**GameStop Corp.**
**OPCO 18th Annual Consumer Growth & e-Commerce Conference**
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Brian: Thank you all for attending the 18th Annual Oppenheimer Consumer Growth & e-Commerce Conference here in Boston. My name is Brian Nagel. I am the Product Lines and e-Commerce Analyst at Oppenheimer. So thanks again – thank you all for attending. Very pleased to introduce our next presenting company, GameStop, and the company's CFO and COO, Rob Lloyd. So thank you Rob.

Rob: Thank you. Good morning.

Brian: We're going to structure this as a fireside chat. I've got a number of questions I was going to ask Rob. But if at any moment anyone from the audience wants to ask a question, just raise your hand and we'll work you into the conversation.

I think Rob, look, I think – let's start with you got some news out this morning.

Rob: We do. Not much, but a little bit.

Brian: Maybe just update for those who maybe – maybe just update what you guys said this morning and we can talk from there.

Rob: Sure. So new story, two stories I think broke yesterday about conversations we're having exploring a possible sale and so our comment this morning, our release was basically that we are having those exploratory discussions. Obviously, no assurances that anything will come of those conversations in terms of a final transaction. And really, that's the only comments that we can make until such time as there's something – the timing is either more appropriate or something more we can talk about.

Brian: Perfect. So my mind, the news today comes after a rather hectic, if you will, several months here for GameStop. Talk from your perspective, again, just maybe to help update the audience, some of the management changes. What's basically transpired from a management perspective at GameStop to get to where we are now?

Rob: Sure. Well, obviously for those of you that have followed GameStop for awhile, you know that our former CEO, Paul Raines, fell ill. He had a recurrence of brain cancer which ultimately took his life in March. He stepped away from the company in November to seek medical treatment and then in February after a process focusing primarily on internal candidates, we named Mike Mauler as our CEO. Mike resigned from his role as CEO in May after a very short tenure. We had some other management changes as well in the February timeframe when Mike was named CEO.

I think as we went through the internal process and the board was focusing on who was the right candidate to take over as the CEO, they focused on a couple of things. One would be our performance over the course of the last few years, and the other was the strategy going forward. As you know, we've embarked on a lot of diversification in the past few years, adding over 1300 stores in our technology brands business, as well as adding a collectibles business, which is principally sold inside our GameStop Stores, but also through Thinkit.com and through some collectibles-only stores.

We had a lot of focus on that diversification, which cost us, I think, in terms of some focus on our core video game business. That and the strategy going forward I think were the things that led to the other management changes, specifically our former COO and Head of Strategy both left the firm.

In terms of the going forward, the board, Mike Mauler and I, as well as other members of our management team were aligned around the need to focus on what we currently own; fix the operational issues inside those businesses; regain an understanding of what the consumer behaviors are around video games and collectibles and how we can create an environment in our stores to continue to appear to the core gamer, increase the engagement of the casual gamer and then draw moms and families into the store. We've seen that moms and families are – we skew a little bit more that way in terms of that collectibles customer.

So strategically, the gentleman who left the company back in February thought we needed to continue to focus on diversification. As the CFO, my view was that you as investors would want us to steward the capital we've already spent on the things that we've acquired, make sure they're running well before we put any more capital into expanding those diversified businesses. So that's the focus that we have now.

Since Mike Mauler left the company in May, we're continuing to focus on a few key things. Around the video game business it's understanding that customer; it's improving the pre-owned business, which involves an understanding of the customer and how we can attract more people into trade games in the stores. It's focused on the collectibles business inside our stores and improving the operations there, merchandise selection, inventory turns, markdown cadence and gross margins in that space. And then inside of our AT&T business, there's a lot of effort going on to improve the compensation arrangement with AT&T, to improve the operational performance with a lot of growth from 90 stores to over 1300. I think there were some operational things we were not executing as crisply on as we could have. We brought in some executive help to do that. And then lastly, to drive the sales of entertainment products using a third party to help create some sales techniques. And we've recently finished rolling out the training associated with that.

So those are the principal operational areas that we're focused on as we work with an interim CEO, with an eye towards a CEO search and then hopefully naming a new CEO sometime later this year.

Brian: So let's take a step back and we'll take the business in two parts, the video gaming and then the non-video gaming. As far as video gaming, we recently had the E3 conference. How should we think about coming out of that event, maybe the title lineup, for the balance of this year in a potential driver for GameStop's business?

