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# EDITED TRANSCRIPT

GME - Q3 2012 Gamestop Corp. Earnings Conference Call

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## OVERVIEW:

GME reported 3Q12 consolidated global sales of \$1.77b, consolidated global net earnings, excluding impairment charges, of \$47.2m and diluted EPS, excluding impairment charges, of \$0.38. Expects 4Q12 diluted EPS to be \$2.07-2.27.



## CORPORATE PARTICIPANTS

**Paul Raines** *GameStop Corp. - CEO*

**Rob Lloyd** *GameStop Corp. - CFO*

**Tony Bartel** *GameStop Corp. - President*

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

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

## CONFERENCE CALL PARTICIPANTS

**Brian Karimzad** *Goldman Sachs - Analyst*

**Seth Sigman** *Credit Suisse - Analyst*

**Colin Sebastian** *Robert W. Baird - Analyst*

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

**Bill Armstrong** *C.L. King & Associates - Analyst*

**Tony Wible** *Janney Capital Markets - Analyst*

**David Magee** *SunTrust - Analyst*

## PRESENTATION

### Operator

Good morning. Welcome to the GameStop Corporation's third-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 the GameStop's public documents and is the property of GameStop. It is not for rebroadcast or use by any other party without the written prior consent of GameStop.

At this time, I would like to turn the conference over to Mr. Paul Raines, CEO of GameStop Corporation. Please go ahead, sir.

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### Paul Raines - GameStop Corp. - CEO

Thank you for joining the third-quarter GameStop earnings call. Before we begin our remarks, I want to thank our 30,000 hard-working associates in 15 countries around the world who day in and day out are providing the finest customer service to gamers in stores, online and on digital platforms.

I particularly want to recognize our heroic teams along the mid-Atlantic coast and in the Northeast who have worked passionately to reopen our stores damaged as a result of Hurricane Sandy. We are happy to report that all of our associates and their families are safe and our Gamer Fund charitable foundation is working to provide those most affected with the support they need.

As you saw in this morning's release, the quarter played out within our guidance on top line and ahead on earnings by \$0.06 over consensus. The GameStop formula continues to show strong resilience in the face of challenging category headwinds, and the new categories of digital and mobile are creating new profit pools that we are exploiting aggressively. Rob Lloyd will give you more detail on how the earnings were achieved in the quarter.



New software declined at a rate slower than the market, driving another unprecedented 320 basis points of market share growth. Our business model is more dominant than ever on new titles, and although the category has declined this year, we are excited about the new titles coming now and in the near future. Tony Bartel will share some insight with you on how we see the software outlook improving now and into 2013.

With just a few days left until the Wii U launch, our consumers' appetite for innovation is very high. We encourage you to come to one of our 3000 stores with the new interactives and experience for yourself the fresh and unique gameplay that Wii U provides. It is clear to us that a new console launch has never in history benefited from the kind of holistic strategy we are deploying, and we expect to have significant share growth from the last Wii launch.

We are bullish on this new console, and Tony will give you some color on our work with Nintendo on the Wii U coming on November 18.

Once again, we produced very strong margin expansion during the quarter, up 200 basis points year-over-year and 260 basis points in two years. As we have shared on previous calls, we are transforming the business model towards richer margins through the creation of the new categories of digital and mobile to supplement our preowned and new software and hardware. DLC for consoles, casual game platforms, PC downloads and preowned smart phones and tablets are all good profit models where GameStop is uniquely positioned to leverage its assets.

Although we have a great deal to learn in these areas still, we are satisfied that we are delivering the potential that we saw in these segments a couple of years ago. We continue to execute our transformational strategy with success through the end of the current console cycle.

Turning to factors that are directly within our control, expense management is rooted in GameStop's DNA and remains a very high priority going forward. We have begun to overlap the large CapEx investments we made during 2010 and 2011 in business transformation. Those investments are showing results that you are seeing in market share growth, digital and mobile profitability and strong positioning of the Company as we enter the next console cycle. We are committed to SG&A reduction while maintaining a high rate of technology innovation.

On the international front, our teams around the world continue to pursue their markets with tenacity around cost reduction and a flair for innovation. During the quarter, all of our international segments had stored comps comparable to the United States, and our ability to replicate the best practices we develop is accelerating. Loyalty rollouts, websites, digital sales and mobile sales are all ideas developed in only the last three years and they are playing a key role in our success in all of our overseas markets.

GameStop is a leading global retail innovator, and Mike Mauler will give you further color on our efforts.

Mike Hogan is joining the call today, and his responsibilities now include marketing, preowned video games, gamestop.com, Kongregate.com and strategic planning. We are proud of the work Mike and his team have done in reinventing our marketing approach in the last few years, and he will share with you some insights on how PowerUp Rewards is migrating to a dominant consumer platform and how we will leverage the tool at holiday.

In terms of capital allocation, we continue to execute the strategy we committed to in 2010. Our buyback execution has been disciplined, and we have grown our dividend over the past year. Our commitment to investors is for continued return of cash flows to you, plain and simple.

As we think about the past few years, it has been a challenging time for most players in the video game business, as well as consumer electronics retailing. We have said on various occasions that we believe we have to drive a higher rate of internal change than the rate of external change around us to be a viable player in the future. The video game industry has struggled with reduced visibility to the next console cycle over the past year. As you look at our new profit pools and the margin expansion they are driving, GameStop has, at the very least, demonstrated a knack for finding business opportunities in the console downturn.

As we now shift into an environment where console launches will again drive innovation in the minds of consumers, the Wii U is the beginning of the next generation and demonstrates the potential of the complete GameStop business we are building. New video game hardware and software, preowned hardware and software, digital gaming of all kinds, preowned smart phones and tablets and new tablets all come together in a rich mix for a global specialty retailer.



