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EDITED TRANSCRIPT

GME - Q2 2012 Gamestop Corp. Earnings Conference Call

EVENT DATE/TIME: AUGUST 16, 2012 / 3:00PM GMT

OVERVIEW:

GME reported 2Q12 consolidated global sales of $1.55b, consolidated global net earnings of $21m and diluted EPS of $0.16. Expects full-year 2012 EPS to be $3.10-3.30 and 3Q12 diluted EPS to be $0.28-0.36.

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PRESENTATION

Operator

Good morning. Welcome to the GameStop Corporation second-quarter 2012 earnings call. 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 call over to Mr. Paul Raines of GameStop Corporation. Please go ahead, sir.

Paul Raines - *GameStop Corp. - CEO*

Good morning and thank you for attending GameStop's second-quarter earnings call. Joining me today are Tony Bartel, President of GameStop; Rob Lloyd, Executive Vice President and Chief Financial Officer; Mike Mauler, Executive Vice President of International Operations; as well as Matt Hodges, Vice President of Investor Relations.

I am pleased to begin our call as always by recognizing our passionate GameStop associates around the world. In the United States, across Europe, in Canada and Australia, our team continues to provide outstanding service and innovation.

During the second quarter, the physical console category continued to experience double-digit declines and GameStop continued to gain share as we approach the console transitions. As you saw in our press release this morning, our second-quarter performance was in line with the guidance we provided at the end of the first quarter. Our comp rate of negative 9.3% was within our forecast and reflects the decline of hardware and software towards the end of this console cycle.

Earnings per share were also within our guidance. As we have noted on prior calls, the end of a console cycle is difficult to forecast for the industry, but we are satisfied that we modeled the quarter accurately. We continued to see strong margin expansion during the quarter of over 230 basis points. This margin expansion reflects the increased penetration of our preowned video game business, as well as the increasing contribution of our digital and mobile businesses.

It is worth noting that since the second quarter of 2011, GameStop has now delivered five consecutive quarters of significant margin expansion, averaging 202 basis points per quarter. As in prior console cycles, the flexibility of the GameStop model drives greater preowned and now digital and mobile growth as new hardware and software decline. As the next generation of consoles enters the market in late 2012 and 2013 and '14, we will see top-line growth accelerate and earnings growth.

We are pleased with our digital mobile and new merchandising assortment such as headsets and sound accessories. It is clear that our investments over the last few years are paying off within our other category, growing 40.6% in the second quarter.

In the digital and mobile space, we have built businesses that did not exist just two years ago and today represent 10% of sales. Although the duration of this console cycle has put pressure on the industry, the GameStop team has explored and expanded into new areas to build long-term growth opportunities. Tony Bartel will share color with you on the US business and will also give you some insight into when we expect to see the physical console category return to positive growth.

The international segment outperformed our US business by about 80 basis points on the comp line and results varied by country. We are seeing strength in markets where competitors have exited or reduced their footprint such as Australia where our loyalty program recently surpassed one million members. We continue to leverage best practices such as loyalty and POSA rapidly across the world. We are also executing well in building new digital and mobile businesses in those markets.

As a reminder, the international cost-reduction efforts in the past two years have included closure of our Swedish support center, exit of the Portugal market, outsourcing of support functions in Spain and closure of 112 stores in the last two years. Mike Mauler and his team have navigated well through a challenging macro environment in Europe.

We had a tough comparison to a very strong preowned business in the second quarter of last year. The preowned business also felt the decline in traffic related to new software during the quarter. I would like to highlight some of the positive points in the US data. Sales of preowned current gen software were flat versus a 16% decrease in new current gen software. Sales of preowned current gen hardware grew 24% versus the new hardware category that declined over 25%. This indicates to us that most of the weakness in preowned for the quarter was concentrated in older platforms. Overall, the preowned category significantly outpaced growth of the industry by approximately 20 points. We also expect the Wii U launch to have a positive impact on preowned traffic at holiday.

PowerUp Rewards continues to be the primary driver of the performance of preowned and the PowerUp Rewards program will reach 20 million members by the end of this week in the United States, maybe by the end of today. The PowerUp community represents 74% of sales year-to-date and they continue to transact roughly five times nonmembers. Average transaction frequency is once every 47 days and the collective game library hosted online holds over 334 million games. Our global loyalty programs now comprise more than 24 million members and we continue to use the programs to give us a unique competitive weapon.

On the capital allocation front, we increased our rate of share buyback during the quarter. We are committed to returning capital to shareholders through buybacks and dividends and our return of cash to shareholders through those channels is up 65% year over year. Our current cash flow forecast provides for over $2 billion to be returned in the next four years. We currently have $300 million remaining in a Board authorization for buybacks and our Board approved a 67% increase in our dividend to an annualized $1 per share this week. Our commitment to returning cash to shareholders is clear. Rob Lloyd will share more details with you on our outlook and capital allocation during his remarks.

Since the fall of 2008, GameStop has executed a transformational strategy at the direction of our Board to reposition the Company for the future. Since that time, we have dramatically grown marketshare in console gaming, reinvented the preowned business, built a digital gaming business, launched a mobile business, built an almost 20 million-member PowerUp Rewards community, consolidated international businesses and have returned $1 billion to shareholders through buybacks and dividends.

