THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GME - Q3 2016 GameStop Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 22, 2016 / 10:00PM GMT

OVERVIEW:

Co. reported 3Q16 total sales of $1.96b and EPS of $0.49. Expects full-year 2016 EPS to be $3.65-3.80. Expects 4Q16 global revenues to range between down 10% and down 5% and EPS to be $2.23-2.38.

CORPORATE PARTICIPANTS

Paul Raines *GameStop Corporation - CEO*

Rob Lloyd *GameStop Corporation - EVP and CFO*

Tony Bartel *GameStop Corporation - COO*

Mike Mauler *GameStop Corporation - EVP, President of GameStop International*

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

Jason Ellis *GameStop Corporation - President of Tech Brands*

CONFERENCE CALL PARTICIPANTS

Brian Nagel *Oppenheimer & Co. - Analyst*

Ray Stochel *Consumer Edge Research - Analyst*

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

Mike Olson *Piper Jaffray & Co. - Analyst*

Seth Sigman *Credit Suisse - Analyst*

Ben Schachter *Macquarie Research - Analyst*

David Magee *SunTrust Robinson Humphrey - Analyst*

PRESENTATION

Operator

Good day, and welcome to GameStop Corporation's third-quarter 2016 earnings conference call. A supplemental slide presentation is available at Investor.GameStop.com.

(Operator Instructions)

I would like to remind you that this call is covered by the Safe Harbor disclosure contained in GameStop's public documents, and is a 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. Please go ahead.

Paul Raines - *GameStop Corporation - CEO*

Thank you. Good afternoon, and welcome to the GameStop earnings call. I want to first thank our family of associates for their efforts, and ask them to make this the best holiday season ever for our family of companies.

Speaking with me today are Rob Lloyd and Tony Bartel. And available in the room to answer your questions are Mike Hogan, Mike Mauler, Mike Buskey, Jason Ellis, and Matt Hodges.

Our third quarter played out along the lines of the guidance revision we issued on November 2. Video game hardware and software came in below our forecast, and caused us to reduce our original guidance. Hardware sales declined by double digits, and new software and pre-owned value sales declined mid-single digits. Most of our miss related to the weak pick up rate on a few key titles and related hardware bundles.

There has been a lot of discussion about the rate of change in digital penetration, but the truth is that in the console business, only Sony and Microsoft know the exact numbers of the entire ecosystem. We are comfortable with the digital transition of our console business at 5% per year, as outlined in our investor day document.

As we think about what our cash flow generation looks like across several potential scenarios regarding digital penetration, we feel very confident in our ability to transform our business, appropriately manage our variable versus fixed costs, and ultimately drive strong long-term free cash flows, which will support our balanced approach to capital allocation, including a commitment to repurchase activity, and our strong dividend.

Further, we have prepared for this digital migration through an innovative diversification of our business, and a full half of our profit came from these new ventures in this last quarter. We also expect lift from three new consoles, plus virtual reality next year, but more on that later.

Moving on to our growth businesses, they all had very good quarters. Our digital business grew 13.2%, with particular strength coming from our mobile segment, including Animation Throwdown. Also, remember that we are linked to the growth in console digital gaming through our sale of digital currency for the PlayStation Network and Xbox Live, as well as a downloadable content.

We have a 35% to 40% market share of those digital currency products, and this portion of our digital business grew 26% during the quarter. Collectibles grew 37.3%, led by hot intellectual property such as Pokemon, Five Nights at Freddy's, and Harry Potter. We expect continued growth in this category, as we continue to integrate our GameStop branded stores, ThinkGeek.com website, and our ThinkGeek and Zing standalone stores.

We will also benefit as we globally maximize supply chain and merchandising efficiencies. Technology brands had a strong quarter, as we integrated our largest acquisition, weathered through the Samsung recall, and still managed to deliver a whopping 262% increase in operating earnings for the quarter. Strong performance, and we recognize Jason Ellis and his team in Salt Lake City for another good quarter.

Our capital allocation policy remains unchanged, as we continue to pay our dividend and buy back shares in line with our previous guidance. So you see, the GME team continues to be optimistic and energized. We foresaw the cyclical downturn of the console industry, as well as the digital migration, and we strategically and proactively have been preparing for it by diversifying the Company.