In addition to these categories, we have built the fast-growing PowerUp Rewards customer platform and we are disciplined capital allocators.

Looking forward, we are confident we have the right strategies in place and are executing them effectively. As we move into the 2012 holiday season with a new gaming console and look to 2013, we relish the opportunities and challenges we face. With that, I will now turn the call over to Rob Lloyd.

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**Rob Lloyd** - GameStop Corp. - CFO

Thanks, Paul. Good morning. I'd like to start by reviewing the results of the goodwill impairment testing we discussed on our second-quarter earnings call. As a brief reminder, we initiated an interim impairment test of our goodwill and other intangible assets as required under ASC 350 of generally accepted accounting principles, due to a temporary decline in our stock price during the second quarter.

As a result of the completion of this impairment test, the Company recorded a charge to goodwill of \$627 million and a charge to intangible and other assets of \$51.8 million, or \$44.5 million net of tax. These are non-cash charges which do not affect our future operations, cash flows or liquidity position. The charges primarily relate to our international reporting segments, with charges of \$101 million and \$107 million relating to goodwill recorded in Australia and Canada, respectively, upon the merger with Electronics Boutique in 2005.

The charges for Europe were \$420 million for goodwill and \$47 million in other assets, and were largely due to the goodwill and other assets recorded from the merger with EB and the acquisition of Micromania in 2008.

Now I will discuss the quarter. During the third quarter, our consolidated global sales were \$1.77 billion, down 8.9% from last year, with comps down 8.3%. Comps were down 9% in the US and down 7% internationally. Our same-store sales were within the range we forecasted in last quarter's call.

There were a few strong titles launched during the quarter, such as Madden 13 and Borderlands 2, but due to comparisons to last year's title lineup and declines in hardware at the end of the cycle, we saw a decline in comps.

On a category-by-category basis, new software sales declined 12% compared to a 19% decrease in the US market. Preowned sales during the quarter were down 8.8%. The US was down 6.3%, and international declined 10.5%, excluding the effects of currency fluctuation. The preowned business again outperformed our new software and hardware results and outperformed the US market by 17%.

Sales in the other category grew 31%. Digital sales increased 32% over the third quarter of last year, with strong growth in PC digital. Our digital receipts or non-GAAP revenue totaled \$127 million, with GAAP revenues totaling \$50.8 million. PC software sales grew in the quarter due to Guild Wars and World of Warcraft Mists of Pandaria. Mobile sales grew 50% from the second quarter, from \$28.8 million to \$43.2 million this quarter.

Consolidated global net earnings, excluding impairment charges, were \$47.2 million and diluted earnings per share for the quarter were \$0.38, exceeding consensus estimates by \$0.06 and the high-end of our guidance by \$0.02. The earnings were the result of continued margin expansion and expense control.

Gross margins for the quarter were 31.4%, up 200 basis points from last year as our digital and mobile businesses continued to grow and our sales mix skewed towards the other category. Margins in new hardware, new software and the preowned business each increased when compared to 2011. The margin rate in the other category was 38.5%, down from 43% last year due to the growth of the mobile business, with margins of approximately 30%, and the strength of PC software sales, with margins around 20%.

Other as a percentage of sales grew from 12.6% to 18.2%. The dollar increase in gross profit for the Other category was \$18.2 million, with the growth coming from digital and mobile businesses. Mobile gross margin dollars were \$12.7 million in the quarter. Digital gross margin dollars grew 23% to \$30.3 million.



Total SG&A expense dollars declined 1% this quarter from last year as we've continued the focus on controlling our SG&A. Depreciation and amortization was also about 7% less than last year.

Excluding our GameStop Kids stores, we ended the quarter with 6650 stores. We opened 34 and closed 11 in the US and opened 11 and closed 12 internationally. We've reduced store count by 33 net stores this year, and still expect to reduce our store base by about 1% total for this year.

In recent meetings with investors, we've been telling you that we will provide greater clarity on the profitability of our store portfolio. As of the end of the third quarter, 2% of our US stores and 5% of our international stores did not produce positive cash flow in the trailing 12 months. In total, only 3% of our stores are not cash flow positive. As part of our plan to reduce store square footage by 1%, we will close over 200 stores during fiscal 2012.

In an effort to maximize store-level efficiency and profitability, we continually analyze the US store portfolio using our PowerUp database to determine where our sales transfer process can be applied. We continue to experience sales transfers of at least 40% in our closed stores, resulting in 20% or more in increased combined profits. Recent comp history and potential new consoles in the next 18 months present conflicting opportunities for our stores. However, you can rest assured that we will remain vigilant in our analysis of closure opportunities and in managing our store portfolio. We plan to provide guidance on 2013 store count in January as we progress in our 2013 planning process.

During the quarter, we repurchased 3.7 million shares at an average price of \$20.59, for a total of \$76.8 million. The effect of buybacks done during the quarter did not impact our EPS results as EPS using the guided share count was still \$0.38. Our share buyback now totals more than \$1 billion since January 2010, with 51.1 million shares purchased at an average price of \$20.29. The \$241 million remaining on the last repurchase authorization has now been replaced by a new \$500 million repurchase authorization.

The Company also declared our quarterly dividend of \$0.25 per share to be payable on December 12.

Now for the fourth-quarter outlook. We forecast same-store sales to range from down 7% to up 1%. The upcoming Wii U launch and the strong consumer demand we've seen for the AAA titles released in November give us optimism about the quarter, but we are cautious in our outlook given the struggles of the game industry thus far in 2012.

We expect preowned sales to decline from last year as fewer new title sales this year have led to a lower inventory build than we typically have going into the holiday season.