Rob: Sure. Well, we've seen a pretty sparse lineup in the first half of the year. So what we saw in E3 gave us a lot of excitement. One, for the back half of this year, but also into next year. So you've got a lot of titles coming in the Fall, particularly October – *Assassin's Creed* followed by *Call of Duty – Black Ops 4.* The *Black Ops* series is the strongest of the *Call of Duty* series. We tend to get a *Black Ops* game every third year from a different studio. So that's exciting. You've got *Battlefield 5* coming and then *Red Dead Redemption 2.* And *Red Dead Redemption* is expected to be one of the top couple of titles for the year.

Moving into November you've still got *Fallout 4* coming and then a couple of key titles for the Switch. So we're excited to see all of that, but really, the moment that spreads into the Spring with some of the games coming then, the *Division 2*, as well as several others – I think February 22nd shapes up to be one of the busiest days in the video game space in years. So we're excited about that as well.

Brian: Now you mentioned Switch quickly, but that has been a real key bright spot here. You've done well in selling it. I guess the question is, where do we go from here? I mean how much – how is demand continuing to shape as now we've lapped the initial launch of Switch for both the hardware and the software.

Rob: We're pleased with what we're seeing from the demand on a week in/week out basis. I think it's settled into a cadence in the April timeframe and early May, but then with school letting out, I think we're seeing some lift in that. That'll show I think in the NPD numbers. So we're pleased with that. Obviously, the demand, the supply side issues that were there for the first six months after launch are behind us. So it's pretty readily available. And then the titles that are coming in the Fall, one's *Pokemon*, so that's obviously huge. Not necessarily what you'd call a tent pole for a Nintendo console, certainly for the handheld. But we think it will become one. And then the other tent pole is *Super Smash Brothers*, so that's going to be exciting as well in the December timeframe.

Brian: Sticking with the video gaming side, again, I've studied GameStop for awhile; we've known each other for awhile; but the sector has evolved. And there have been – part of the evolution I guess, technology. We take this maybe piece by piece. But full game downloads. There has been a headwind I'd say to GameStop, but also an opportunity. Where do we stand right now on the whole discussion of full game downloads for GameStop?

Rob: I think we're well into the evolution. These consoles, Nintendos and – I mean Microsofts and Sonys, are in their fifth year. And the download percentage – so the number of games that have been sold as downloads, as opposed to physical, has been growing, call it 3 to 5% a year since these consoles launched in 2013. I think we're in the low 30s now. That varies, depending upon the type of title and the publisher that's putting the title out. And I'd see that 5% a year or so growth rate continuing for a couple more years.

Brian: Maybe then a similar type question with downloadable content. That's clearly been more of an opportunity group for GameStop. [right] Maybe discuss what is downloadable content and how have you capitalized on that? Or what do you see that sort of say technology going in the video gaming category?

Rob: So downloadable content is – there's a couple of things you can look at. You can look at full game downloads. When customers buy a game after launch, do they download it in full, or do they buy the physical form? Add-on downloadable content is the kind of content that publishers will release, call it 60 to 90 days after a game launches. We do very well at selling that. Full game downloads we're probably say high-single digits in terms of share. Add-on content, most notably for us coming in the form of what we call a Season Pass. That's where you're paying in advance to get all of the content that's going to drop on a game across the next year. We're probably at 35% share or so on that. And the reason is because the best time to engage the consumer about content for the game they want is when that game launches and when they're buying it in the store.

So we'll find that with collector's editions, limited editions that come with something else, maybe in the box, some add-on content, whatever, the Season Passes for all the future content, as well as the collectible items. And so because we're so good at launching that as part of the game, that's how we can get a mid 30s share on it.

Brian: And then the last component with respect to the digital universe is really the currency that's used to go on Xbox Live with the membership to download games, to conduct in-game transactions, like in *Ultimate Team* from *EA*, from *Madden and FIFA, Short-Cash* for *Grand Theft Auto,* those kinds of things. We estimate we're about 25% share in the currency that's used.

Currently, where we're seeing a lift in currency comes from *Fortnite*. So *Fortnite* is a very popular game right now that I understand is taking a lot of time from kids, but also messing up some pro sports careers. So I think that's particularly notable here, right? Didn't somebody wind up not being able to pitch because of carpel tunnel or something?