Unfortunately, last month, some key titles underperformed our expectations. But that happens from time to time in a hit-driven category. Our job is to improve our ability to forecast those titles, and mitigate risks.

Our operating earnings were up 9% over last year, but our overall earnings were hampered by debt costs related to the recent AT&T dealer acquisitions. Those dealer acquisitions are highly accretive to us, and we're excited to be working with such a great partner. We are cautiously optimistic on the future of video gaming.

The arrival of virtual reality in larger quantities creates an opportunity for us. The Nintendo Switch, which I played at Nintendo a few weeks ago, we believe could be another game-changer that will expand the audience for gaming. And the new PlayStation and Microsoft Scorpio consoles will also provide innovation to the category.

Our digital business will continue, as we ride the growth of DLC, gaming currency, [indie] titles, and our Kongregate mobile game publisher. The collectibles business is big and getting bigger. Managing the fast growth of the category, with the variety of omnichannel and standalone formats we use for distribution is complex, but it is in our wheelhouse. We saw strong growth in the early days of video gaming, so we are prepared for it on the collectibles side.

Lastly, our technology brands is one of the most exciting growth units we have, and our partnership with AT&T will continue to bring us greater opportunities. The foundation for all these businesses continues to be our PowerUp Rewards program. At roughly 50 million members worldwide, this CRM program brings us many advantages.

First, it brings us a deep consumer insights, as we execute weekly and monthly consumer survey panels, to understand their behavior in gaming, collectibles, mobile, and other products. As an example, we discovered through our PowerUp Rewards catalog that our gaming consumers really like the ThinkGeek items for the use of their points, which led us ultimately to the acquisition of that innovative website, called ThinkGeek.com.

Another advantage is that we are also able to pinpoint what specific collectible item consumers want with a video game, like a statue or a T-shirt. PowerUp also allows us to have tailored communication directly with members, via email or their PowerUp phone app. As an example, we can identify which consumers have the heaviest trade inventory at home, to provide incentives for them to come in and trade towards a new title.

Another example of this power is the promotion we stealthily launched today, to provide for a $1 purchase of Call of Duty: Infinite Warfare, with selected trades. We are only beginning to scratch the surface of the potential of this program.

In summary, we enter the holiday season with optimism. Our strategy for the last few years has been to diversify the business, and we're seeing solid signs of progress on that front.

The fact that our operating earnings increased this quarter, in the face of negative physical video games, is an indicator of that progress. Another indicator of progress is the fact that this quarter, 50% of our earnings came from businesses other than physical gaming.

Now the fourth quarter is all about execution and delighting our customers in our stores and websites. We hope to do so, and expect to report solid results in our January update. And with that, I will now turn the call over to Rob.

Rob Lloyd - *GameStop Corporation - EVP and CFO*

Thank you, Paul. Hello, everyone.

As you can see in the release, we have separated tech brands out into its own category, due to its rapid growing materiality to our overall business. It was previously included in mobile and consumer electronics. Starting now, we will report the mobile and consumer electronics sales that occur in the GameStop branded stores in the other category.

With that, let's dive right into the results of the quarter. Total sales were $1.96 billion, a decrease of 2.8% compared to the prior-year quarter. Comparable store sales decreased 6.5%, driven by a 20.6% decline in hardware, and 8.6% in software.

The US comp was down 8.4%, and the international comps were down 2.3%. Pre-owned sales declined 6.4% during the quarter, but continued to outperform hardware and software. Hardware margins increased from the prior-year quarter, due to warranty sales. Software margins were comparable to last year. Pre-owned margin for the quarter was 46.4%, up slightly from Q3 2015.

Digital receipts increased 13.2%, driven by DLC and console digital currency. GAAP digital revenues increased 11.8%, led by the contribution from Animation Throwdown, our new Fox game on Kongregate. GAAP digital gross profit was $35 million, up 11% from Q3 last year, with the margin rate reaching 78.3%, comparable to Q3 2015, but down from Q2, due to the mix of gross versus net sales recognition within the category.

Tech brands revenues grew 54.4% to $216.3 million, and tech brands' operating earnings were $23.5 million, an increase, as Paul said, of 262% compared to Q3 last year. Year to date, tech brands has delivered $56 million of operating earnings, a 456% increase from $10.1 million last year. The operating margin for the quarter was 10.9%, and year-to-date was 10.1%.