Diluted earnings per share are forecasted to range from \$2.07 to \$2.27, using weighted-average fully-diluted shares outstanding of approximately 122 million, which incorporates buybacks through the third quarter. We expect our full-year comparable store sales guidance to range from down 6% to down 9%. We are reiterating our previously-announced full-year 2012 EPS guidance as a range from \$3.10 to \$3.30, using weighted-average fully-diluted shares outstanding of 127 million, which also incorporates buybacks through the third quarter. Our earnings guidance does not include the effect of any fourth-quarter buybacks. The guidance range reflects the continued expansion of our margin rate and our ability to control costs in a difficult sales environment. Now I'll turn it over to Tony for his comments.

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**Tony Bartel** - GameStop Corp. - President

Thank you, Rob. Although the industry had another difficult quarter, we continue to outperform the rest of the market, as our competitors saw 24% software declines, while we have only had a 12% software decline, increasing our Q3 software market share to 44% in the US. In addition, our digital revenues grew 32% over Q3 of last year, with PC digital growing at 55% and console digital growing at 20%.

As mentioned earlier, we have shared the success of launching DLC at the day of launch that we had with Activision's Call of Duty Modern Warfare 3 Elite, and most major titles are now launching with day one season passes. For instance, we attached 13% of the season pass to Ubisoft's Assassin's Creed III, and 27% of the Halo 4 map pass to Microsoft's Halo 4 at launch.

Finally, we are attaching double digits to the blackouts to season pass on Activision's Call of Duty Black Ops II.

It is important to note that we are now the only retailer that is selling Microsoft game-specific DLC, and we deliver it to PowerUp Rewards customers at the time of purchase so that they can begin the download to their Xbox 360 before they leave our store.

Even though our digital receipts outgrew the software category by 51 basis points in the third quarter, the decline in the gaming category has negatively impacted our console DLC and POSA cards, resulting in a lower growth rate than we anticipated. Although Q4 is expected to be significantly higher than our year-to-date digital growth rate, we anticipate that we will end the year between 30% and 40% overall digital growth, or \$590 million to \$635 million of digital receipts.

We now offer over 2000 downloadable games in our stores and on GameStop.com, and we saw our PC digital download sales nearly triple during the quarter. We've also expanded the ability to fund steam wallets of nearly all of our stores globally, and we are seeing this drive PC customers into our stores and into our loyalty programs.

Kongregate grew 29% during the quarter as we now have 240 games that monetize through endgame transactions. Revenue from endgame transactions grew 77% during the quarter. Game Informer digital subscriptions grew 140% during the quarter, and we now stand at 8 million total subscriptions and 2.7 million digital subscriptions.

Moving now to our mobile segment, our mobile business grew to \$43 million and is on track to deliver our full-year goal of \$150 million to \$200 million at a greater than 30% margin rate that we have previously communicated. We sell new Android-based tablets in over 1600 stores domestically and 800 internationally. We are also utilizing our recently-launched a web in store technology to allow for all US stores to sell tablets, as well as any other item that may not be available in the store at that time, and have them shipped free of charge to our customers' homes.

GameStop has a rich heritage of trading and selling hardware and software, and we have expanded our expertise to smart phones, media players and tablets that we accept in trade in all of our US stores. These trades are fueling the sale of preowned C devices, new tablets and new and preowned hardware and software. Trades of mobile devices represented over 10% of trades that we received during the quarter and have been increasing weekly.

Based on the success that we have seen with our efforts in preowned mobile devices, we have converted 268 stores to an expanded selection of preowned and new mobile devices and related accessories. These stores have an average of 15 linear feet dedicated to mobile devices, and early results show a sales lift of approximately 7% in the converted stores. After the holiday, we will solidify our plans to convert additional stores next year.

Looking forward, we are excited to be in the fourth quarter, where we are seeing major releases meeting our high expectations. The last three weeks have been exciting as we've hit new record launch levels for the Assassin's Creed and Halo franchises. And, based on early trends, Call of Duty Black Ops II is on its way to being our largest-selling game ever.

Also, with nearly 500,000 customers on our Wii U reservation waitlist worldwide, we are excited about the demand for Wii U. The Wii U waitlist is another example of how we are integrating PowerUp Rewards into all areas of our business. Wii U's software is also reserving very strong, with over 1.2 million reserved titles worldwide. The reservation of Wii U games to reserved consoles is more than double that of the original Wii launch. Top-reserving Wii U titles are Ubisoft ZombiU and Assassin's Creed III, Activision's Call of Duty Black Ops II, Warner's Scribblenauts and Nintendo's Super Mario Brothers.

While we remain very excited about Wii U's potential, we also caution that we have limited knowledge of supply, and we may not be able to satisfy the strong demand during our fourth quarter.

Additionally, in order to take advantage of the growth category of children's toys and games, we've opened up 82 GameStop Kids stores in malls across the nation. These stores have an expanded selection of kids' games, toys, action figures, plush toys, clothing and accessories that cater to our younger audience and gift-givers. These stores are helping us to drive sales of top-drawer titles such as Activision's Skylanders Giants, which has grown 5.5 times over the same launch window last year.



Finally, we are very excited about the first two quarters of 2013 as they look very strong, with announced titles including Konami's Metal Gear Solid Rising, Sony's God of War Ascension, Microsoft's Gears of War Judgment, EA's Dead Space 3 and Crisis 3, Square Enix's Tomb Raider, Take-Two's BioShock Infinite, Ubisoft's Splinter Cell Blacklist and Take-Two's Grand Theft Auto V. We enter 2013 with record-high share levels, and we expect the strong 2013 release schedule to generate significant trades to fuel our preowned business.