As we look at the rest of the year, we are focused on the Wii U and new software title launches this fall and driving growth in our new businesses and tablet launches. Also, while the market is constantly changing, history is on our side. In three prior console cycles over the last 15 years, GameStop and its predecessor companies have seen sales acceleration and cash flow growth. Today, GameStop's marketshare is roughly double what it was during the last console launches. Digital and mobile businesses are growing aggressively. Our capital allocation is returning cash and is investor-friendly. We are regularly meeting with investors to understand their priorities. Our management team and Board of Directors are committed to the success of GameStop and are optimistic about the future. I will now turn the call over to Rob.

Rob Lloyd - *GameStop Corp. - CFO*

Thank you, Paul. Good morning. I would like to begin by reviewing our second-quarter results. Our consolidated global sales were $1.55 billion, down 11% from last year with comps down 9.3%. Comps were down 9.6% in the US and down 8.8% internationally. Our same-store sales were within the range we outlined in last quarter's call, as we expected. We had some strong titles during the month of May like Max Payne 3, Diablo III and Ghost Recon, but there were few major releases in June or July and we experienced overall traffic declines. Our number of transactions declined 5% during the quarter while the average transaction also declined 5%, indicating a slowing in traffic and highlighting the lower mix of hardware at the end of the console cycle.

New software sales declined 21% compared to a 29% decrease in the US market. Overall, we gained 340 basis points of new software share in the quarter. We also outperformed the market in new hardware as our decline was less than the US market decline.

As I mentioned, our international comps were down 8.8%. The situation with GAME Group has really only cleared up in Australia where GAME closed all of its stores in June and July. Our operations in Australia have benefited from this.

Preowned sales during the quarter were down 11%. The US was down 7.1% and international was down 14%, excluding the effects of currency fluctuation. Given the decline in traffic overall, the positive news in our results is that preowned outperformed our new software results by 10%.

Our digital business increased 27% over the second quarter of last year with strong growth in PC digital and international console digital. Our digital receipts, or non-GAAP revenue, totaled $134 million with GAAP revenues totaling $55 million.

Mobile sales grew from $12 million last quarter to $28.8 million this quarter. Consolidated global net earnings were $21 million and diluted earnings per share for the quarter were $0.16, in line with our guidance range. The effect of buybacks done during the quarter did not impact our EPS results as EPS using the guidance sharecount was still $0.16.

Gross margins for the quarter were 33.5%, up 230 basis points from last year as we grew our digital and mobile businesses and saw a shift in sales from new hardware and software to the higher-margin other category. Margins in new hardware, new software and the preowned business each increased slightly when compared to 2011. The margin rate in the other category was down slightly from last year due to the sales of Diablo III, which has a lower margin than other products in this category.

Other as a percentage of sales grew from 13.5% of sales to 21.3% of sales. The dollar increase in gross profit for the other category was $27.7 million with the growth coming from digital and mobile businesses, as well as the sales of Diablo 3 and Skylanders toys. Digital gross margin grew 38% to $30.5 million. Mobile gross margins were $9.3 million at a 32% rate.

Total SG&A expense dollars again declined slightly this quarter from last year as we have continued to focus on controlling our SG&A. Depreciation and amortization was also about 7% less than last year. We ended the quarter with 6,628 stores. We opened 28 and closed 14 in the US and opened eight and closed eight internationally. We still expect to reduce our store base by about 1% this year.

Over the last two years, we have been very clear that we intend to return cash to our shareholders and in support of this, GameStop's Board of Directors has taken another step to increase total shareholder return. On Tuesday, they authorized an increase in our regular quarterly dividend to $0.25 a share, which is an increase of 67% compared to last quarter's dividend. At the current stock price, that would represent a dividend yield in excess of 5.5%. We believe a strong dividend will reward existing shareholders and will attract additional shareholders seeking quality companies with sustainable cash flows. We repurchased 7.6 million shares in the second quarter at an average price of $17.96 for a total of $136.4 million. We have approximately $300 million remaining on our current buyback authorization.

Now for the third-quarter outlook. We forecast same-store sales to range from down 5% to down 10%. We are excited about the title lineup, but are cautious in our outlook given the overall traffic declines we have seen this year. We expect diluted earnings per share to range from $0.28 to $0.36 using weighted average fully diluted shares outstanding of 124.5 million, which incorporates buybacks through the second quarter. We are revising our full-year comparable store sales guidance to range from down 2% to down 10%. This change reflects the uncertainty surrounding consumer demand at the end of this cycle in spite of the strong title lineup in the back half of the year. We are reiterating our previously announced full-year 2012 earnings per share guidance as a range from $3.10 to $3.30 using weighted average fully diluted shares outstanding of 128.5 million, which incorporates buybacks through the second quarter. The guidance range reflects the continued expansion of our margin rate and our ability to control costs in a difficult sales environment.

As we stated in the earnings release, due to the recent decline in our stock price, the net book value of our equity now exceeds our market cap. As a result, we are performing an interim impairment test of our goodwill and other intangible assets as required under ASC 350 of generally accepted accounting principles. Management believes that any potential impairment charge will be related to the goodwill and intangible assets recorded in our international reporting units, which are carried on our books at $920 million.