Collectibles revenues grew 37.3% compared to the prior-year quarter. This is the first quarter with ThinkGeek results included in both periods. Our collectibles margin rate was 36.3%, down slightly from Q3 of last year.

Third-party fulfillment costs for ThinkGeek will continue to impact the category margin rates, until we complete the move of the ThinkGeek distribution operations in early 2017. On the strength of our new higher-margin businesses, consolidated gross margins were 36.1%, up 360 basis points from last year. Year to date, gross margins are up 390 basis points.

The expansion of gross margin in the growth in gross profit comes from the shift in sales mix from hardware and software, the higher-margin sales categories like tech brands, collectibles, and digital. One-third of our gross profit in the quarter came from our diversified businesses, up from 23% in the year-ago quarter.

SG&A increased $41.6 million or 8%, due to the growth in technology brands. SG&A as a percentage of sales increased from 26.1% in the prior-year quarter, to 28.9% for this year's third quarter. The increase was due to the decline in sales overall, and the growth of tech brands. SG&A in the video game brand segments declined $11.1 million.

To date we have made good progress on our $30 million cost reduction goal, reducing by $26.7 million through nine months. Despite the softness in video game sales, our operating earnings grew 9% to $98.8 million. Note that 50% of operating earnings in the quarter came from sources other than physical games, a trend that we called out during our investor day earlier this year.

As a reminder, in FY15, 25% of our earnings came from non-physical gaming, and we expect that number to reach 30% or more for FY16. Interest expense increased by $8.3 million year over year, due to the issuance of additional senior notes and borrowings on our line of credit. Our tax rate at 39.5% was higher than Q3 of last year, due to return to provision adjustments recorded in the quarter.

Net income decreased $5.1 million $55.9 million in the third quarter of last year. Our EPS came in at $0.49, the high end of the revised guidance we issued on November 2.

Let me shift now to store counts. We closed a net of nine video game stores, and now have 3,940 in the US and 2,008 internationally. Year to date, we have closed a net of 98 video game stores.

We now have 1,569 technology brands stores, including 1,429 AT&T branded stores. We now have 69 collectibles stores, 15 ThinkGeek in the US, and 54 Zing stores in other parts of the world.

Our free cash flow through July was down compared to the same period last year, due to the timing of inventory purchases and subsequent payments, which resulted in $200 million more in inventory which was already paid for going into Q3 this year. This unlevered inventory was sold through in the third quarter.

That, coupled with inventory purchases and accounts payable timing in Q3, resulted in year-to-date free cash flow of approximately $31 million, which is comparable to $54.7 million through nine months last year. We're on pace to exceed $400 million in free cash flow for the year, within our cash flow guidance.

Our Board approved our quarterly dividend of $0.37 per share, payable on December 13. By the end of this fiscal year, we will have paid out close to $700 million in dividends, since we initiated the program in February 2012. During the quarter, we bought back 1.35 million shares at an average price of $26.63, for a total of $36 million.

Since the end of the quarter, we have continued to buy back shares under a pre-existing 10b5-1 plan. Since inception, our buybacks have totaled $1.94 billion. Coupled with dividends, we have returned more than $2.6 billion to shareholders in the past seven years, while also making investments to diversify the business.

Now I'll move on to fourth-quarter guidance. Global revenues are forecast to range between down 10% and down 5%, with same-store sales ranging from down 12% to down 7%. Both hardware and software sales are expected to decline approximately 15% to 20%. This forecasted decline is based on comparisons to last year's title slate, and known title launch and hardware results so far.

As we think about the cadence of the quarter for the total industry, we expect November to be down over 20%, December to be down double digits, and January to be near flat to the prior year. We're forecasting pre-owned revenues to be down approximately 2% to 4% in Q4 versus the prior-year quarter. We expect collectible sales for the full-year to come in closer to the high-end of our $450 million to $500 million range.

Tech brands sales are expected to grow more than 35% in the fourth quarter. We expect operating earnings from tech brands to be $30 million or more for the quarter. We are reaffirming our investor day guidance of operating earnings of $85 million or more for tech brands in FY16.

We expect earnings per share for the fourth quarter to be in a range between $2.23 and $2.38 per share. And for the full year, we're maintaining the EPS range we gave on November 2, from $3.65 to $3.80 per share. I will now turn it over to Tony for his comments.