With that, I will turn the call over to Mike Mauler.

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

Thanks, Tony. Good morning, everyone. As Paul mentioned, our international operations exceeded expectations in the third quarter. Excluding impairment charges, all three segments individually improved profitability versus Q3 of 2011, and in total, increased operating earnings by 34%. Despite overall comparable store sales of minus 7% during the quarter, a strong focus on cost control and a 240 basis point increase in gross margin percent drove the improvement in operating earnings, with the most significant improvements generated by our German and Australian businesses.

As a reminder, over the last 12 months, we restructured our businesses in Spain and northern Europe, where we consolidated operations in Ireland, resulting in significant reductions in SG&A. During this time, we have continued to focus on driving profitability in the preowned business, and I'm pleased to say that during the third quarter, international preowned margin rates increased 500 basis points over prior year and are now in line with US preowned margin rates.

During the quarter, we continued to make progress with our strategic initiatives. International eCommerce grew 35% during the quarter. Digital sales grew at greater than 30%, and our mobile product sales increased 55% versus Q2, as these new product lines were rolled out to all countries.

Finally, our loyalty program continues to expand, with Australia's loyalty program reaching 1.3 million members or 6% of the country's population. And we continue the expansion this month to new markets in Germany, Austria, Switzerland and Italy.

Our strong focus on managing the basics of our business and the rapid execution of GameStop's strategic transformation is driving profitability not only during the bottom of the current cycle, but will ensure that GameStop International is the international leader as we enter the next new console cycle. And now I will turn it over to Mike Hogan for his comments.

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

Thanks, Mike. I have a brief update on PowerUp Rewards. Our PowerUp membership continues to grow. Today, we have over 21 million US members. By way of comparison, last year at this time, heading into holiday, we had only about 14 million members.

Year to date, roughly 75% of GameStop US sales are attached to a PowerUp number; that is up significantly versus this time last year.

And our PowerUp Pro renewal rates are increasing, now running in the high 50%. Year to date, that puts us at around 40% Pro members overall.

Our database of customer transactions also continues to grow, and we now have over 360 million games in the customer game library, which, as you know, we use for a multitude of purposes, including customer segmentation, targeted game offers, trades, et cetera.

And PowerUp is driving top-line growth in a challenging category. The physical games category is down more than 20% year-to-date according to NPD. GameStop sales performance is considerably better than the category, and PowerUp member sales are leading total GameStop growth. PowerUp member sales also drive our preowned business, which is outperforming both the category and total GameStop sales.

There are a number of reasons for this. We've seen real success in our ability to drive increased spend and share of wallet through better communication and through targeted offers, like the buy two, get one coupon that is exclusive to Pro members, exclusives like Modern Warfare 3



prestige token, and value promotions like 50% off selected Sony titles. The purchase metrics continue to be extremely strong, with members still spending about five times as much as nonmembers.

We recently rolled out a program to communicate to our members the full value of their PowerUp Pro membership. As you know, the program costs \$14.99 per year, but we found that the average Pro member was getting many times that amount in annual value, between the savings, the bonuses, subscriptions, buy two get one, and other offers, and that does not even include game exclusives. The initial response has been extremely positive and we expect it to help lift renewal rates.

Finally, PowerUp Rewards is cost-effectively driving our new products and categories. One of the major barriers for any new business is the cost of customer acquisition. PowerUp Rewards allows us to leverage our current heavy spenders in new products and new categories at an extremely affordable cost. For example, we introduce members to the opportunity to buy DLC at GameStop. This is done through targeted e-mail, but also through point-of-sale integration. This program has been extremely effective at driving our DLC business.

A new category example would be our recommerce business. We are introducing PowerUp members to this new product category. PowerUp members are driving the success of this business and already contributing more than 65% of our recommerce sales.

Let me turn it back to the operator now.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Brian Karimzad, Goldman Sachs.

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### Brian Karimzad - Goldman Sachs - Analyst

Good morning. I guess first one is on the assumptions you have baked in for the fourth-quarter comp outlook. What range of supply scenarios do you have baked in there for that Wii U launch?

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### Rob Lloyd - GameStop Corp. - CFO

I'm not sure that we are comfortable stating exactly what the units are that we are looking at, but we did bake in a pretty wide range, just given what we know from past Nintendo launches, as well as what we have visibility to at this time. We are confident in the consumer demand; the supply side is what is the unknown for us.

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### Paul Raines - GameStop Corp. - CEO

Part of what is happening here, too, is we are approaching this launch very differently from every other competitor and from our own historical, and we think that influences decision-making as well, so we are going to be very cautious with that.

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### Brian Karimzad - Goldman Sachs - Analyst

Okay. And then any reason the margin progress we've seen in the new and used software businesses this year won't hold for the foreseeable future?



**Rob Lloyd** - GameStop Corp. - CFO

Clearly what is going to be an impact on the margin rate in the fourth quarter overall and particularly in the hardware area will be the Wii U launch. When new hardware consoles launch, they typically have more like a mid-single-digit margin rate attached to them, as opposed to the rates that we've seen particularly in the third quarter overall. So that will be an impact.

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**Paul Raines** - GameStop Corp. - CEO

You will certainly see -- you'll see mix effects. The precision, though, of what these teams are doing -- you heard Tony and Mike talk about what is happening with preowned, and -- I mean, the tools that we are using here aren't going to change. Mix definitely will change.

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**Brian Karimzad** - Goldman Sachs - Analyst

I guess what I'm getting at is on the software side specifically, the games you've seen have been a result of actions you've taken and there is some sustainably sustainability to them and not just mix?

