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GME - Q3 2014 GameStop Corp Earnings Call

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OVERVIEW:

Co. reported 3Q14 consolidated sales of $2.09b, consolidated net earnings (excluding divestiture costs related to Spain) of $64.3m and adjusted diluted EPS of $0.57. Expects full-year 2014 EPS (excluding divestiture costs) to be $3.40-3.55 and 4Q14 diluted EPS to be $2.08-2.24.

CORPORATE PARTICIPANTS

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Rob Lloyd *GameStop Corp. - CFO*

Tony Bartel *GameStop Corp. - President*

Mike Hogan *GameStop Corp. - EVP Strategic Business & Brand Development*

Mike Mauler *GameStop Corp. - EVP of International*

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PRESENTATION

Operator

Good day, everyone, and welcome to the GameStop Corporation's third-quarter 2014 earnings conference. At the conclusion of the announcement, a question and answer session will be conducted electronically.

(Operator Instructions)

I would like 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 Paul Raines, Chief Executive Officer of GameStop. Please go ahead sir.

Paul Raines - *GameStop Corp. - CEO*

Thank you, operator, and welcome to the third-quarter earnings call for GameStop. As always, we start by thanking our associates around the world for their outstanding customer service on behalf of our valued customers.

I am very pleased to be back at work full-time after my recent illness. During my three month medical leave, I received excellent care at the Tisch Brain Center at the Duke University hospital in North Carolina as well as the Baylor Sammons cancer center here in Dallas. The doctors, nurses and staff in both facilities are outstanding and I am grateful to them for their efforts. My treatments have gone very well and I am blessed to say that I had excellent results on my follow-up visit to Duke and Baylor last week. I have a great health prognosis and look forward to many future conversations with you.

It is also great to return to the business and see the outstanding work done by our team and associates. We have developed a deep bench over the past few years and it is great to see their success in my absence. Our Board has supported extensive talent development and succession planning. And it pays off in a situation like the one we just experienced.

Joining me today on our call are Rob Lloyd, Chief Financial Officer; Tony Bartel, President; Mike Mauler, Executive Vice President of International; Mike Hogan, Executive Vice President of Strategic Business and Matt Hodges our Vice President of Investor Relations.

We will be closed on Thanksgiving day next week in the United States out of respect for our associates and their families. To all our associates on this call, you know that the phrase protect the family means a lot to us. Sometimes we have to move aggressively into new businesses to protect the family and sometimes we have to not let the pressure from other retailers distract us from our values.

A few themes to keep in mind as we turn the corner past Black Friday into holiday. First of all, the shift of Assassin's Creed by a week impacted our quarter by $0.05 per share. And the overlap of Grand Theft Auto represented a large comp impact. GameStop's two-year comp for the third quarter is 18%, among the highest in retail.

Second, digital growth was 52% so the growth of digital downloads is providing an nice tailwind to GameStop as well as many publishers. Third, our Technology Brands unit is growing aggressively and we expect solid growth in 2015 from the AT&T relationship and the new cycle of Apple products. We may also acquire new Technology Brands in the future.

Fourth, we launched a PowerUp credit card in the quarter and the approved credit on the portfolio is over $140 million and likely to be used heavily at holiday in unique ways. As we market the PowerUp base in both video games and Technology Brands.

Lastly, our buyback was aggressive in the quarter as we continue to believe our shares are undervalued. Our recent debt offering was oversubscribed, indicating that we can be flexible with our capital strategy. In the spirit of keeping our remarks brief and allowing you to ask more questions, I will now hand the call over to Rob and Tony but feel free to also ask Mike Mauler, Mike Hogan and Matt Hodges questions at the end of our prepared remarks. Rob?

Rob Lloyd - *GameStop Corp. - CFO*

Thank you, Paul. It's great to have you back. Good afternoon, everyone. I'd like to start with a brief overview of the third quarter and guidance for the fourth quarter.

Overall the majority of our product categories performed well during the third quarter; however, our results were impacted by two primary factors. The first was that Assassin's Creed moved out of our third quarter and into our fourth quarter after we gave guidance. The second was that the AAA titles launched during the quarter like Destiny and Super Smash Brothers faced a very tough comparison to the powerful AAA titles in Q3 of last year including GTA 5, Pokemon X and Y, Battlefield 4 and Assassin's Creed 4 Black Flag.

Our consolidated sales were $2.09 billion, down 0.7% from the prior year quarter with a comp decrease of 2.3%. Consolidated net earnings for the third quarter, excluding divestiture costs related to Spain, were $64.3 million, a decrease of 6.3% from last year. Adjusted diluted earnings per share for the quarter were $0.57. We estimate that the impact of the movement of Assassin's Creed had a comp impact of over 2% and an EPS impact of at least $0.05 given the sales we had in the first five days after launch.

We are forecasting same-store sales for the fourth quarter ranging from negative 5% to plus 2%, given that we are comping the launch of the next-gen consoles from last November. We expect the full-year comps to come in plus 2% to plus [5%] (corrected by company after the call). We expect diluted earnings per share to range from $2.08 to $2.24 for the fourth quarter, an increase from $1.89 last year. We are revising our previous full-year 2014 earnings-per-share guidance of $3.40 to $3.70 to a new range of $3.40 to $3.55, excluding divestiture costs, up from $2.99 last year. The decline in prior-gen software sales due to the transition to next-gen consoles has been steeper than expected and titles that moved out of 2014 will both have an impact on our results this year. We are closely monitoring -- we are also closely monitoring the West Coast port situation.