Our historical annual testing of goodwill has shown that the value of the US business has always been far in excess of the net book value of assets recorded in the US reporting unit. This impairment analysis is also not related to our digital acquisitions. At this time, we are in the early stages of the process of the impairment of testing and cannot provide further estimates. There are some very specific steps to follow under the accounting rules, including a complete valuation of the Company's reporting units. It is our intent to complete this process in the third quarter.

Given the difference between our book value and our market cap and given the size of the goodwill and intangible assets on our books, we expect that any impairment charge resulting from this testing would be material to our financial statements, but would be non-cash and would not affect our future operations, cash flows or liquidity. Our review of the future of our business and our ability to generate significant cash flow in the future has not changed. The situation is required by the accounting rules based solely on the decline in our market cap. Our earnings guidance does not include the effect of additional buybacks or the possible results of the goodwill impairment test. Now I will turn it over to Tony for his comments.

Tony Bartel - *GameStop Corp. - President*

Thanks, Rob. The second quarter continued a negative trend in the console category as evidenced by a 26% category decline due to a falloff in the handheld category, large declines in console sales and a 29% decrease in software sales. In spite of the category decline, our unique offerings, such as exclusive content, informed associates and buy/sell trade model, helped us grow share by 173 basis points in the quarter. In software alone, we outpaced all of our competitors by over 11 points as they declined over 32% while we declined 21% during the quarter.

As we look forward to the next three quarters, we see an increasing number of key title launches, all of which are reserving better than their predecessors. In fact, many of the major titles are reserving up double digits over prior year giving us confidence that the back half of the year will be significantly better than prior quarters.

Strong launch titles for Q3 include EA's Madden NFL 13, FIFA Soccer 13 and Medal of Honor Warfighter; 2K Games' Borderlands 2; Blizzard's World of Warcraft expansion pack, Mists of Pandaria; Nintendo's Pokemon Black and White version 2; Activision's Skylanders Giants; and Capcom's Resident Evil 6.

Q4 launches include Activision's Call of Duty Black Ops 2, which is on track to be our largest game launch of all time; Ubisoft's Assassin's Creed 3; Microsoft's Halo 4; Ubisoft's Just Dance 4; and the launch of Nintendo's Wii U console and related software and accessories.

Q1 announced titles include Kaname's Metal Gear Solid Rising; Sony's God of War Ascension; Square Enix's Tomb Raider and Take-Two's BioShock Infinite. Based on the strength of these launches, we see a shrinking category decline in quarters three and four culminating in one of the strongest first-quarter growth numbers that we have seen in a number of years.

As Paul and Rob mentioned earlier, our digital receipts grew 27% over last year. Console digital grew 9% and PC digital grew 76%. Although we expected console digital in the second quarter to be less than our 50% annual growth rate due to tough comparisons driven by the acceleration of Activision's Call of Duty Elite sales into 2011, our digital console growth rate was lower than expected. The overall decline in console-related traffic significantly impacted our sales of Xbox Live and PlayStation Network points cards.

As we have discussed, the success that we are having attaching DLC on the day that a new title launches as part of our integrated launch campaigns, we are now seeing most major software titles providing sellable DLC content at the time of launch. We expect this to provide a significantly higher attach rate in our fourth quarter.

As part of our ongoing process to improve discovery and delivery of digital content to our customers, we recently simplified the delivery method of codes to customers purchasing Microsoft DLC. Leveraging our PowerUp Rewards program, we are now providing those customers with a streamlined simple way to download digital items for Xbox. This new process allows these customers the ability to immediately begin their DLC download from any connected device, including a smartphone inside of our stores.

Customers can immediately start their download by clicking on two simple links from an e-mail that they receive at their time of purchase. By removing the number one consumer friction point of inputting a 25-digit code via a game controller, we have made this process significantly simpler.

Also, we can now sell a broader assortment of DLC and we can sell it earlier, allowing us to incorporate DLC pre-orders with nearly all major title pre-order campaigns.

Finally, we expect increased console traffic to drive stronger growth of Xbox Live, PlayStation Network and Nintendo points cards in the back half of the year. Our PC digital download business more than doubled in the second quarter as we streamlined our PC offerings in store and moved PC sections to more prominent locations. Our strategy of offering over 1,700 games digitally is resonating with our customers and resulting in sustained growth.

In addition, we launched the ability to front Steam Wallets in our stores and this has been a strong addition to our digital offerings. Enabled by our proprietary digital code delivery system, the sale of this currency is bringing in new customers who are eager to take advantage of our associate knowledge and our buy/sell trade model.

Also, we are currently reserving the digital version of Blizzard's new World of Warcraft sequel, Mists of Pandaria, in both the standard and the deluxe edition as part of our expanding digital relationship with Blizzard.

Kongregate grew 50% as we added 42 games that monetized through in-game transactions. Revenue from in-game transactions grew 108% during the quarter. Game Informer continues to grow at a strong rate and we recently announced that Game Informer's physical magazine grew 38% to 8.2 million subscribers, making it the third-largest physical magazine in the nation. In addition, with 2 million paid digital subscribers, it is also the largest paid digital subscription in the world. We are in the process of rolling out digital Game Informer in all countries internationally.