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**Rob Lloyd** - GameStop Corp. - CFO

The mix in any particular quarter on software can depend somewhat on the titles are released in that quarter. And so I can't tell you that I've examined the impact of the three titles we've seen so far versus the titles that are coming from Nintendo. But generally, I would expect that it would be in the range that you typically see from our software margins.

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**Brian Karimzad** - Goldman Sachs - Analyst

Okay. Then just quickly on the buyback, it slowed down a bit in the quarter, and it looks like it was a bit front-end loaded, although it is pretty strong quarter for you on cash. Anything to share there on your philosophy?

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**Rob Lloyd** - GameStop Corp. - CFO

If you look at the second and third quarters combined, we bought back \$213 million worth of shares. Comparing that to the second and third quarters in 2010 and 2011, we were in the range of \$75 million to \$100 million.

So what we are trying to do is be more -- spread the buyback out throughout the year and then take advantage of opportunities where we see that the price is not where we want it to be. So clearly in the second quarter and the early part of the third quarter, the price was suffering, and as a result, we were able to buy more heavily in that timeframe.

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**Brian Karimzad** - Goldman Sachs - Analyst

Okay, thank you.

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**Operator**

Seth Sigman, Credit Suisse.

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**Seth Sigman** - *Credit Suisse - Analyst*

A question on the mobile business. It seems to be ramping nicely and it looks like in your guidance you imply a big pickup in the fourth quarter. Obviously, there is some holiday seasonality there. But how should we think about the drivers of that growth? Any metrics on per-door economics? And maybe you can share that would be improving in the fourth quarter. And any early thoughts on how that business should play out in 2013? Thanks.

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**Paul Raines** - *GameStop Corp. - CEO*

Tony will answer some of this on the store model or trades and some of the other things. I would say to me, when we talk about this mobile business, first of all the consumers' appetite for this as a holiday gifting item is clearly going to be pretty strong. It is a great area. We've expanded the assortment and we've expanded linear footage. Tony, maybe you want to share some of that -- some color on that.

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**Tony Bartel** - *GameStop Corp. - President*

Sure. Clearly, as I talked about, the stores that we've actually expanded linear footage on, we are just completing that, so that is clearly going to contribute to it. I have a couple of other factors that are going to take place.

Seasonality is definitely one of these. We did have a good sample last year of stores, so we have modeled similar seasonality in the fourth quarter. The other thing is that we are still rolling out internationally with the sale of recommerce. And so you're also going to see international play a large part in contributing to the growth and the expansion in the fourth quarter.

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**Paul Raines** - *GameStop Corp. - CEO*

It's a very good web business, as well. That's the other thing, is our consumers, particularly at holiday, go to the web, shop for these items. Our web in store technology now opens thousands of storefronts that weren't there before. So there is lots of tailwinds on this.

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**Tony Bartel** - *GameStop Corp. - President*

We've also used the BuyMyTronics acquisition to identify additional SKUs that are very popular with consumers. And so we are using that to expand the amount of SKUs that we accept in all of our stores, and therefore sell in all of our stores. So that's another contributing factor.

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**Seth Sigman** - *Credit Suisse - Analyst*

Okay, thanks. And just a quick question on expenses. As you start to plan out for sales growth going forward, how do you think about the operating leverage in the model in Q4 and into next year? Are there any areas where you still need to increase spending or are you pretty lean at this stage?

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**Paul Raines** - *GameStop Corp. - CEO*

Let me start it off, Rob, and you can comment on planning. If you go back, Seth, we were very focused on driving operating margin targets of this year. I think we gave a guidance of 7. I think it was 7 to 7.3 was our guidance at the beginning of the year. So we've been very focused on operating margin.

If we can reach this range, we are very close to GameStop's all-time highs in operating margin. So that is a big priority for us. Rob, maybe you want to talk about what we are doing around the planning, around the scenarios for 2013 based on launches, et cetera.

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**Rob Lloyd** - *GameStop Corp. - CFO*

Going into 2013 and in this fourth quarter even, you have the opportunity with the top line, its being driven by hardware sales, to really gain some leverage on the cost side. And so steps we've taken in the past have not only protected the profitability as we've gone through 2012, but they set us up for what can then be further leveraged as we go forward. So we remain focused on our cost structure and cost control and reducing costs where possible.

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**Seth Sigman** - *Credit Suisse - Analyst*

All right, thank you.

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**Operator**

Colin Sebastian, Robert Baird.

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**Colin Sebastian** - *Robert W. Baird - Analyst*

I guess first of all, looking out beyond the holiday period, I'm curious what we should expect in terms of correction, software pricing, just given the aging cycle, what your expectations are there. And it related to that, how you are seeing currently pricing hold up on used software.

And secondly, on the mobile question, I guess as a follow-up. I'm curious if you are refining your strategy [deal] in terms of providing unique, game-centric platforms where you've loaded up games on devices? Or is this shifting more towards GameStop becoming a tablet retailer? Obviously, you've done very well with Nexus 7, and that presumably gives you some ammunition to sell other popular platforms. Thanks.

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**Paul Raines** - *GameStop Corp. - CEO*

There's a lot there. Why don't we start with pricing, Tony? You got any comments on the current gen pricing?

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**Tony Bartel** - *GameStop Corp. - President*

Yes, Colin. I have received no information to lead me to believe that current gen software pricing will be going down. And as a result of the follow-up question, so given the fact that we anticipate that it will stay very consistent, I would think that our preowned pricing will also stay very consistent as well. So there is no indication that I am receiving that there will be a reduction in the current gen software.