Anyway, we're seeing more currency sales to support *Fortnite*, and we're seeing more accessory sales as the better your accessories are, the better you're able to play and survive in that game. So even something like *Fortnite* which is a downloadable game, comes with a season that comes out I think it's every eight or ten weeks, where you'll buy the season; you'll buy things in the game to increase the enjoyment of the game; not necessarily improve your game play, but that's driving currency sales and as I said, accessory sales. So we participate in that too.

Brian: So on the downloadable content side. How has that changed the way people play games? Or maybe even say it better. How has downloadable content changed the way people play and then consume games from GameStop?

Rob: In terms of how they play them, the online game play environment is much bigger, it's bigger than it's ever been; but it's been a pretty strong part of the game environment for seven or eight years now. So what we've seen through the years is games that have a strong online component tend to do better than those that are more single player, mission based. So you'd want to have an online component and now you want to have a battle royale component. That's essentially what *Fortnite* is, the name for that genre, and you'll see more of that in the games coming this Fall.

It changes the way consumers interact with GameStop in that not a dramatic shift, but as time has gone on, people are holding onto their games longer, to either get that online currency that's coming or keep playing with their friends in that online environment. That affects the trade-in environment in our pre-owned business. We can come back to that. But, it's important that we still – we do over $1 billion a year and selling currency and content to customers to enable them to engage in the digital environment. And we do that because there's still a large segment of the population that wants to pay for something with cash or trade-ins, something other than a credit card. They either maybe don't want to or don't have, if they're a teenager, or a less than fully employed young adult. They don't have a credit card to put into the online environment. So we do very well appealing to that part of the population that needs to come in our stores to buy their digital goods and their physical goods.

Brian: So there's – so you mentioned quickly the pre-owned business. Historically, pre-owned has been a key profit margin contributor to GameStop, key competitive differentiator. Trends have been weaker lately. So I guess maybe we can start with just describe kind of the evolution of pre-owned, maybe some of the challenges you've experienced lately at GameStop with pre-owned and then the way out from here.

Rob: Sure. So through the years, more games that we've talked about have gone digital download. There are fewer games getting published every year and, therefore, there are fewer physical games getting sold, because of those two factors. Which means there are fewer games available for trade at GameStop. So approximately half the games that get sold in the US get traded in at a GameStop. That statistic has kind of held over time. We can see some probably our heaviest Power-Up awards customers trade with us nine times a year. More casual might trade a couple a times a year. So what we've got to do a better job on and what we're focused on in terms of how we use our marketing dollars is, engaging a broader section of the customer base in that trade program. Getting them to come in and trade in their game.

I think that's part of the way out with the pre-owned business is just we've been focused pretty heavily in the last few years on that customer that trades nine times. Can we get a 10th trade out of them? Can we keep them trading at nine times? And we sort of ignored the segment that isn't trading that much and we need to engage them better. So that's a heavy focus.

The other thing we've seen is that hardware and accessories are becoming a larger percentage of the pre-owned pool. And so the business is shifting a bit. So a lot of work has gone in in the last year or two to create trade-in offers that support the hardware and accessory side of the business as well. So that's part of the shifting margin profile that we talked about in our guidance back in March.

Brian: I mean the real key in our standards on the pre-owned side, it's much more of a supply than demand-driven business, correct?

Rob: Absolutely. The key on pre-owned is, you'll sell everything that you can get, the key is getting it. So that's where increasing the awareness on the part of the consumer base that we take trades, engaging them in the trade process becomes so much more important and that's where the marketing really becomes a factor.

Brian: And there's really not much in the way of competition for GameStop out there, in terms of other companies with a pre-owned business, correct?

Rob: Not really, no. Through the years, what you've seen, Amazon's getting into it, Wal-Mart's getting into, Best Buy's getting into it. Their efforts in the space are pretty limited and so really, GameStop owns the bulk of the market. The market's not measured, so it's hard to know exactly how much we have, but we estimate we're three quarters or more of the pre-owned market. And so it is largely ours and it's up to us to drive that awareness.

Brian: So shifting gears to the non-video gaming side. It's been in tech brands. Several years ago you launched tech brands. Now the biggest, one of the biggest businesses is the AT&T Stores. Now you've recently encountered some challenges with AT&T, so maybe we can discuss that. But how do you view the overall strategy for tech brands, in particular that AT&T business from here?