Spawn has completed its national private beta and we are confident in our game virtualization and low latency technology. Based on consumer feedback, our success in selling mobile devices and the imminent launch of new consoles, we have decided to move our technology to a PC-based model. Customers tell us that they prefer to leverage cloud gaming to power their mobile locations and we are in active conversations with publishers and developers to leverage our patented game virtualization technology to deliver hundreds of games to PCs, tablets and connected TVs. We expect to launch this new service in the summer of 2013.

Our mobile business continues to ramp, generating $29 million of revenue, which is more than double our sequential run rate over the first quarter and on track to deliver our full-year goal of $150 million to $200 million that we have previously communicated. We now sell Android-based tablets in over 1600 stores domestically and 800 internationally.

During the quarter, tablet sales were bolstered by the sale of the Google Nexus 7 tablets. In spite of limited supply, we were the first retailer to except pre-orders on the tablet and we have established ourselves as one of the top-selling retailers of this high demand tablet. We expect the supply to improve dramatically in the back half of the year and we look forward to meeting the strong demand that we see for this tablet.

We have applied our buy/sell/trade heritage to iDevices and other mobile devices and are seeing increasing trades, as well as strong consumer demand. Trades of iDevices represent 10% of trades that we received during the quarter and have been increasing weekly. We also began to take the most popular 43 Android devices and the Kindle Fire in trade.

During the quarter, we executed a successful national marketing campaign aimed at driving awareness of our trade-in program that resulted in a significant lift in trades. We are leveraging our 185,000 square foot refurbishment center to test and wipe all iDevices with state-of-the-art proprietary processes designed to get product back into our stores as quickly as possible.

Finally, we have expanded the number of stores selling iDevices to over 3,800 stores and we will be selling in all domestic stores before the holiday season. All stores globally are accepting trades. Based on our trade and sales results to date, we expect to achieve our full-year projection of $150 million to $200 million of revenue this year with at least a 30% margin. With that, I will turn the call back to our moderator for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Tony Wible, Janney.

Tony Wible - *Janney Montgomery Scott - Analyst*

Thanks. I was hoping you guys could update on that 2014 guidance for digital. How do you feel like you are tracking towards that with the current results? And I also don't know if you can share any thoughts on the next gen machines. You had indicated you were doing some survey work last time. Do you share some of those results and specifically do you see those machines carrying cartridges and discs?

Paul Raines - *GameStop Corp. - CEO*

Thanks, Tony. Why don't we let Tony talk a little bit? I think the interesting part is the DLC situation, right, Tony? You want to share some thoughts on that and then maybe Rob can talk about the guidance?

Tony Bartel - *GameStop Corp. - President*

Yes, absolutely. For the balance of the year, we still feel comfortable with our 50% growth rate that we have previously talked about. I think as we look forward to the next console cycle, clearly, we have not seen the consoles. We are not exactly sure what type of technology they will have, but we have clearly established ourselves as a strong digital player. Our ability to download DLC, the technology that we have provided, especially with the changes we have recently made to the Microsoft process make it very simple and we feel like we have fueled a lot of the growth that has taken place in DLC. So regardless of what technology comes with the next consoles, we are very well-positioned from a digital perspective to continue to see solid growth.

Paul Raines - *GameStop Corp. - CEO*

What is interesting, Tony, to us is that while -- the console business has been tough the first half of this year. I mean you guys have seen the NPD data. It has been a challenging year and physical console has been tougher on the declines than I think anyone in the industry thought they would be. What is interesting though is underneath the surface, the amount of work going on at publishers and at GameStop to prepare for the fall on DLC -- it used to be, right, Tony, that you would have one title every now and then would have some DLC. Now it is pretty much a standard part of our go-big launches is what's your DLC, right?

Tony Bartel - *GameStop Corp. - President*

Exactly. I think like I shared in my remarks, what has happened is we have talked with the publishers about the success, especially that we saw with Call of Duty Modern Warfare 3 Elite. Nearly every major title now -- it is almost table stakes that you need to have DLC at launch and that is directly a result of GameStop's salesforce and our process and our ability to sell that DLC.

Paul Raines - *GameStop Corp. - CEO*

Rob, anything you want to say about -- we don't have a lot to say about the 2014 guidance other than what is out there.

Rob Lloyd - *GameStop Corp. - CFO*

Right. The target that is out there has not changed.

Paul Raines - *GameStop Corp. - CEO*

Let me say the next gen -- one more comment on next gen machines, Tony and that is I got some good advice this morning that, in terms of the Wii U, we have to be pragmatic about the Wii U. The sentiment publicly is almost like there is not going to be a console and we have a lot of information around the Wii U that we saw at E3 and that we have had conversations. The PowerUp community -- we are actively engaged in the launch of that device. We can't talk about it until our partners do, but let's not be overly aggressive in our models, but we do have a Wii U launch built into our plans for the holiday.

Tony Bartel - *GameStop Corp. - President*

And we have also been working with Nintendo for the past year on their digital strategy as well. So that is yet another revenue source for our digital.

Paul Raines - *GameStop Corp. - CEO*

So all of this will be part of how we go to market with the PowerUp community. As a reminder, there are 24 million consoles out there in the PowerUp community. Every one of those consoles is available to trade at GameStop and we are going to do everything we can to bring them in.