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**Paul Raines** - *GameStop Corp. - CEO*

As far as the mobile, it is a challenge. Colin, you know we got into this mobile business because we saw it as a gaming platform, customers are asking for it. What we've discovered is there is room for a buy/sell/trade electronics player, and so we have inside our stores this growth vehicle that we are trying to manage appropriately, et cetera. Tony, maybe you want to talk about some of the plans around mobile.

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**Tony Bartel** - *GameStop Corp. - President*

Absolutely.

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**Paul Raines** - *GameStop Corp. - CEO*

As far as gaming goes.

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**Tony Bartel** - *GameStop Corp. - President*

Sure. Clearly, we see mobile as a growth category, tablets in particular. And we started by putting games -- actually pre-loading games onto the tablets. You will see us continue to be game-centric in our tablet selection. The highest attaching accessory that we have to our tablets is our proprietary Bluetooth controller now those are coming onto the market.

Obviously, we see people using tablets a lot for gameplay, and that continued on with the Nexus 7 as well. So you will see us continue to be game-centric as we sell tablets, although consumer demand is really going to lead us. So as we see other devices in the mobile base that consumers are looking for, our buy/sell/trade model allows those products to be very affordable. And so we think that we can actually go beyond gaming. So far, it has been very game-centric. I think you will see us expand that.

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**Paul Raines** - *GameStop Corp. - CEO*

The other thing that we should discuss -- and I'll ask Mike Hogan to give us his thoughts on this -- is one of the things we are finding is PowerUp Rewards is making us an extremely strong customer acquisition platform. And so we have a lot of people coming to meet with us who want to launch their product in stores. Mike, maybe talk about how you use PowerUp Rewards to drive the Google Nexus successes we've had and so forth.

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

Sure. One of the things I think we are finding is that the cost of customer acquisition, of course, is very high, and that applies not only to our business but to other businesses as well. And I think you've seen some of the successes we've had around DLC, for example, taking current end-users and introducing them to a (inaudible) product category.

To Tony's point, we think that the tablet business is pretty -- i-device and such is very close in to our current business as well. So what we've been able to do is a number of things. One is to segment consumers and identify them by their preferences. We've been able to take consumers, once they've been introduced to the new product, and cross-sell a number of accessories, games and timecards and things that go with it. So we have, we feel, a pretty full pipeline in terms of ways to do that.

In addition, we are feeding information back at the store level. Because one of the things that we've found is even more powerful than the e-mail connection is taking the right information about the consumer and their preferences and what they've purchased in the past and making it available at the point of sale, so when the consumer is in the store, the associate can suggestively sell the right device for the consumer.

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**Colin Sebastian** - *Robert W. Baird - Analyst*

All right, great. Thanks, Mike. And I guess Rob, just lastly, in terms of capital allocation, any planned uses of cash or liquidity needs that might prevent the Board from considering a higher dividend down the road? Thanks.

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**Rob Lloyd** - *GameStop Corp. - CFO*

I would say that there isn't anything that is planned at this time. We continue to look at opportunities out there for us to invest in. But we don't see anything on the horizon that would deviate us from the share buyback and the dividend plan that we are on. And we have spoken about our desire to continue to have a dividend that increases over time, and that there is room in the formula for us to increase that dividend when the time is right.



**Colin Sebastian** - *Robert W. Baird - Analyst*

Great. Thanks very much.

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**Operator**

Arvind Bhatia, Sterne, Agee.

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

Thank you, guys, and congratulations on the quarter. I wanted to talk about your long-term goals with respect to the mobile business. I think you had given us some long-range plans, dollars, margins et cetera. I wonder how you feel about them after you've had a chance to run this business for some time now. Recalling I think a \$650 million type number, do you see the market opportunity any differently today, larger, about the same? Any color there long term would be helpful.

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**Paul Raines** - *GameStop Corp. - CEO*

I guess I'll start it off, and maybe Mike Hogan can talk about what we see in sort of the size of the market and that kind of thing.

I think, Arvind, we got into this because it was adjacent to gaming. And consumers are coming to us with iPhones trying to trade, and Samsung products and wanting to trade to buy a gaming product. We also saw consumers playing games on tablets.

So that's how we got into it. We did a pilot. It went extremely well. And we discovered that our competencies around refurbishment worked very well in this space. So now we are in it.

I think the thing that is going to be interesting for us is we continue to see this buy/sell/trade competency as being a very unique and differentiated capability for GameStop. So while we have tremendous expertise in gaming, the buy/sell/trade impact to electronics is enormous. And if you look at BuyMyTronics.com, they are able to handle literally thousands of SKUs that we don't carry in our stores.

So we think -- and we're not ready to give you revisions to the market size, et cetera, probably until next year. We certainly feel pretty good about our estimates for this year and think it has been a very exciting profit pool.

So Mike, maybe you can talk a little bit about what you think the size of this market, just general numbers, is in the US and around the world.

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

You know we have a pretty detailed model that we use in terms of projecting the video games market. We also have a model that we built to take a look at the recommerce market. And we would say the market in the US was over \$1 billion last year in 2011 and continues to grow into double digits this year. We would think that this category is going to be between \$2.5 billion to \$3 billion in the US by 2015.

So we continue to see a lot of growth in the category. I think to Paul's point, things that we have learned about the category is retail footprint is very important. A lot of players we see struggling with growth because they don't have stores, places where consumers can come and actually get cash for their -- or trade credit for their product. And also the buy/sell expertise. So we feel very good in terms of our positioning for our growth within the category. But we are very bullish on the overall category growth.

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**Paul Raines** - *GameStop Corp. - CEO*

We will have details for you in the new year on how we plan to manage that in our various platforms and stores and brands.