Turning back to a more detailed review of the third quarter, International comps were plus 3.1% with a positive comp of 8.4% in Australia and New Zealand; the US comp was down 4.8%. New hardware sales increased 147.4% based on the continued strength of the next-gen console adoption. The adoption rate continues to grow on a monthly basis as we measure sales compared to the same point in the last cycle.

We outperformed the US market leading to a hardware share gain of 390 basis points. The primary reason for the decline in new software sales of 34.4% was the comparison of this quarter's hit titles to those of the third quarter of last year as I mentioned earlier. We achieved over 47% software market share in the quarter, our second highest quarterly share ever, behind only last year's third quarter.

pre-owned sales increased 2.6% compared to the prior year quarter. The US was up 2.2% and International was up 5.2% or 9.8% excluding FX impact. This marks the third consecutive quarter that pre-owned business has grown and we expect this trend to continue throughout 2015 as value-oriented consumers find great deals in Xbox 360s and PlayStation 3s and in pre-owned next-gen consoles and software.

Our digital receipts were $210 million, a 52% increase over the third quarter of last year with over 80% growth in International, driven by console, digital sales associated with Destiny and FIFA. Globally, we attached DLC subscriptions to over 30% of Destiny sales during its launch.

GAAP revenues totaled $54.9 million and increased 19%. We are on track to achieve a 15% increase in digital receipts for the full year to over $830 million. Our mobile revenues increased 125% from the third quarter of last year to $126 million, primarily from the $85 million delivered by our Technology Brands businesses. Since the end of last year we've added 190 Technology Brands stores. Through three quarters these businesses have contributed $216 million in topline and approximate $23 million in operating profit, with an operating margin over 11% for the third quarter.

Overall, consolidated gross margins for the quarter were 29.7%, an increase of 130 basis points [compared to] 28.4% in the third quarter of last year. The increase was primarily due to the addition of the Technology Brands businesses. Gross margins on hardware were 10.8% and gross margins on software were 23.2% this quarter, both rates are in line with guidance we gave earlier this year.

Gross margins on pre-owned improved over 300 basis points over the prior-year quarter to 47.6% as we were less promotional compared to last year when we were driving trades towards next-gen consoles. We continue to monitor our stores and have not seen an impact on pre-owned trades or sales due to other retail competition.

Digital gross profit grew 10.3% to $35.2 million and the digital margin rate was 64%. Mobile gross margins of 40.1% were driven by the growth in Tech Brands. The continued success of the Next program from AT&T is having a dramatic impact on margins in our Spring Mobile business.

SG&A expenses were 23.6% of sales this quarter compared to 21.3% of sales in the third quarter of last year. Total SG&A expense dollars increased $45.8 million due primarily to the addition of Technology Brands which accounted for $33.9 million of the increase. In addition, we had charges of $6.9 million included in SG&A related to the shutdown of Spain. The total charge for the sale and shutdown of our business in Spain was $13.9 million. The $6.9 million in SG&A was for severance and lease liabilities and another $7 million was in cost of sales for inventory write-downs.

We sold 45 stores to Game Digital Plc and closed another 56. Our focus was on a smooth transition for customers, honoring commitments to our landlords and vendors, and treating our associates as fairly as possible. While we no longer operate stores in Spain, we are in the process of shutting down our office and distribution center and we expect that we will have approximately $1 million in costs in the fourth quarter. We expect to fully complete the process, including the financial impact, by the end of our fiscal year. Following the exit, we can concentrate our International efforts in markets with leading performance and opportunities for growth.

We ended the quarter with 6664 stores. 4183 US video game stores, 2073 International video game stores and 408 Technology Brands stores. Which include 311 AT&T branded stores operated by Spring Mobile, 51 Cricket stores and 46 Simply Mac stores. We opened 5 video game stores and closed 19 in the US and opened 11 and closed 120 internationally, which includes the changes in Spain. We added 55 Tech Brand stores through acquisitions and opened 34 more.

During the third quarter we repurchased $144 million of our stock with 3.6 million shares at an average price of $40.25. Year to date, we've repurchased 6.8 million shares at an average of $39.90 for a total of $271.7 million. Our guidance for the year was to buy back between $250 million and $300 million.

[Life] to date we have repurchased 67.4 million shares at an average price of $24.36 for total of $1.64 billion. We've reduced our outstanding share count to less than 110 million and as result, $0.01 per share is now equivalent to only $1.1 million in net income. As we indicated last week through an 8-K, our Board of Directors approved a new $500 million share repurchase plan and authorized the fourth quarter dividend of $0.33 per share to be paid on December 16.

Now I'll provide a little more color on the fourth quarter outlook. We've launched most of the AAA titles for the fourth quarter and as I mentioned earlier we expect diluted earnings per share to range from $2.08 to $2.24, which represents growth of between 10% and 18.5% from last year's fourth quarter. We're using weighted average fully diluted shares outstanding of 110 million following buybacks through the third quarter.

The full-year 2014 earnings-per-share guidance of $3.40 to $3.55 uses weighted average fully diluted shares outstanding of 113.5 million following buybacks through the third quarter. Full-year EPS growth is forecast to range from 13.5% to 18.5%. We expect Technology Brands to contribute another strong number and operating earnings in the fourth quarter, bringing the first full year of Tech Brands contribution to over 5% of our projected operating earnings. We expect to end the year with approximately 500 Tech Brand stores.