And then as far as '13 and '14, I mean you guys read the same blogs we do. There is plenty of buzz about consoles and I will probably leave it at that.

Tony Wible - *Janney Montgomery Scott - Analyst*

Great, thanks a lot, guys. Congratulations again on trying to manage in a tough environment.

Paul Raines - *GameStop Corp. - CEO*

Thank you, Tony.

Operator

Seth Sigman, Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

Hey, guys, good morning. First, a question on your preowned business. Given the declines that you are seeing in the old generation preowned, can you just discuss how much old gen inventory you have at this point and how you plan on managing that?

Paul Raines - *GameStop Corp. - CEO*

Yes, yes, let me start us off. Rob, I don't know if we have the numbers now for Seth or if we can get them. I think it is a fair question. What is the exposure on the old gen and really what do we need to do to position ourselves? It is clear that our offering and our strategies with PowerUp and everything else are still working pretty well as we expected on the current gen product. The old gen product has some different variables in it that are harder to manage.

You have got -- for example, we have reduced our number of stores carrying PS2 last year because what we found is that, if you look at the PowerUp data, PS2 gamers are concentrated in certain areas by ethnicity, by urban, by income. So we have got work to do on how we are going to target that group more cautiously. We do think that we suffered from the traffic in the category overall and particularly in that older console platform. When traffic is down as it was, a lot of our promotional activity isn't as impactful.

And I am sure some will ask us about the margin rate and could you spend more to buy more traffic. If you look at our GameStop promotion we ran for seven weeks or so this summer, part of the promotions just aren't as impactful as you budget them to be because of the traffic rate. So I think there is questions there. Rob, the inventory number?

Rob Lloyd - *GameStop Corp. - CFO*

I don't have the inventory information in front of me on that, but I can tell you that, as we see some of these older platforms decline, we see sequential declines year over year in these categories as we move through the quarter. So for example, as we moved through 2011, there was less and less PS2 getting sold every quarter. So we are not worried about our ability to move the inventory that we have onhand and we expect to see that the impact of the older platforms will lessen on the overall preowned category as we move forward.

Seth Sigman - *Credit Suisse - Analyst*

All right, that's helpful. I appreciate that. And Paul, I just want to go back to your comments on the Wii. I realize you can't share much about the details of the product at this point, but you mentioned some feedback that you are getting from PowerUp. I mean what are you hearing from consumers about their appetite for that console and I guess just next-generation consoles in general?

Paul Raines - *GameStop Corp. - CEO*

Well, Seth, we have been studying technology curves here and if you go back and look at technology shifts, like what is the classic case study, the 5.25 inch floppy disc to the 3.5, etc. and you look at those S curves, we clearly see that the consumer is looking for more innovation.

It is interesting, in Europe, I like to say to Mike Mauler that I think the consoles are more meaningful as a technology platform in Europe than they are in the US because Americans are further down the tablet scale and so forth. But I think when we talk to our community, there is a tremendous appetite for the IP that comes with those new consoles. I mean the fact that you can play an updated Pikmin on the Wii U like we saw at E3, there is a tremendous appetite for that and all of our consumer work and focus group work and survey work tells us that the consoles have tremendous installed bases and tremendous loyalty and fan base.

The challenge has been is that you have to -- in today's world, consumers have to see innovation. So I am getting a little philosophical there, but let me just wrap that up by saying we see tremendous demand and interest in consoles as evidenced by our ability to do contests and surveys with consumers. There is a lot of appetite, and even in our own employee base, right, Tony?

Tony Bartel - *GameStop Corp. - President*

Right. As I visit stores, Seth, there is a strong excitement around Wii U. I think that that excitement is going to obviously accelerate as Nintendo kicks in what we fully anticipate to be a very strong multimedia ad campaign that is coming. So I think when you see that -- I mean if you think about the console, there has really been very little said about it since E3 and yet there is a tremendous amount of excitement in our stores. So I think that I fully suspect that Nintendo will support it with a very strong marketing campaign and it will create even greater demand in the marketplace.

Seth Sigman - *Credit Suisse - Analyst*

All right, thanks for that. Good luck in the upcoming quarters.

Paul Raines - *GameStop Corp. - CEO*

Thank you, Seth.

Operator

Bill Armstrong, CL King & Associates.

Bill Armstrong - *CL King & Associates - Analyst*

Good morning, guys. So your digital receipts were up about 25% in the first half. You still expect 50% for the year. It sounds like it is a combination of more titles coming out that are going to have digital content attached to it, as well as possibly some boost from Nintendo. Is that fair or are there other drivers also that are going to drive that acceleration in the second half?

Paul Raines - *GameStop Corp. - CEO*

One thing, Bill, and Tony will tell you about what he is seeing with publishers, but don't forget that two-thirds of the year is ahead of us from a sales point of view. That is one of the things in this category -- we were talking to some media this morning. Someone told me aren't you -- isn't it dangerous to be counting on holiday so much. And I said, I guess it is, but we have been at this for a long time and it is always holiday. So two-thirds of the year is ahead of us. I know the doomsday folks don't see it. Tony, what about publishers?