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

One question on 2013. I know we are not talking about guidance here. But you gave us some really good color on some of the titles that are in the first -- in the early part of 2013. But I wondered if you can give us some of your views on just the year itself. If you assume additional console launches in 2013, is that a transition year, as people -- certainly people anticipate a new console and then maybe there is some slowdown sometimes prior to that. Are you looking at it that way or are you looking at this to be a different type of transition, where it is pretty gradual and you don't really see much change? And, like you said, the titles the early part of the year are very strong. So just some general color on the year would be very helpful.

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**Paul Raines** - *GameStop Corp. - CEO*

Tony, you got the crystal ball out? Uncharted waters kind of thing.

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**Tony Bartel** - *GameStop Corp. - President*

I got the crystal ball out. I think, clearly we don't have announcements from two of the major platform holders, but there is a lot of speculation about the launches. I think it is important to note that we do go into 2013, as I said, at record share levels. We are more than double market share versus when we went into these console launches last time. So I think that is really important to note as we move into these console launches.

But that is console launch in general, whenever it may occur. I'll let Rob pull out his crystal ball and talk to you about 2013.

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**Rob Lloyd** - *GameStop Corp. - CFO*

The market share is important, because we continue to demonstrate our ability to gain share as we launch new titles. Tony talked about the title releases that we see coming up. The big unknown for 2013 is the base from which we are starting, which is an industry that has been down 20% to 25% this year. So you can put some strong titles in there, we put the unknown of the consoles in there, and it's very difficult for us to form a picture at this point. But in the past, when we've seen this sort of year running up to big console launches, it is a bit of a transition year.

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**Paul Raines** - *GameStop Corp. - CEO*

The other thing that has not been discussed is we believe we can change the cadence and schedule of this transition, because we are using PowerUp Rewards in a way that has never been done. We can tell console makers how many people want a particular feature on their console. And we can share with software manufacturers what type of games do people want to play on a new console. And we think that our mission here is to use PowerUp rewards to shape the schedule and shape what comes out in the future. So that -- I think that is the work that has to be done.

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

Very helpful. Last quick one is the impact of Sandy. I know it is hard to quantify, but any early thoughts on numbers?

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**Paul Raines** - *GameStop Corp. - CEO*

Tony, do you want to talk about Sandy?

**Tony Bartel** - GameStop Corp. - President

Clearly, having a major storm hit on the launch date of one of your largest titles is not what we would have predicted. However, we had heroic efforts on the parts of our associates. We had hundreds of stores that were out on the day, and we did literally have people on the ground on the island of Manhattan, touching every single store the very next day. We were open before our competitors. So as a result, we were able to minimize the loss significantly, so it has really been a very minimal event for us.

Like I shared earlier, we had record launches for Assassin's Creed III. They met our expectations. So clearly, it did not impact us dramatically. I cannot tell you how proud I am of the team on the East Coast. I have heroic story after heroic story of things that people did. But the ability for us to get up -- we only have six stores that are down at the current time. So within two days, we had nearly every one of our stores that were impacted back up again, far outpacing the ability of our competitors to bring their stores up.

So to a certain extent, we really mitigated what could have been a very disastrous event and it really had no impact on our sales.

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**Paul Raines** - GameStop Corp. - CEO

By the way, I don't want to miss the opportunity to fill the analyst community and investment community in on something interesting. We created in September here at GameStop a charitable foundation we call the Gamer Fund, and it's a funded by internal donations, by employees, et cetera.

That charitable foundation has been very active in the community in Sandy, and we've been able to assist many of our associates who've lost homes, who've had all their belongings destroyed, et cetera. We would welcome donations from the analyst community, so I'll ask our IR team and Matt to send you all envelopes, if you want to support the Gamer Fund here through Sandy.

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

That's great, guys. Appreciate that. And good luck with the quarter.

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**Operator**

Bill Armstrong, C.L. King & Associates.

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**Bill Armstrong** - C.L. King & Associates - Analyst

Good morning. Just a question on the gross margin in the Other category. I know you talked about the mix shift causing the decrease. Were there any other dynamics going on during the quarter, perhaps movement in margins within some of the subcategories?

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**Rob Lloyd** - GameStop Corp. - CFO

I think the one thing that we maybe didn't mention was that the video game accessories are in that category. That is a relatively high-margin product set for us. And that was impacted by the overall NPD type data that you see around the category. So that is really the only other thing I might call out.

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**Bill Armstrong** - C.L. King & Associates - Analyst

So the margins within accessories didn't change, it was just that accessory volumes were down?

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**Rob Lloyd** - *GameStop Corp. - CFO*

Yes, again the mix.

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**Bill Armstrong** - *C.L. King & Associates - Analyst*

Yes, okay. All my other questions have been answered, so thanks.

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**Operator**

Tony Wible, Janney Capital Markets.

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**Tony Wible** - *Janney Capital Markets - Analyst*

A couple questions. First is, what kind of inventory allocation did you get in 2006 on the Wii? I don't know if you could share kind of the number of the units.

And secondly, on the i-device business, what has been the average transaction size that you guys have been running on that? And now that you guys have had it up and running for a bit, can you kind of describe where the mix of trade-in versus kind of demand for units is coming from? Is it Touches, Phones, tablets, et cetera?

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**Paul Raines** - *GameStop Corp. - CEO*

Rob, do you have any data on the -- we may have to get -- you've got a lot of numbers in your head. Do you have the Wii (multiple speakers) --?

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**Rob Lloyd** - *GameStop Corp. - CFO*

I don't have the actually Wii allocations from 2006 in any sort of accessible memory bank, unfortunately. But you know, what we've looked at in terms of forecasting this quarter is where our share sits with Nintendo, how we've performed on recent launches. Clearly, our reservation list and the power of that waitlist that we created with the power of customers in September has been a factor in what we have visibility into at this time as far as allocation is concerned.