Rob: I think there's still runway to grow that business. I don't think we intend to do that in the short term. We did experience with AT&T a compensation change a year ago where they shifted compensation from the wireless transactions on which the business was built into the entertainment transactions as they acquired DirectTV and are pushing more content across the network. That had a dramatic impact on us and so we've gone back to AT&T and had discussions about how that impacted our profitability, the health of our store portfolio. But most important to AT&T, it's impacted our ability to continue to invest in that space. So they would like us to continue to acquire underperforming dealers. They would like us to open stores and we're not in a position where that's investable right now.

So our focus is on improving the health of our existing store portfolio. We've seen some compensation changes from them coming in phases. The first phase shifted compensation back towards wireless from entertainment. That's good, since wireless are the bulk of the transactions. And then the second phase is designed to assist us in higher operating cost markets where we're had a lot of growth in the past. So New York, LA would be examples of that. That should come in the July timeframe. So we have estimates of what that will mean, but nothing to speak of in terms of guidance from anything yet.

The third piece is designed to incent us to open stores and we're not there yet. That's coming later this year. It's not yet thoroughly defined. And as I said, our focus is on making sure we're operating the stores we already own to maximum efficiency. To that end, growing as we did in terms of store count, our operational processes are not as crisp as they need to be. So we brought in an executive who's now the number two guy in that operation. He comes from managing the entire store base for T-Mobile and then managing earlier in his career the East Coast for Verizon. So he's also had big jobs as Samsung. So he understands the space very well. He's operated at scale inside the wireless business and that's what he'll bring to the table for us is the ability to drive sales, execute operationally and control costs in a 1500, 1300 store chain.

Brian: Talk a bit about collectibles. Another push, it's been successful for GameStop, both in the standalone stores, as well as I think what you're doing in your video gaming stores. But maybe just discuss a bit about the overall category, how it's enhancing the model.

Rob: Yeah, it's obviously been additive to the video game stores. It's a part of keeping the stores very healthy, such that less than one percent of our US store base is not making money for us. So what we are trying to do with collectibles, similar to tech brands, we've had a tremendous amount of growth in that space. Now it's time to continue to drive that growth, but also focus on the operational execution. So to that end, we brought an executive in about nine months ago to run that business for us. She has built out a team now with merchants that have experience in large categories of this space -- licensed goods, toys, etcetera. Not straight up toy store type stuff, but more what appeals to our customer base.

And so the merchandising expertise around that I think is going to help us be better in store in terms of providing a fresh set of product, to keep the customer coming back to explore what's new and different than what we have that appeals to them. At the same time, understanding the lifecycle of the merchandise and the initial markup that you want, and then can mark down through the lifecycle, so that you don't have the kind of clearance events that we've had in the past that have impacted the margin in a particular quarter. Ideally it smoothes that out and just brings – this team will bring more expertise to the space and we think enable us to operate it more effectively and continue to grow it.

Brian: Our time is beginning to wind down here. Any questions from the audience?

Q: Can you go back to the comment you made about outlining the cadence of the whole digital downloads and titles and kind of the _____ from Microsoft has been creating? Has it changed your _____ at all?

Rob: Yeah, so if you go back to the end of the last console cycle, the estimates were 8 to 10% of the games were getting downloaded at that time. We're in the low 30s, so that's across 4.5 years. Part of what has gotten us to the point where we are now is the ability of the consumer to download the game in advance of the servers going live. I mentioned online component being an important part of the game. So when the servers go live and you can start to play, you want that download out of the way. And I think there was a recognition allowing the customer to start downloading three days early, gets it out of the way and you're ready to play. To some degree there are added content chunks that get put into these games that are downloaded. That's an incentive for the consumer to download. In some cases you see some discounting associated with the price of the game, typically 10% where it happens. Such that the consumer can get a little break if they get it in digital form as opposed to physical form. Those kinds of incentives have helped to get it into the 30s.

In terms of what Microsoft talks about with their Gamer Pass, they recently announced that *Black Ops 3,* I think, and *Fallout*, the last version of *Fallout* are added to that environment. Those games are two and three years old. What they're trying to do is get the gamer into let's play *Black Ops*, let's play *Fallout*, so that when the new versions some out they're more incented to buy them. So they're pushing the Gamer Pass and they're pushing the continued evolution of digital, which I think down the line a couple years out people start to talk about what streaming could be. We'll have to see how that remains to impact the industry.