The projected 2015 operating product -- profit on that year ending store count is in excess of $50 million and we expect to grow the Tech Brand store count by another 300 stores next year. We are very pleased with how these new businesses have added to our revenues and profits in the year since we acquired them.

We are positioned as the leader of the next-gen console business as we approach the holidays and 2015. The titles that moved out of 2014 and our new Technology Brands businesses set us up nicely as we move into 2015. Now I'll turn it over to Tony for his comments.

Tony Bartel - *GameStop Corp. - President*

Thanks, Rob and good evening everyone. We continue to successfully execute against our goal of winning the new console launch. Our software market share on Xbox One and PS4 hit an all-time high at 56% for the quarter. In addition, our hardware share on Xbox One and PS4 is at all-time highs.

As the installed base on this generation of consoles continues to grow, we are poised to continue our market share increases. This launch continues to outperform the previous cycle with hardware units up 73% and software units up 24% over the prior launch. For GameStop, we are up 157% and 102% for hardware and software, respectively.

The third quarter of 2013 had some big titles to overlap, though November has had several strong releases leading us into the holiday. New titles are driving the installed base and we are pleased with the recent launches of Activision's Call of Duty, Advanced Warfare; Take-Two's GTA 5 for the new generations; Microsoft's Halo, Master Chief Collection; Ubisoft's Assassin's Creed Unity and Far Cry 4 and EA's Dragon Age, Inquisition. All of these titles met our launch expectations and many of our sales are being funded with trade currency and have strong digital attach.

We are also excited about tonight's launch of Super Smash Brothers for the Wii U and Pokemon Omega Ruby and Alpha Sapphire as well as Ameba. We expect these games to be strong system sellers. The recent price decrease on the Xbox One has significantly increased sales of that platform and we expect consoles to be in high demand this holiday season. We will be ready at 12.01 AM on Black Friday with great deals on both new and pre-owned gifts, and we are happy that our associates can spend Thanksgiving Day with their family and friends.

Affordability of all the great titles and consoles will be a key concern for our customers and we are thrilled to be offering two forms of unique currency. First, our simplified trade pricing has made it easier for customers to understand the value that they are getting for their unused games. And we have seen an increase in trade penetration as a result of this initiative. We expect to generate over $250 million of trade credit in the fourth quarter and over 70% of these credits directly fund the purchase of new consoles and software.

Also, we introduced our PowerUp Rewards private-label credit card to all PowerUp Rewards customers this quarter. This card is a third-party program with Alliance Data Systems and provides qualified reward customers up to $2,000 in credit to be spent at GameStop stores along with special financing offers through the end of 2014. To date, we have granted 235,000 members $145 million of credit and we expect over $100 million of that credit to be spent in the next few weeks before holiday.

PowerUp Reward credit card customers have a transaction size double that of our average customer, are six times more likely to purchase an Xbox One or PS4 and are 50% more likely to purchase digital content. Globally, our loyalty programs now reach over 40 million people with 29.5 million members in the US and 11 million members internationally.

Our pre-owned sales grew 2.6% during the quarter. This was fueled by strong trade growth as well as $36 million of value merchandise that we purchased during the quarter. So far this year we have improved our market share by 230 basis points in the value category.

Multi channel grew 20% during the quarter led by 91% growth in our pickup at store program where customers can hold a product online and conveniently pick it up at a local store. Mobile transactions increased by 79% and 69% of our online traffic is now coming from a mobile phone or tablet. We released a major upgrade to the GameStop mobile app and with over 6.1 million installs, this app makes it easier to research products, find local stores, track pre-orders and manage your PowerUp Rewards account and game library.

We also recently launched our holiday hub and trade center which provides holiday shoppers with great gift ideas and deals and also allows customers to easily find the value of their unused games, consoles and electronics. In addition, we are continuing to evolve our customer experience with our GameStop Technology Institute that is testing cutting-edge retail technology in 36 stores in the Austin, Texas area. GameStop Technology Institute is working with 23 partners including AT&T, IBM, Microsoft and Texas A&M Center for Retailing Studies to test employee advocacy technology that promotes and recommends localized products, events and promotions on social media, location-based messaging on consumer's mobile devices, Beacon technology that provides interactive consumer messaging on key product offerings, the use of ultra high-speed enabled tablets to provide our associates with relevant consumer offers and a mobile app to tie all of these technologies into a seamless consumer experience.

In Technology Brands, the iPhone 6 launch in September resulted in our largest ever mobile product launch. Consumers were excited by the form factor and screen size changes delivered by Apple, evidenced by a record level of pre-orders and a large increase in retail store traffic. The demand for the iPhone has remained high after the launch period and we expect it to remain high through the holiday season.

In addition to the iPhone driven demand, AT&T made a series of changes to its rate plan offerings, which were also exciting to consumers. These include the price adjustments to their mobile share value plans in association with the Next device financing options. Our transaction close rate is also at an all-time high in the retail stores as consumers are seeing the value of the AT&T network, the mobile share value rate plan pricing and the Next program.

Turning to digital, our 52% growth is higher than the growth reported in the most recent quarter by our four largest publishing partners. Year to date, our digital growth is also higher than this group. Or console digital growth alone is 72% as we continue to play a vital role in the discovery and affordability of digital content.