Tony Bartel - *GameStop Corporation - COO*

Thanks Rob. Our third quarter underscored the importance of the strategic vision we laid out during our investor day back in the spring. While the traditional video game market continues to transform itself, we have taken decisive and proactive steps to offset the expected decline with gains in digital, technology brands, and collectibles.

One of the key takeaways for our investors is that these newer businesses have historically stronger margin and growth rates, which is allowing us to expand the profitability profile of our overall business. While new innovation drove share gains for us in October and flat share for the quarter, consoles and video games underperformed our expectations, particularly those that were launched in late October. And while we expected to see continued erosion in video games in the fourth quarter, as Rob shared, we also expect to gain additional share, as we have more titles launching.

There were some bright spots to note. First, we're seeing strong demand for new consoles. The PS4 Pro is off to a strong start, and VR is generally on the shelves for less than 10 days. According to NPD, we dominated the VR launch with 40% market share in VR software and hardware during the quarter.

Pokemon Sun and Moon were the largest launch of the year, and we expect to see strong demand throughout the holiday period for these titles. We also are seeing solid consumer interest for the upcoming launch of Switch from Nintendo.

The Switch uses physical media, and then Nintendo products have historically had a low digital download rate, so we expect this to be a console that drives strong sales of physical product, along with the console. This plays to our strength as our attach rate on physical games is twice the rest of the industry when we sell new hardware.

As we think about 2017, we're going more confident about the quality and breadth of the upcoming console refresh cycle. As with previous launches, PowerUp Rewards gives us a strong competitive advantage, and next year's launches will also play to our strengths.

For instance, we know that 27% of our PowerUp Rewards customers, who are aware of the Nintendo Switch, plan to purchase this console. This pre-launch metric is in line with the purchase intent for the Xbox One at the same point in time.

As a reminder, over three-quarters of our sales come our 50 million PowerUp Rewards members. Over the last 12 months, we have grown this powerful program by 10% globally. This strong and loyal group remains a critical competitive advantage for us, that has allowed us to grow our share over the last few years, despite the transformation that is happening on the gaming side of the business.

Our decline in pre-owned sales reflected the slow new game sales during the second quarter. We continue to seek out next-generation product to meet demand. Year to date, pre-owned sales growth is 6.4 points higher than new software growth, and we expect to end the year with a double-digit spread, as we see strong trades come in with recent launches.

We're working closely with our publishing partners to bolster new game sales, and you can see one of those programs in our stores today, as we're selling Activision's Call of Duty: Infinite Warfare Standard Edition for $1, plus the trade of one of 30 select games. This provides great value that will shift new game sales forward from Black Friday, by leveraging our PowerUp Rewards database, as well as our buy-sell-trade program.

I also want to make sure I highlight the strength of our digital business, which grew 13%. The key drivers of our growth were our mobile games, console currency, and downloadable content. Kongregate launched its two most successful games ever during the quarter: Animation Throwdown, featuring popular Fox IP, and Peter Molyneux's The Trail.

Animation Throwdown has 5 million installs on the iOS and Android platforms, and was the number one game on Android, and the number two game on iOS at launch. It remains a top 50 grossing game in dozens of countries.

Peter Molyneux's The Trail is an Apple Editor's Choice, and has reached 4 million installs in less than two weeks. This beautiful and innovative game was number one on iOS, and number five on Android in its launch week. This game is already a top 50 grossing game in 40 countries. We expect both of these games have long revenue-producing tails, and we encourage you to download them on your mobile devices.

We are also driving our indie business. Based on the successful launch of our Song of the Deep title, we now have dedicated space in each of our US GameStop branded stores for top Steam games. This allows us to use our marketing expertise and buy-sell-trade model, along with PowerUp Rewards to drive additional digital sales outside of the console ecosystem.

Turning to technology brands, we finished a very successful quarter, in spite of significant headwinds. During the quarter, we seamlessly integrated 436 stores into our technology brands business. Through strong coordination with our AT&T partners, we integrated all of these stores while maintaining best-in-class customer service.

Even more impressive is the fact that we continued to improve efficiency in our acquired stores. Including the most recent acquisitions, we continue to improve store productivity by over 30% and are significantly exceeding our 20% IRR hurdle. We also continue to add annuity-like subscriber management fees with each acquisition.

