, it means that we over perform on that direct fulfill piece of it. So it's actually beneficial for us, when you have an in-demand product.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Great. Thanks and good luck.

Tony Bartel - *GameStop Corporation - COO*

Thank you.

Paul Raines - *GameStop Corporation - CEO*

Thank you, David.

Operator

At this time, we have time for two more questions. Our next question will come from Shawn McGowan with Needham.

Sean McGowan - *Needham & Company - Analyst*

Thank you. A couple things to hit on. First, would you -- going back to Brian's question early -- would you say that the decline of the next gen being greater -- I mean, of last gen being greater than anybody thought, do you think that's a function of how rapid this new generation is being adopted, that one explains the other?

Paul Raines - *GameStop Corporation - CEO*

I think -- and these guys can comment on it -- the adoption of hardware has been extraordinary in this generation. And if you remember, we would say, for years we would say we've never gone into a console cycle with PowerUp rewards. It's a massive tool. We've provided you tremendous trade credit. We communicated with you. And when we launched, we achieved extraordinary market share. And I think that's where a lot of the dollars have gone early.

Tony Bartel - *GameStop Corporation - COO*

It is. The other thing is, Sean, the early adopters generally bring their entire plans with them. And so what you're seeing is the advent of online play is much stronger this launch than it was last launch. So I think that once you move to a new platform, you move your whole plan there and you pretty well move your entire game play, at that point.

Sean McGowan - *Needham & Company - Analyst*

Makes sense. And then Rob, looking at some of the gross margin in the revenue buckets, some higher than I thought, some lower than I thought, but particularly with the comments we just got on the value portion, do you think that the gross margin in pre-owned is sustainable at this level, and can you comment on the sustainability of the various other buckets as we go through the year?

Rob Lloyd - *GameStop Corporation - CFO*

Sure. You know, a year ago we talked about the value category and we thought it would have an impact on the pre-owned business. And a year, or actually probably five quarters into it, it really hasn't had much of an impact. And so while the 49.1 and the 49.5 we posted in these quarters last year is actually a little higher than our historical range, I think we're still comfortable saying high 40s for pre-owned margin. So we do believe that is sustainable.

And then I think what you see in the digital category is an increase of margin rate from the mid-60s to the high 70s is a function of how we've accounted for Kongregate differently this year. And I would say that that business looks sustainable, as well. The bulk of our revenues on the digital side of our business are now recorded on that commission basis, and so we think that is the pattern. And then the Other category is impacted by what Mike Mauler described with his commentary around the Collectibles and Loot Merchandise. And if we continue to grow that business, we think that it's going to be beneficial for that category and for the business overall. I will say it's probably a little early for me to give you a range of where you can expect that margin rate to be for Other.

Sean McGowan - *Needham & Company - Analyst*

Okay. Thank you. Very helpful.

Operator

Thank you. And our final question today will come from Curtis Nagle with Bank of America.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Great. Thanks so much for taking the call. Just one question on the Collectibles category. You said, I think it was $500 million in about three years, but I just wanted to understand now and what would be the geographical breakdown. And then just a quick follow-up. Was there any change -- or I guess what was the attach rates you guys saw for next gen AAA DLC?

Paul Raines - *GameStop Corporation - CEO*

Mike, you want to take that geographical distribution? It's kind of a guess.

Mike Mauler - *GameStop Corporation - President, International*

Sure. This will be the first year where we're really selling this category in all stores. We ended Q4 last year of having it rolled out. And as I mentioned, we're now expanding those sections. We'll be completed with that expansion by the end of the second quarter.

So for this year, we're estimating somewhere between $150 million and $200 million. But there's still a lot of road left for the year, and we'll see how that plays out. But yes, $500 million in three years is what we're targeting.

Paul Raines - *GameStop Corporation - CEO*

One thing you might say about geography, Curtis, is the United States is a big beat, as Tony and Bob Puzon roll out, and Mike Buskey and the team roll out in the US, they will quickly become dominant. Australia, though, has a very high sales per store number. Part of it is because they've been at this for two years, Mike, right? Europe probably less so. So that's a little bit. We've probably got to update that on future calls. But that's a little bit of what's going on with that loot business. And Tony, attach rates?

Tony Bartel - *GameStop Corporation - COO*

Attach rates are still very strong, Curtis. In fact, we just had one of the highest attach rates ever on Mortal Kombat X. So still remaining very strong on the new platforms.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Okay. Thanks again for taking the call.

Tony Bartel - *GameStop Corporation - COO*

Thanks, Curtis.

Paul Raines - *GameStop Corporation - CEO*

Great. Thank you, ladies and gentlemen, for attending our call today. Thank you for your support of GameStop, and we'll look forward to seeing you in the future.

Operator

Thank you. And again, ladies and gentlemen, that does conclude our conference for today. We thank you for your participation.