A couple of interesting data points taken from recent research with gamers indicates that the average price being paid by a customer for a full game AAA download is $22. When asked what price a gamer expected to pay for a recently released full game digital download, the answer in these surveys was approximately $35. Our buy/sell/trade model has enabled videogame customers to purchase a full game physical disc for full price believing that they have a $20 residual value for that game. Since this residual value is 100% funded by GameStop, publishers benefit by maintaining the higher retail price and are able to remain financially viable.

It is important to note that, like the industry, much of our full game digital content was given away at no cost to the consumer with a hardware bundle. In fact, year to date we estimate that over $100 million worth of games have been digitally delivered for free in hardware bundles. We want to help ensure that our industry does not make the same mistake as other entertainment categories by driving the perceived value of digital goods significantly below that of a physical game. When the free digital token programs end, we believe that the industry will need to work together to continue to price goods in a way that sustains profitability and encourages a great innovation that this category needs.

In addition to console digital, we're also continuing to grow in mobile publishing. Kongregate again doubled its business over last year, growing 98% during the quarter. We remain a top 10 third-party mobile publisher with nearly 30 million installs of our 14 games on the app store and 12 games in the Google Play store.

Looking at the holiday quarter, we are excited about having the hottest consumer electronics products in our stores. We have a great new financing option for our qualified PowerUp Rewards customers and we have launched new mobile and in-store technology to make shopping at GameStop the most simple and affordable way to find the best consumer electronic gifts for this holiday season. With that, I will now open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mike Olson, Piper Jaffray.

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

Good afternoon. A couple quick ones here. If you lost $0.05 from Assassins in the quarter, does that mean that you're gaining $0.05 from Assassins in Q4 and if so, is the rest of the weaker guidance for Q4 all related to cautiousness around legacy gen software or is there any reason you just talked about this but is there any reason to believe full game downloads are impacting the new software category?

Tony Bartel - *GameStop Corp. - President*

You said you had a couple questions, did you have another question as well?

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

Second question is should we expect preowned gross margins to come down from this elevated level or do you think that's sustainable?

Tony Bartel - *GameStop Corp. - President*

Okay. Rob, I'll address the first and then kick it over to you and then Mike if you want to talk about preowned margins staying at this level when we're done. What happened yes, the answer is that it will go into the fourth quarter so the reason for the fourth quarter guidance moving down is the fact that the impact of the decline in 360 and PS3 is offsetting a very strong business and outperforming business on the Xbox One and PS4. So that's what's taking place in the fourth quarter and that's which reflected in our forecast and Rob, do you want to add to that?

Rob Lloyd - *GameStop Corp. - CFO*

There's not much to it. I think you covered it.

Paul Raines - *GameStop Corp. - CEO*

You do have the port factor that is not clear to us yet, but Rob mentioned it in his remarks as well.

Tony Bartel - *GameStop Corp. - President*

Mike, you want to talk about preowned?

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Mike Hogan - *GameStop Corp. - EVP Strategic Business & Brand Development*

Sure. As far as the preowned business I think we're very happy with the performance the business. One thing I think we should point out is we're very competitive in our pricing and monitor every day you can see it in a quarter in which the new software declined pretty substantially we actually had positive growth in our preowned business in addition to being been able to expand the margin. As far as the outlook for margin going forward I'll turn that over to Rob.

Rob Lloyd - *GameStop Corp. - CFO*

Yes, we had guided to a pretty broad range 42% to 48% earlier in the year when we introduced the value concept. I think we're pleased with the inroads we've made so far on the value side of the business and it is allowing us to address many of the ins at the out of stock positions that we had in our stores and some of our better selling preowned titles. And we're pleased with the margin rates we've been able to achieve thus far. I'd say at this point we're pretty comfortable with where the margin rates have been and while I won't alter that broad range going forward I think if you look at what we've done since we introduced the value again we've been able to hold our margin

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Paul Raines - *GameStop Corp. - CEO*

What did you guys by? We bought 26 million you said? 36 million. The only thing I would say there too Mike is we probably have not bought as much as we thought we would when we started this. The good news is you're getting a much better margin rate. The less good news is that we're not growing as fast as we'd like to although 2.5%, 2.7% is a pretty nice number on a big base.

Tony Bartel - *GameStop Corp. - President*

Let me also go back and clarify the 360 and PS3 decline. Year to date in the US, Xbox 360 and PS3 software and hardware are down 57.8% on a dollar basis. That's clearly significantly more than we anticipated at the beginning of the year and so that's what we factored into our fourth-quarter forecast.

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

Thank you.

Operator

Colin Sebastian, Robert Baird.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Great, thanks. Good afternoon. By the way welcome back, Paul.

Paul Raines - *GameStop Corp. - CEO*

Thank you very much, Colin. And I forgot to mention this earlier but many of you have sent me very nice notes. Thank you very much for your thoughts and prayers.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

First off, just given the pressure coming from the legacy platforms, I wonder if there's any data to suggest that those consumers moving away from those older consoles are eventually planning to step up to the next-gen as opposed to migrating away from those platforms altogether? And separately and perhaps related, it's pretty clear at least to me that price cuts are needed on these older platforms, I'm wondering if you'd already expected that by now and since we haven't seen that, is that something we should expect either still this year or are we going to have to wait until next year?