For the quarter, tech brands grew operating profit nearly four-fold, in spite of strong product headwinds. As many of you know, the Samsung Note 7 was projected to be an innovative driver of the business; however its massive recall, coupled with the low supply of iPhone 7s impacted profitability in our stores. We did see resilient flat comp traffic in our stores, but our comp gross profit per store fell by 9.5% due to product shortages.

We mitigate some of the product outages with the sale of fast growth ancillary products, such as DirecTV and high-speed internet. As an example, DirecTV sales were up 12% on a comp store basis over the second quarter. This demonstrates the power of choosing the right partner, as AT&T continues to bring us new innovative products that drive traffic and profit.

We're on track to deliver our previously-announced guidance of $85 million to $100 million of operating profit from technology brands this year, more than tripling last year's performance. Our operating margin rate will exceed 10% for the year.

Collectibles also continued their strong growth trajectory, as we added 22 dedicated stores globally, and increased square footage inside our GameStop branded stores during the quarter. We expect to end the year with over 10% of our square footage dedicated to this exciting growth category.

We see collectibles as a strong category with a rich and long history, as well as a very predictable launch schedule. As a reminder, our addressable category in the US alone is $11 billion. We believe this mark will grow to $16 billion by 2019, which would make it larger than physical video games by that time.

Details on this category are shown on slide 11. We've also included a calendar of notable releases and events through 2017 on slide 12. This illustrates the consistent launch-driven nature of this business.

In addition, we also show projected launches of major movie IPs through 2020 on slide 13. Please note that these are four IPs with over $25 billion of box office receipts, that are planning on launching dozens of movies in the next four years.

We're actively working to partner with all major IP holders, many of whom we do business with today. Mike Hogan and Mike Mauler are leading our global licensing efforts, and recently procured agreements with several key IP holders, to provide exclusive global products through our collectibles ecosystem.

Also, we are leveraging PowerUp Rewards and ThinkGeek.com to drive our product development and discovery of this category in our stores. We're also leveraging the strong ThinkGeek name globally. We expect to end the year with over 60% annual collectibles revenue growth, and expect to continue strong growth in 2017.

In summary, while the video game market continues to transform, our diversification efforts are working. They have accelerated, and they are keeping us on track toward the 2019 goals that we shared at investor day. With that, I'll turn the call back over to Paul.

Paul Raines - *GameStop Corporation - CEO*

Great. Thank you, Tony. Operator, I think now we will move into the Q&A session of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Brian Nagel, Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Couple of questions here. First off, on the pre-owned or the used business, you addressed a lot of it in the prepared comments. My question is, as we look at the weakness there at this point in the cycle, is it more of a using supply or demand-driven softness in sales? And then the second question on that is, is the guidance you laid out for the fourth quarter, you assume a bit of an improvement from what we saw in fiscal Q3? Not significantly, what should we think about as the drivers there for that modest strength in use? And then I'll follow up with another question.

Paul Raines - *GameStop Corporation - CEO*

Yes Brian. I will let, probably Tony is probably the right guy to answer. Just remember, in the old days at GameStop, pre-owned was the high-margin category. Remember that. That wasn't that long ago, too.

And then when hardware will come out, our market would decline, and when hardware would age, margins would go up, as pre-owned had a higher penetration. What's interesting is we have created this strategy that diversifies our Company so that pre-owned is not the only high-margin category, and fact, I would say probably a little higher margin than collectibles, but certainly tech brands and digital are much higher margin than pre-owned. So we have to keep that mind. Tony, do you want to talk about the trade issues?

Tony Bartel - *GameStop Corporation - COO*

Sure, to answer you directly, Brian, it is a supply issue at this point. We had a low new game sales in Q2, so it takes about 90 to 120 days for that to cycle through. So there is a lot of demand for the product, especially the next gen product that we have, and so that's why programs like the $1 trade program that we have today are so vital, because they are bring in a lot of that product that people want, so that is how we're going to be able to drive that supply. We see plenty of demand

---

Paul Raines - *GameStop Corporation - CEO*

Rob, do you want to talk about the guidance that you have assumed in Q4 versus Q3?