Tony Bartel - *GameStop Corp. - President*

Yes, there are three things to remember, Bill. First, I will remind you that we accelerated a significant amount of DLC into last year with the sale of Elite. Recall that we sold 700,000 copies of Elite last year. And in year-over-year growth, in 2011, we were selling those as individual map packs. We are rolling over that, so that -- we did not expect to be at a 50% growth rate in Q1 and Q2. We expected to be below 40%.

Then you have got the international side of the business where we have Sony rolling out DLC in all of our countries, so that is an additional element as well. And then like I have shared, really up until Elite, you had never seen people launch DLC with titles, as we have shared with people, our success in that. Now you see every single major title that is ahead of us is releasing -- or most of them are releasing with DLC counterparts.

As we articulated in our Q1 earnings call, we attached over 40% to Mass Effect 3 on DLC on the date of launch. So that is where a lot of our growth is going to take place.

Paul Raines - *GameStop Corp. - CEO*

The other thing I would say too is -- so if you accept that the attach rate is going to be better and that there will be more content available at launch, then it is up to how good can we get it making it a frictionless experience. You heard Tony talk about the change we made on the Microsoft DLC. I would encourage you to go buy some DLC at our stores from Xbox Live. What you will see is that we have created a really unusual process where, before you leave the store, you are getting an e-mail on your phone that you can physically activate the download before you leave the store.

And the download -- the other day, I went and bought Minecraft with my son and I walked out of the GameStop store in South Lake, Texas to go get a frozen yogurt with him and before I knew it, we get home, the Minecraft is already downloaded and on his Xbox. So we are trying to make it a frictionless process. We have a lead in selling console and other types of digital content in store and we think our lead is getting bigger.

That industry is nascent and it is counterintuitive. I know that people would buy digital content in store, but go to our stores and you'll see what is emerging there. Not just in console right, Tony, in the PC digital and everywhere?

Tony Bartel - *GameStop Corp. - President*

And I was just going to say the last point is to realize we are well above 50% on our PC business. We are beginning to take parts that are working in the US and export those to the rest of the world as well. So we continue to see growth and obviously traffic is going to increase Q3 and Q4 with all these title launches and the Wii U launch. All of that is going to help drive digital in the back.

Bill Armstrong - *CL King & Associates - Analyst*

Got it. That is a great explanation. Just one other question. On the other sales category, in Q1, it was down slightly year over year. In Q2, it was up $95 million. What changed there? Is there any change in the way you are accounting for that category or what causes a sudden huge increase?

Rob Lloyd - *GameStop Corp. - CFO*

There is no change in the way we are accounting for anything in there. Obviously, we are pleased with the increase in digital and in mobile, but don't forget that PC entertainment software is in that category. So when you launch a Diablo III, it is going to have a big impact on the overall number.

Bill Armstrong - *CL King & Associates - Analyst*

Okay. And I think you mentioned Diablo III also as a main driver for why that category's gross margin was down as well.

Rob Lloyd - *GameStop Corp. - CFO*

Well, yes, because its new software like margins. So you're remixing in that 20%-ish with everything else that is going on in the other category with the higher margin rates.

Bill Armstrong - *CL King & Associates - Analyst*

Got it. Okay, thanks very much.

Operator

(Operator Instructions). Colin Sebastian, Robert Baird.

Colin Sebastian - *Robert W. Baird - Analyst*

Great, thanks for taking my question. Paul, maybe a follow-up on one of the earlier console questions. From our own checks, it seems pretty clear now that physical discs will still be a large part of the distribution mix of software in the next gen. But as you look beyond that launch to the first two or three years after, if the overall industry shifts the balance to more digital and physical distribution, do you foresee a time when the mobile and digital segments could effectively drive the majority of GameStop's sales? Is that something we can expect in the future?

And then my other question is with regards to the capital allocation strategy and specifically the increase to the dividend. As the Board looks to optimize the way it returns cash to shareholders, I wonder if there are any planned uses of cash or liquidity needs for the business that would prevent the Board from considering a significantly higher regular dividend or even a one-time payout.

Paul Raines - *GameStop Corp. - CEO*

Maybe why don't we start with -- Rob, why don't you talk about the dividend and then Tony and I will talk about this transition to digital. Because the dividend I think is not getting enough discussion today, candidly, in the media. I think it is very important for people to understand our thinking on this, Rob. Why don't you share that with them?

Rob Lloyd - *GameStop Corp. - CFO*

Sure. When we started the dividend, we started with a 2.5% yield on what the stock price was at that time. We had every intention, and I think that we tried to communicate this, that we wanted to be able to grow the dividend in the future and this move, increasing the dividend from $0.15 to $0.25, up 67%, is pretty substantial, indicates that we intend to grow that dividend.

We continue to review our capital allocation options with the Board of Directors on a regular basis and we will continue to view what we do between dividend and share buybacks. From an overall capital allocation standpoint, we don't see anything significant on the short-term horizon that is going to change our approach to capital allocation. So you can expect that we will continue to return 100%-ish of our free cash flow to shareholders. And as I said, we will continue to discuss dividend and buyback with the Board of Directors.

Paul Raines - *GameStop Corp. - CEO*

When we did the work, Rob and his team led us through a lot of an analysis on capital allocation and I think one of the things that is interesting is given our undervalued share price, we are really, with this dividend increase, we are in sort of an averagey payout of our cash flow to our peer set. Yet our yield is higher because of our share price.