Tony Bartel - *GameStop Corp. - President*

Sure, Colin I will answer that. This is Tony. The 73% increase that we've seen in the units especially in hardware units we're actually very excited about Xbox One and PS4 and like I said that's outperforming our expectations so we do see quicker adoption in that category than what we had anticipated. As the price cuts we think it would be excellent and definitely would increase the sellthrough rate on the old generation consoles. We definitely think that would help. But we have not factored anything into our forecast at this point.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Okay. Then maybe as a follow-up to the question around the EPS. The $0.05 we know from the shift of a title into Q4, I wonder how much of the remainder of the sales impact and what EPS impact there was from the shortfall on the legacy platforms and given that EPS plus the $0.05 would have been in line with your guidance and consensus, the shortfall on the older platforms, was that more hardware or more software?

Tony Bartel - *GameStop Corp. - President*

Rob, you want to take that question?

Rob Lloyd - *GameStop Corp. - CFO*

Sure. I can't say that we dissected the data to specifically see what the shortfall impact on the prior-gen software might have been, but I'd say that the biggest area where we're feeling it is in prior-gen software sales but prior-gen hardware sales have also been on a steeper trajectory down this year than we expected.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Okay, thanks, guys.

Tony Bartel - *GameStop Corp. - President*

Thanks

Operator

Tony Wible, Janney Capital Markets.

Tony Bartel - *GameStop Corp. - President*

Hi, Tony.

Tony Wible - *Janney Montgomery Scott - Analyst*

Sorry about that, Paul. I was saying that welcome back, it's great to have you on the call.

Paul Raines - *GameStop Corp. - CEO*

Thank you, Tony.

Tony Wible - *Janney Montgomery Scott - Analyst*

That's said, what can you guys tell us about the launch of the iPhone you guys have now had the Tech stores for a very short period of time. Would you have anticipated seeing a little bit more business or how does a new iPhone filter through all the different parts at GameStop, the core store to Simply Mac this spring and also -- when do you think that seventh gen headwind starts to shift? What are the specific catalysts you think that are out there to cause that?

Tony Bartel - *GameStop Corp. - President*

Let me first talk about the iPhone launch. Clearly we sold every single iPhone that we could get our hands on in the Simply Mac and in our Spring Mobile divisions. We also benefited from iPhone 6 in all of those locations by taking back trades. We also -- so we took the trades of all of the old phones into all of our GameStop stores and to Simply Mac stores and obviously into Spring Mobile store so we benefited dramatically. We also work with AT&T with our direct fulfill program which give us even additional capacity so we had strong demand in it benefited not only the direct sales but also the trade in of inventory. That we had.

Paul Raines - *GameStop Corp. - CEO*

Tony, the other point I would make is that if you go back to our initial discussions on Technology Brands, I guess Rob it's a year and change since we started talking to these guys? It was clear to us that Apple had a significant product pipeline, now some people believe them, some people didn't but I think if you look at what's unfolded and Rob mentioned we're very pleased with what's going on in Technology Brands in general, it's clear that that was a pretty good bet. The question is going to be up can we get enough product? Can we keep the pipeline flowing? I think that's been very successful. As far as trades, Tony, do you have anything to say a trades at GameStop stores?

Tony Bartel - *GameStop Corp. - President*

Trades went gone up significantly as we -- I went through the iPhone 6 launch and they met our expectations and we continue to take trades in all of our GameStop stores. As far as the seventh gen headwind, Rob talked about a couple of titles that have moved out into the first quarter of next year, some are actually behind that so we feel very confident given where we're at in cycle and given our strong performance with this growth and given the outperformance of Xbox One and PS4 that we're very close. Next year we're expecting very strong first quarter. Rob, you have any other thoughts on when the headwinds meet?

Rob Lloyd - *GameStop Corp. - CFO*

We had been saying that we think that the intersection of prior-gen, the decline curve and then the acceleration of the next-gen in sort of a way that would hold for the future we think is in the first quarter of next year.

Tony Wible - *Janney Montgomery Scott - Analyst*

Got it. And just to clear up on the mobile. The mobile revenues per store I think if I did my math correctly were down about 9% sequentially. I assume that's just a timing issue with when you added those new stores since it is such a sizable pace there?

Rob Lloyd - *GameStop Corp. - CFO*

I'm sorry, can you --

Paul Raines - *GameStop Corp. - CEO*

Mobile revenues per store down 9%.

Tony Wible - *Janney Montgomery Scott - Analyst*

That's a function of adding the stores or was there anything else behind that drop?

Rob Lloyd - *GameStop Corp. - CFO*

-- acquisition I think that has to do with the timing of the store count and when during the quarter we -- I mentioned that we added I think it was 55 stores through acquisition and a lot of that had to do with timing of when those stores got added.

Tony Wible - *Janney Montgomery Scott - Analyst*

Great. Just wanted to confirm that. Thank you.

Operator

Seth Sigman, Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

Thanks and welcome back, Paul. I just wanted to follow-up on the guidance for the fourth quarter and just hoping maybe you can give a little more color on the specific category assumptions and whether any of the other assumptions changed such as hardware because it seems like the sales reduction seems a little bit worse than the EPS so I'm just trying to reconcile that.

Rob Lloyd - *GameStop Corp. - CFO*

I'm sorry, can you run back to that for me?

Seth Sigman - *Credit Suisse - Analyst*

Maybe you could give a little bit more color on the specific categories assumptions for the fourth quarter, hardware, software, how to think about them and if there were any other factors that changed incrementally relative to your initial guidance besides software?