But either way, our place inside that ecosystem is to appeal to the customer that can't get their goods online. They're used GameStop as a place to go pay cash, pay with trades, whatever it is in order to get their digital access points.

Brian: Is there a question there?

Q: Yes. You mentioned earlier that GameStop promoted this year was to regain an understanding of consumer behavior. [right] Speaking from the consumer perspective, are there any trends going on that GameStop notices that we haven't executed as like a downloadable content, such as resells and pre-owned games? We're all aware of that. Is there anything that GameStop sees that they can capitalize on in the future?

Rob: Yeah, I think if you walk our stores in the United States, you know they need some work. And I think what we've allowed ourselves to do is fall into a little bit of a trap where we're focused on serving that core hard – that hardcore gamer. And the behaviors that we note at a very high level are that gamer comes into the store the night of the launch, in advance of the launch to trade maybe within a couple of the days of the launch, comes up to the counter and says I want *God of War*. And they don't need to shop the store, the know exactly what they want. They're not as worried about what the store looks like.

The more casual gamer, not the mom and family, but in between, wants to shop the store. They want to browse it, they want to see what kind of used deals they can find. And the stores are not very shoppable right now. The messaging to the consumer is a bit messy. When you move beyond that casual gamer into the mom and family, the stores can just be intimidating. So a lot of what we're trying to understand is, as customers interact with GameStop, what do they expect? Within those sort of segments, the hardcore gamer, the more casual gamer, the mom and family, what do they expect? How can we design a store environment that's appealing to them for what it is they want out of their GameStop shopping experience? That could be around the collectibles; it could be around how to browse pre-owned games; it could be around how to learn about the new games and what's appropriate for their kids. All of that.

To a degree, we have stores in markets that are larger, that maybe can provide a more experiential customer experience. So imagine as things evolve in the e-Sports world, perhaps we've got an environment that's more suitable to having local feeder tournaments or something that engages the customer that wants to be involved in e-Sports, they want to see local teams compete, they want to try to compete themselves, they want to buy the kind of gear that the pro-gamers are using. Those kinds of things are what we're exploring and learning about the customer as we think about how to invest a little bit and change that store environment.

Q: When you say pro-gamers, do you guys have any eyes on the PC gaming industry?

Rob: That would be sort of part of we're testing a three of four foot section in some stores where you can get the kind of gear that the PC gamers use as well.

Q: [inaudible]

Rob: I think that's a ways out. Even EA says you might see something in a couple of years. But again, that's the environment in which the customer that doesn't have a credit card needs to get there in some way. And we're very beneficial to that customer. We actually see a shift in payment types when we sell digital goods. It's 10% less being paid for with credit cards and 10% more being paid for with cash and things like trade. So I think we'll still be relevant to that customer base going forward.

And then, of course, you don't get to a world where that happens automatically. You get to a world where there is an evolution towards that. To a degree, some of that's going to be formed by the fact that these games cost so much to make that the publishers want to be able to sell them for $60 for as long as possible. In the past when we've seen streaming environments, you've seen the kind of content that comes into them is a couple of years older. It's past its point where you can get full price or even a $40 price for the game being sold new. And it's a way to ring extra dollars out of that. So it remains to be seen how brand-new content would be handled in the streaming world. I think that's years off.

Brian: Maybe just to wrap up then, Rob. Another key positive of the GameStop story for a long time has been both the cash generation of the company and then the capital redistribution, both in terms of buybacks and now a really healthy dividend. Clearly the backdrop for you company is – it's fluid at this point – but how, from your position as CFO, how do you view capital redistribution as a priority?

Rob: We obviously have a pretty healthy commitment to a dividend, which we've seen. We continue to generate a lot of cash flow. We look at the future of the business and see that cash flow generation continuing. So obviously a lot of conversations take place with the board around how to deploy the nonsmoker, non-dividend part of the free cash flow. We've stated that this year we intend to refinance our 2019 notes, take $75 million off of the outstanding principal there. So that puts a little less stress on the balance sheet. We'll continue to look at that debt load going forward. And then obviously we continue to look at buybacks and with the announcement today and the news yesterday that there are exploratory conversations going on, obviously that can have an impact on what you do with the capital as well.

Brian: Rob, thank you very much for attending. We appreciate it.

Rob: Thank you.

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