So we think that in speaking with shareholders, it is important and it is important for our shareholder return to be a broader balanced equation. So I think we are early on in the dividend process.

As far as the transition to digital, let's talk a little bit about it and Tony will help me on this. One of the things that we say a lot around here is it is important to understand the technology. It is also important to understand chronology. And we spend a lot of time in Silicon Valley through GameStop Digital Ventures and we meet with a lot of people focused on technology. Yet as retailers with millions of visits a week, we have to understand chronology. Consumers simply do not adopt all technologies at the same rate.

So yes, we think that the next consoles will have plenty of physical discs in them. As you know, the density of games is getting deeper, all of the different functionalities. We also think these consoles will launch with some DLC. We have built an ability to sell digital content in stores and online, but because we think there is a transition at some point in the future, not in the short term, you are seeing us make bets on tablets. We are developing controllers for tablets in our R&D center and there is a lot of activities going around trying to sort of plant seeds in the digital space. Tony, any --?

Tony Bartel - *GameStop Corp. - President*

Sure. Well, you will continue to see us innovate along DLC and digital delivery like we just did with Microsoft, just keep making it simpler and easier, allowing people to discover and find content. I think as we look at the digital space, the number one thing that we see is that people find it very difficult to get their product discovered. And so what we do better than anyone else, we do it great in the physical space, now we are starting to do it very well in the digital space as well, we help content get discovered.

When you talk about having 20 million PowerUp Rewards, these are gamers who spend way more than the average gamer. We are able to take them and introduce them to games that they may want to play on the digital side as well. So when we make investments like we did in Impulse, like we have with Spawn, like we did with Kongregate, like we are working on on our mobile app that we will launch later this year that will be a discovery app on -- a cross-platform discovery app.

What we are doing is we are bringing our strengths of being able to curate games and then help people discover those games digitally. So we think that works in the digital world. We also think that that works in a hybrid world where you have a console with a disc, which we also believe that that will be the case, but there will be an expanding amount of DLC and honestly, we are driving that expansion.

Operator

David Magee, SunTrust Robinson Humphrey.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Hey, guys. Nice job managing in a tough environment. A couple of questions. One is relative to the Wii U, how important is that to your fourth-quarter assumptions? If the naysayers are correct on that platform and it doesn't do all that well maybe initially, how much downside do you have from that?

Paul Raines - *GameStop Corp. - CEO*

Rob, I don't think you are prepared to give any numbers on what our forecast includes on Wii U, is that correct?

Rob Lloyd - *GameStop Corp. - CFO*

That's correct. I won't talk about numbers, but I will talk about what we said all along and that is we are cautious in how we forecasted it because we have been through Nintendo launches before. We have confidence in the allocations that we will receive. We have demonstrated to Nintendo in the last couple of things that they have launched that we can move product in a hardware launch. And we're confident that we will move product and we will get a nice allocation of -- a nice share of the allocation. What we can't control obviously is the overall quantity of available for the market and so we have taken a cautious approach with that.

Paul Raines - *GameStop Corp. - CEO*

I think we have got to keep thinking to ourselves, David, that we have got to be pragmatic, not aggressive on the forecast for Wii U, but pragmatic. There is going to be a Wii U. It is a compelling gameplay device and we have that included in our forecast.

Rob Lloyd - *GameStop Corp. - CFO*

And remember a comment that Paul made in his remarks. Remember that our marketshare now versus when launches took place before is roughly double and so any success that we are going to see in all of the upcoming console launches, we will double our participation in those.

Paul Raines - *GameStop Corp. - CEO*

I think it is true that there are naysayers on Wii and on Wii U and that is fine. People make their own judgments, but if you believe that device will have any impact at all, GameStop will get outsized results on that.

Operator

Mike Hickey, National Alliance.

Mike Hickey - *National Alliance Securities - Analyst*

Hey, guys, thanks for taking my questions. Just thinking about international markets for a while, obviously there has been some sort of macro considerations, the negative side on Europe relative to domestic. Yet, for the last couple quarters, it looks like your international comps have actually been outperforming what we have seen here in the US. So can you just provide us with a little bit more granularity on what is happening over there?

Paul Raines - *GameStop Corp. - CEO*

Our resident bon vivant is here, Mike Mauler, who will handle that question.

Mike Mauler - *GameStop Corp. - EVP, International Operations*

Sure. Certainly we have had our share of economic headwinds, especially in Europe and part of the reason for the same-store sales difference is a decline in some of our competitors, such as GAME closing their Australian stores. But also a significant driver of the results is really our focus on the basics and sharing best practices over the last two years. And we have talked about it on other calls in terms of expansion of our used and refurbishment capabilities and the increase in used margin, as well as driving reservation growth.

So for example, last year, we mentioned that as we entered into Q3, we had 100% more new release reservations versus prior year. This year, we actually had another 68% more reservations than last year as we enter Q3, which is a strong driver of sales.

Also, as Paul mentioned, we have had a strong focus on restructuring and closing underperforming stores over the last year. In northern Europe, our restructuring generates approximately $4.5 million annually in savings and our closure of 112 stores over the last two years generates or eliminated losses of approximately $3.5 million annually.