Rob Lloyd - *GameStop Corp. - CFO*

We don't give a lot of guidance around particular categories, but I will say that we see software growth in the fourth quarter. The hard part of the comp is obviously that we're launching the next-gen that had right around this time in November of last year. I will tell you that we gave guidance earlier in the year on the categories on the margin rates for the individual categories and we see those margin rates with the exception of mobile we see those margin rates continuing or within those guidelines that we gave. Mobile obviously has been running higher than the guidance that we gave and that's because of the impact of the Next program within the Spring Mobile stores.

Paul Raines - *GameStop Corp. - CEO*

Tony, anything on allocation or Mike, anything on allocation you guys are concerned about?

Tony Bartel - *GameStop Corp. - President*

The only thing that we are concerned about is what you've already mentioned what Rob already mentioned and that's the fact about the West Coast work stop, or slowdown that's currently happening. We monitor that daily to make sure that product level will be here so that could impact hardware and aside from that Mike --

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Mike Mauler - *GameStop Corp. - EVP of International*

We expect demand for hardware be very, very strong and historically that second Christmas after you've had a new launch can be the spotty allocation issues. Hopefully enough will be manufactured -- we believe the demand is going to be there.

Tony Bartel - *GameStop Corp. - President*

Absolutely.

Seth Sigman - *Credit Suisse - Analyst*

Got you. Okay, that's helpful. I guess the second question is as you think about your used inventory today, can you give us a sense of how much of that used inventory is last generation versus the current generation. I'm just trying to understand that if demand is weaker for the last generation and you still have a lot of product there does that have implications for the used business at least in the near-term until next-generation can really pick up the slack?

Paul Raines - *GameStop Corp. - CEO*

That's an interesting question right, because, and Mike you have to answer the inventory questions, I think if you -- availability of current gen or old gen going forward is directly tied to performance of your used inventory so that's going to be an interesting debate.

Mike Mauler - *GameStop Corp. - EVP of International*

Overall, used inventory is up going into the fourth quarter but don't have a breakdown by category.

Rob Lloyd - *GameStop Corp. - CFO*

What I can tell you is that historically almost regardless of the amount of preowned inventory that we have going into November the same percentage of that inventory is going to sell through by the end of the holiday season. So what we've found over the years in this business whether it's going through new cycles or in the depths of a cycle is that we want to have as much preowned inventory as we can going into November so we feel pretty good about the amount of inventory we have and we're not particularly concerned about what generation it's tied to.

Seth Sigman - *Credit Suisse - Analyst*

Okay, thanks for the color. Appreciate it.

Operator

David Magee, SunTrust Robinson Humphrey.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Hi, everybody. Paul, great to have you back.

Paul Raines - *GameStop Corp. - CEO*

Thank you, David.

David Magee - *SunTrust Robinson Humphrey - Analyst*

So just if I were to rank the impacts of the fourth quarter in terms of concerns it's the prior-gen software being number one, number two being delays of NextGen to next year, and then three being the port cost risk I guess, is that the order priority of those three factors?

Tony Bartel - *GameStop Corp. - President*

That would be correct.

Rob Lloyd - *GameStop Corp. - CFO*

The port risk is the slowdown that's going on in terms of the bringing in of goods. (Overlapping/Multiple speakers).

David Magee - *SunTrust Robinson Humphrey - Analyst*

So you're not paying higher cost now, some retailers I think have already encouraged some higher cost around that issue?

Tony Bartel - *GameStop Corp. - President*

No. We are not. It's more of an availability issue, David

David Magee - *SunTrust Robinson Humphrey - Analyst*

Okay. Are you seeing anything different with regard to full game downloads either what you're hearing in the sector or with your own experience outside of that are those games being attached to the consoles?

Tony Bartel - *GameStop Corp. - President*

What we can say is our digital continues to grow very quickly as we talked about with 52% digital growth we're clearly driving this market forward and 9.5% of our total sales were represented by our digital receipts, they represent 9.5% of our sales and with 56% market share on the new console on the physical our folks are testing a lot of dlc. If you've been to our launches what you see is our associates walking up and down the lines at every launch around midnight they're walking up and down the lines helping people discover the great deals, the content again over 60% of that content or large portion of the content is funded by non-credit card types of currency so really what we do in the digital space we do a great job of helping people discover and afford this digital content.

Paul Raines - *GameStop Corp. - CEO*

The interesting thing David is and Tony had a couple paragraphs on this what we're seeing is a tremendous amount of free giveaways. On full game downloads. And that's driving pretty confusing set of numbers coming from our published department in that some will say delivered digitally, some will say downloaded, some will say -- our numbers are very clean, it's what we take payment for from the customer. There's going to be a turning point down the road here on this gaming business where the sustainability of giving away full games is going to be tough. We're in the publishing business at Kongregate and one of the great advantages there is that we have -- we don't have a console maker. We do have a platform owner but we don't have a console maker between us and the customer. The Apple relationship and the Google relationship is a lot simpler for the consumer to navigate free to play, with the console relationship somewhere in here it's going to be tough for everyone to make money. I think that's what we look at and that's what we think that's why we think our buy/sell/trade business ironically is tied to the success of full game digital downloads rather than their case of us disappearing over this is really not the case.

Tony Bartel - *GameStop Corp. - President*

It actually enables an investment in the category which is vitally needed.