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**Paul Raines** - *GameStop Corp. - CEO*

Tony -- on the mobile stuff, Tony will talk to you a little bit about hot SKUs. I just would make a point with you, that it is really very much a smart phone and tablet business now. We take Android SKUs. Amazon Kindle is becoming one of our emerging fast-growth SKUs. So it has gone beyond sort of just an i-device business into very much a smart phone type. Do you want to talk about the hot SKUs, Tony?

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**Tony Bartel** - *GameStop Corp. - President*

Sure, and we don't give out details on our average transaction size, so I can't answer that question. But, given the fact that we do set both the trade price and the sales price, we really have the opportunity to manage inventory. So we are constantly -- we literally deal with that on an hour by hour, day by day basis.

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So really the demand -- the supply that comes in from a trade perspective is exactly what we need to meet the demand that we are seeing. So we manage that very closely, so that fluctuates. For instance, when you have an iPhone 5 launch, clearly one of the SKUs that comes in is the iPhone 4 and the iPhone 4S. So we did a lot of that. And we are able to fluctuate. That's the beauty of this business. We fluctuate the trade price and the retail price to ensure our inventory levels match demand.

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**Paul Raines** - *GameStop Corp. - CEO*

Interesting thing is our online -- Mike Hogan talked about the online competitors. One of the big advantages when you have a storefront is you have great connection with the consumer to get trades. This struggle the online players in this space have is customers just -- there is a lot of friction in shipping you a product that doesn't even have a price agreed to on it, et cetera. So we are seeing advantages from that.

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**Tony Wible** - *Janney Capital Markets - Analyst*

Got you. And going back to the inventory question, I guess another way I wanted to think of that. The market share is double what it was in 2006. Is it too aggressive to imply that your allocation would be double? Because I know Nintendo might be a little bit more ambivalent, but I also guess that Amazon, it doesn't look like, is going to be carrying it out of the gate.

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**Paul Raines** - *GameStop Corp. - CEO*

That's unfortunate.

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**Tony Wible** - *Janney Capital Markets - Analyst*

You can buy one for \$1200.

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**Rob Lloyd** - *GameStop Corp. - CFO*

I don't recall what our allocation was at the time. I don't know what the initial shipments to the US were six years ago compared to what they are today, so I really don't have the facts to answer that.

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**Unidentified Company Representative**

I think again the important point -- we really don't have visibility -- full visibility to the quarter from Nintendo. And as you said, that is a common place to be during a launch with Nintendo.

I think what we do know differently this year than in 2006 is we have a really good read on demand. We know exactly where the customers are who want this product. So we are in constant communication through our PowerUp Rewards team with these customers. So we are offering a true service here.

When we get our allocation, we immediately are notifying the customer. So you don't have to chase the UPS truck, you don't have to go store to store; we will tell you when you are going to get this. That clearly is a superior customer experience than anyone else can offer. And we've talked with Nintendo at length about that process; clearly, they understand the benefit that we are giving to the customer.

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**Paul Raines** - *GameStop Corp. - CEO*

And the software reserves kind of reflect that. Mike, you have something to add?

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

There is one other additional difference this time with the Wii U versus the Wii. This time, Nintendo is doing a worldwide launch in a span of only about three weeks. With the Wii, it was spread over several months. So allocation strategy and the numbers on the Wii probably are not real predictive of what we will see.

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**Paul Raines** - *GameStop Corp. - CEO*

That's a great point, too.

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**Tony Wible** - *Janney Capital Markets - Analyst*

Got you. Great. Thank you.

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**Operator**

David Magee, SunTrust.

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**David Magee** - *SunTrust - Analyst*

Thank you. Good morning and good quarter. I just had a question regarding a comment you had made during the remarks about the majority of your products being sold now to PowerUp members. Did I hear 75% is the number there?

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

Yes, David, that is correct. Year-to-date this year, 75% of our US sales are attached to a PowerUp member.

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**David Magee** - *SunTrust - Analyst*

So I'm curious -- how does that number change going into December, closer to the holiday, when you've got perhaps more casual shoppers? And what maybe gives you an advantage this year that you maybe haven't had in the past to help the visibility of that transaction?

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

The answer is yes, the number will decline a little bit as you go into holiday, because you have a much broader set of customers that comes into our stores during that time frame. At the same time, it is also a great opportunity for us to sign up new members. I believe we signed up over 1 million PowerUp members during December of last year, so it is a great opportunity for us to do that.

It also -- as we looked at the holiday, PowerUp gives a big advantage as we think about things like, for example, Wii U. We can offer consumers not only a wait list, but an opportunity to know what is available, when it is available, when they are going to get it, with direct communication with us.

We've also found that it is a great opportunity to communicate our key value messages over the holidays to consumers who represent the majority of our purchases. So you can imagine, even though the number is going to drop a little below 75%, it is still the vast majority of our sales, and it is an extremely cost-efficient from a marketing perspective way for us to communicate to people not only the titles that are launching, but the hot



deals at Christmas. We can take all of our external marketing, like our FSIs, we can replicate that out to our members. Our i-device sales, we've had great success there. Paul mentioned that will be a great gift idea for Christmas. So we have a really full lineup that we are going to -- and PowerUp is really the core of our marketing program for the holiday season.

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**David Magee** - SunTrust - Analyst

Thank you and good luck.

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**Paul Raines** - GameStop Corp. - CEO

Thanks very much. With that, I will wrap us up. Thanks very much for your support of GameStop, and we look forward to talking to you on the next call. And please come down to our stores and check out the Wii U Interactive. Thanks very much.

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**Operator**

This does conclude today's teleconference. You may disconnect at any time, and have a wonderful day.

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