Finally, I would like to say that we are accelerating our rollout of strategic initiatives such as digital, mobile, loyalty and e-commerce and in fact, e-commerce in Q2 grew 67% over the prior year. So obviously, there is still a lot of work to do. We need to stay focused on the basics and make sure that we are perfectly positioned for the upcoming console cycle.

Paul Raines - *GameStop Corp. - CEO*

Yes, so Mike, I think what I am pleased to see is every day you read the Wall Street Journal and Mike gets a nasty note from me over every change in the bond rating and the unemployment rates everywhere. But I would say, if you look at our conference calls the last, I don't know, five, six quarters, we have tried to communicate that what is happening there is the basics Mike is talking about -- I am pleased -- my last trip with Mike a few weeks ago I see us executing our new initiatives very quickly. I mean if you go to our stores in Europe today, you will see POSA Cards, you'll see DLC like Tony talked about being executed. You will see iDevices happening. You will see our headset assortments.

So playing good defense on the basics and we are moving with a lot of velocity. So now we are not out of the woods. This is a tough environment, but the category is tough. But our position is we are repositioning ourselves for the emerging cycle that is coming and doing a lot of that cleanup work now.

Mike Hickey - *National Alliance Securities - Analyst*

Okay, thanks, guys. It's a great answer. Back to the dividend, that is obviously a big stepup and I think the yield here is going to create an interesting floor potentially from which to grow from a stock price perspective. But is this kind of a steady-state quarter and then you maybe move it up a penny or two as we go forward? Is that how we should look at it?

And then I am guessing -- you talked a little bit of how you manage capital allocation, but when you think about digital growth and Chris Petrovic and his team, what they are trying to build for you, what they have built for you, does Chris still got enough cash to continue to drive the digital piece?

Paul Raines - *GameStop Corp. - CEO*

Does Chris have -- Rob's got all the cash. (multiple speakers). But no, Chris and those guys are doing great work. Let's talk about the dividend just one more time. Our Board looks at capital allocation every quarter. Rob meets with experts and believe me, when you are in a situation and in a category that we are in, there are many experts who want to talk to us and teach us and we are always trying to learn. But we are looking at capital allocation every quarter. So our intentions for the future I think are to continue returning cash to shareholders in the best way we can.

I would say that, as far as digital growth and I will let Tony gave his view on this too, the reason we set up GameStop Digital Ventures is because we knew that we couldn't be smart enough about emerging digital businesses. So we set up a team out there with Chris and his staff. We have met with, I don't know, Tony, 900 startups or something now. We meet with VCs and we have been cautious here, but we have made some acquisitions. Some will argue whether we have been bold enough, etc. We believe we have been smart about capital, right, Tony? But that is going to continue and it is emerging into the recommerce space with (inaudible) and there are more opportunities there.

Tony Bartel - *GameStop Corp. - President*

And the pace at which we were seeing deal flow has not slowed down at all. So we continue to look at deals and we continue to -- I mean Paul talked about $2 billion worth of cash over the next four years. So clearly we have cash flow. If we see a great opportunity, we're going -- we have not hesitated in the past to pull the trigger and we won't hesitate in the future if we find the right opportunity at the right price, which that has been the most challenging piece so far in most of the deals that we have seen.

Paul Raines - *GameStop Corp. - CEO*

And our Board supports -- GameStop, if you read our history, we are in Grapevine, Texas, but we are a pretty high velocity company, have been for the whole -- the founders here were high velocity on acquisitions. We have to be flexible. The industry we are in and the situation we are in, we can't not be smart about emerging technologies and we will continue to try to do that. So Chris will have all the money that we think is necessary to do what we have to do.

Operator

Arvind Bhatia, Sterne Agee.

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

Thank you very much for taking my question. I wanted to actually talk about CapEx a little bit. I just wanted to see where you are in terms of 2012 CapEx plans and how much of that is going to be maintenance CapEx and how we should think about, in the coming years, in light of you are closing 1% of your store base this year. If you could just provide some color on that front. Thank you.

Rob Lloyd - *GameStop Corp. - CFO*

We are right on track with the CapEx plans that we had for the year. I think we announced about $140 million or so, maybe $145 million in our plans and we are on track to that. As we look forward, we are constantly balancing CapEx against other uses of cash, making sure that we are putting the right amount of maintenance capital into the business, also looking at the opportunities that we have, whether or not they are technological developments, enhancements to our POS, whatever it is. And we will continue to do that. I don't want to guide to what our capital spend might be in 2013, for example, but I will say that we are constantly looking at what is appropriate and frankly what is going to help us drive shareholder return.

Operator

And that does conclude our question-and-answer session. I would now like to turn the call back over to Mr. Raines for any further or closing remarks.

Paul Raines - *GameStop Corp. - CEO*

Yes, thank you to investors for your support of GameStop. We are entering a very interesting quarter and would just remind everyone take a good look at what is coming this holiday. The Wii U launch is a real product and there will be lots of activity around it. There will be lots of titles and GameStop is growing some new businesses. So thank you for your support and we will talk to you on the next call.

Operator

That does conclude today's presentation. We thank you again for your participation.