Paul Raines - *GameStop Corp. - CEO*

Yes.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Thank you and lastly has your thinking changed with regard to the market model for 2015 in terms of the central growth next year just given the imagination's we've seen in recent months

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Tony Bartel - *GameStop Corp. - President*

Mike, you want to give an update on 2015 --

Mike Hogan - *GameStop Corp. - EVP Strategic Business & Brand Development*

Sure. I would say no. I would say we're still projecting a strong growth for the console games category for 2015. One of the things that we continue to monitor on a quarterly basis is the percentage of PowerUp members who are intending to purchase Next Generation consoles and the last -- as of the last iteration of that study, that number's still north of 50% so I would say that combined with some strong software including some titles that have gotten pushed from 2014 into 2015 keeps us pretty bullish on the growth prospects for the console category of 2015.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Do you think the overall sector grows faster than this year?

Mike Hogan - *GameStop Corp. - EVP Strategic Business & Brand Development*

I'm not sure we looked at it that way.

Paul Raines - *GameStop Corp. - CEO*

Software versus hardware, two different ways

Mike Hogan - *GameStop Corp. - EVP Strategic Business & Brand Development*

I think that's a good point. On the software side probably yes. On the hardware side, that's probably a question mark.

Rob Lloyd - *GameStop Corp. - CFO*

The other challenges what we've seen so far with NPD is I think the growth rate year to date for the category physical has been around 7% and our market model typically incorporates the digital and not as much is known on what's happening in digital as we move through the year on a month-to-month basis. At the end of the year when Mike is going to the process of updating the market model for us to talk about it which we typically do in the March timeframe, more is maybe known on a look back as to what the actual impact was. It's tough to draw a conclusion in November.

Paul Raines - *GameStop Corp. - CEO*

It is fair to say though Rob that our digital revenue is at $800 million plus-ish is that expectation with a 15% growth, I think Tony mentioned that.

Rob Lloyd - *GameStop Corp. - CFO*

Yes

Paul Raines - *GameStop Corp. - CEO*

That's part of our business is executing as per the market model I'd say.

Mike Hogan - *GameStop Corp. - EVP Strategic Business & Brand Development*

If you take the console category -- console hardware, console software, console digital, we're still expecting the full year there to be in the high teens.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Great. Thanks and good luck.

Paul Raines - *GameStop Corp. - CEO*

Thank you.

Operator

Brian Nagel, Oppenheimer and Company.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Hi, good evening. First off welcome back, Paul. It's great to hear you on the call.

Paul Raines - *GameStop Corp. - CEO*

Thank you very much.

Brian Nagel - *Oppenheimer & Co. - Analyst*

The question I have and as you know there's very much has been and remains a negative thesis where it continues to cloud your stock and that thesis centers on digital downloads and such. As we look at the data in the third quarter release and appreciate all the color commentary here and it's clear what you are saying there was some again some trend story factors, comparisons, delays of games and such, but what can you tell us that basically gets us comfortable that digital -- full game downloads are not in some significant way disrupting the cycle or weighing upon -- we have the market share date putting upon sales of new generation software at GameStop?

Tony Bartel - *GameStop Corp. - President*

I think that like we said first of all, our digital growth is significantly outpacing the category. That's definitely one piece and then we talked about the economics of digital and when you factor in all of these games that are given away free based on the research that we've done it drives a price point down to $22 which is clearly an unsustainable price for a game that's physically is at $60 so I think the economic question that is starting to emerge is a key question that we have and so we're outpacing the rest of the publishing community on our digital growth, we are driving that, we think it's because of what we add to the digital experience in terms of discovery and affordability and also our strong market share that we are using to attach digital content again a lot of digital content that has been sold for real money as Paul talks about is downloadable content that is attached to a physical product. That is a growing category, that is a big category and that is a profitable category for the entire ecosystem.

Paul Raines - *GameStop Corp. - CEO*

It is also true though, you know Brian that the broadband speed, we've been talking about broadband speed for years. The broadband speeds are still a challenge for a full game download and while I don't think there's a huge business there yet, there could be some day we'll be in it but I just don't know if we can download enough games fast enough for people -- I know that's -- but I think the real story is quite different as Tony describes it.

Tony Bartel - *GameStop Corp. - President*

It is frustrating as Paul said not to have information -- good information and everyone seems to be reporting it in a different manner but like you said we're reporting it based on dollars that go through the till.

Mike Mauler - *GameStop Corp. - EVP of International*

And last year it was over $700 million for us and this last quarter it grew 52% so it's a really important part of our business.

Paul Raines - *GameStop Corp. - CEO*

Right. Beyond that the problem you've got is you are going to have digital bears who are going to be digital bears and they're going to be tough to convince. Other than we have to keep posting great growth in digital numbers.

Tony Bartel - *GameStop Corp. - President*

There's really not a proxy Brian for an industry that has gone through a digital transition when you have a player like a GameStop establishing such a strong residual value on the physical side. That is a barrier that you have to get over once you move digital and that's why those price points and all the studies that we're seeing and that we're doing ourselves are saying a $20 to $25 reduction is what's expected by the consumer. That's a huge hurdle that you have to get over to believe that the industry is going digital.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Since we think about this cycle versus last cycle and you talked a bit about the hardware -- the bundling so to say of new gen hardware with a downloaded game, is that in and of itself a new factor versus the prior cycle? Is that something that can be weighed upon at least initially new generation sales of software?

Tony Bartel - *GameStop Corp. - President*

You're talking about the token that bundle -- What is interesting about that, I think that it could be -- again we think it is a short-term phenomenon because if it is being paid for it's expensive to someone in the ecosystem. So I think is an expensive phenomenon but when we look at the attach rates when you look at the physical attach rates of this new generation and you add and GameStop's perspective and you add our digital attach rate what you see is we're identical with the attach rate of the last launch. So there is a shift that's taking place where there's more that is digital today in part due to some of these free giveaways but what you're seeing is still a full attach rate when you include digital and both of those equations.

Rob Lloyd - *GameStop Corp. - CFO*

Some of that takes the form of downloadable content -- at the launch of the physical game.

Paul Raines - *GameStop Corp. - CEO*

The other thing Brian when you talk to publishers about the launch and I remember Titanfall, in many ways these tokens that are bundled in are really a marketing expense for the launch of the console. Every console maker wants to have a high install base, the first year or so but that's why we believe some of these are going to be temporary items because people are going to get tired of giving away digital full games. At some point.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay, that's helpful. Thank you.

Operator

Scott Tilghman, B. Riley.

Scott Tilghman - *B. Riley Caris - Analyst*

Things, good evening, I'll echo everyone else's sentiments Paul and say it's good to hear your voice. I have a few questions and let me lay them out up front since a couple are quick, but first off on the trade credits I'm wondering how soon you think you'll be able to, or whether you want to be able to offer the credits across the brands as you build out the Technology Brands? Second, on the buyback program last year the program wasn't quite as robust as you would have liked and you lost out on some opportunity wondering what you've done to perhaps change that this holiday season and then the third question I had for you is really around publisher support for trade-ins. That's been a key component in the background in the past that you've had support especially on some of the sequel releases. Wondering if that support has changed at all and related to that what if any support you're getting from them if you work toward trying to build a digital secondary market?

Tony Bartel - *GameStop Corp. - President*

Sure. Let me take one and three and then Rob I'll shift buybacks over to you. In terms of a trade credits we're taking that today, Scott, in all of our locating Crickets accept trades, our Simply Macs accept trades, Spring Mobile accept trades and GameStop obviously accepts trades so we're already generating trade credits in all four of those brands so that's happening now

Scott Tilghman - *B. Riley Caris - Analyst*

Can they be used across brands?

Tony Bartel - *GameStop Corp. - President*

Currently in some cases they can be but not in all cases.

Paul Raines - *GameStop Corp. - CEO*

No they can't. What's missing Scott is the use of the PowerUp program across all five forms and that is something we're working on.

Tony Bartel - *GameStop Corp. - President*

And then on the publisher support for the trade credit what they see is they definitely see our trade credit as a form of unfunded discount. From their perspective. We fund that so it obviously creates a strong sales gains that's what striving our strong market share so when you look at our 56% frontline marketshare of Xbox One and PS4 games as we've said several times much of that is driven by the fact that we have very strong trade credit performance on the Xbox One and PS4 platforms. In fact it's higher than what we've had historically so there's not a lot of discussion that we have right now with our publishing partners around buy, sell or trade because we're driving significant marketshare and Rob, you want to talk about the buybacks?

Rob Lloyd - *GameStop Corp. - CFO*

I think his question was more toward power of publishers participating in trade programs.

Scott Tilghman - *B. Riley Caris - Analyst*

Right, historically there's been some support when you've had relaunch or I should say launches of sequel type titles I'm just wondering if that support has changed all and also what if any conversations you've had that you can share on the secondary market for digital that you've discussed previously?

Mike Mauler - *GameStop Corp. - EVP of International*

We touched on the trade support first. I think what we've seen is an increasing support from the publishers on the trades tied to new releases and if you look at this fall for example, in a four-week period you've got Grand Theft Auto, Far Cry, Call of Duty, Dragon Age, you have to be a very wealthy gamer to be able to play all those and the publishers recognize that. So the ability for the gamer to buy one game, play it for a week or two, trade it in, buy the next game and so on and so on, is important to the gamer, it's important to the publishers and obviously important to us as well so we're seeing actually increasing support in that area.

Tony Bartel - *GameStop Corp. - President*

Absolutely so there's definitely support that comes on various games and like you said some of the platform changes are transitions and they're definitely supporting us on that.

Paul Raines - *GameStop Corp. - CEO*

And then on digital trades we have no comment. Top-secret.

Scott Tilghman - *B. Riley Caris - Analyst*

Fair enough. Rob, you're last on the buyback.

Rob Lloyd - *GameStop Corp. - CFO*

All right. We have been more aggressive this year in terms of making sure that our buyback plan to take advantage of when the price moves down. And I don't see the reason why that would change in the fourth quarter.

Paul Raines - *GameStop Corp. - CEO*

As we used to say at Home Depot we are not market -- right, Rob? That's what you guys do for living so we're just trying to buy shares.

Scott Tilghman - *B. Riley Caris - Analyst*

If I recall correctly your blackout window is typically about 24 hours after an event like this?

THOMSON REUTERS

Rob Lloyd - *GameStop Corp. - CFO*

Typically 48.

Scott Tilghman - *B. Riley Caris - Analyst*

Thank you.

Paul Raines - *GameStop Corp. - CEO*

Ready for me? All right. It thank you, everyone. We appreciate your support and that forward to speaking with you soon. Bye-bye.

Operator

Ladies and gentlemen, that does conclude today's presentation. We thank you for your participation.