Rob Lloyd - *GameStop Corporation - EVP and CFO*

So, Tony talked about that it is a little bit of a lag time between when the new titles that launch drive the trade-in activity in the stores, and then we can turn around and sell that. And so sequentially, with Q3 driving more trade activity than Q2, it sets us up for a better performance on a relative basis in Q4.

Paul Raines - *GameStop Corporation - CEO*

Okay?

Brian Nagel - *Oppenheimer & Co. - Analyst*

Got it. And secondly, if I could follow up, to ask a question on the collectibles business, as well. Looking at my model, the growth did slow down year on year in the third quarter, but as you mentioned, that was a lap, you sounded positive going forward, but how should -- we're thinking about our models, how should we think about the year-over-year growth in the collectibles business? Is there parameters you can give us for that?

Paul Raines - *GameStop Corporation - CEO*

In terms of, like, 2017?

Brian Nagel - *Oppenheimer & Co. - Analyst*

Yes.

Paul Raines - *GameStop Corporation - CEO*

As Tony talked about, I think Tony, you said 60% for the full year of 2016. I think it is too early to give you guidance on 2017. You can think about a road map though, that takes us from -- both Tony and I talked about the sales being closer to the high end of the guidance range we gave you for this year, so that's $500 million, on our way to $1 billion by the end of 2019.

So obviously, you have got to grow every year, in order to achieve that, and we have a lot of confidence in our ability to do that. The strategy is to diversify the Company into accretive margin categories.

So when you hear Tony talking about Mike Hogan and Mike Mauler working on licensing, for example, the idea of that is that we do bigger deals, and have more exclusive licensing, to help us keep growing that collectibles business. Maybe you want to talk about that?

Mike Mauler - *GameStop Corporation - EVP, President of GameStop International*

Sure. Mike Hogan and myself spend a lot of time working with the IP holders to expand our relationships outside of video games. In fact, it made really good progress that over the last few months. And these IP holders are really looking for partners that can create a broad range of innovative products, to maintain the excitement around their IP.

At the same time, to partner with somebody that can help maintain the excitement on their IP between their launches. So with Batman having one movie every two years, they want to maintain excitement around the Batman IP between those movies, and GameStop represents a perfect partner to be able to do that, through our video game stores, collectibles stores, ThinkGeek solutions, and our 50 million loyalty members. We represent a very good partner for them. Mike, if you want to add to that?

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

I would just say that to Mike's point, I think for our perspective, we believe that this is a huge category. As we talk with our video game partners, I think what they see in this is, there is a category that is almost as big as physical video gaming. And the perspective for our business to grow with them on the collectibles side, close to what it is on the video game side, is a big opportunity.

And as Mike said, our global footprint, and all of the best channels in which we bring this to life, and there are things that only GameStop can uniquely do, in terms of attaching physical plus digital, in terms of attaching the right collectible to the right video game property, with a targeted consumer through PowerUp Rewards. So we think there's some unique opportunities there that don't exist anywhere else in the market.

Paul Raines - *GameStop Corporation - CEO*

So we look for fragmented marketplaces, that is what we did with technology brands, as Jason and his team rolled up a bunch of small dealers. If you look at collectibles, we rolled up a bunch of smaller business formats into our GameStop stores, and that's what these guys are going to try to do on licensing. So more to come on that.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Well, thank you. Good luck for the holidays.

Operator

Ray Stochel, Consumer Edge Research.

Ray Stochel - *Consumer Edge Research - Analyst*

Can you just help me understand the Switch demand metric that you mentioned of 27%, which suggests there could be a similar number of units to the Xbox Ones sold, which -- and then walk us through if we get a similar number of Switch units as Xbox One units sold, what happens to that longer-term guidance that you mentioned?

Paul Raines - *GameStop Corporation - CEO*

Mike, do you want to take that?

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

Sure. I guess the best way to answer that question is to go back several years, right? So if you go back several years, you go prior to the launch of the Xbox One and the PS4, we started tracking this, and we will track it with our PowerUp members, and also with the broad sample.

And so what we're looking at first of all is awareness. People who are aware of the product, and what they know about it, and second is purchase interest. So purchase interest essentially means the number of people who say, yes, I'm interested in this product.

Obviously not necessarily every one of those people is necessarily going to buy a product, but it is a good benchmark, because you can compare it cycle ever cycle. I think the point Tony was making is that, as we tracked the PS4 and Xbox One over time, we saw obviously both of those curves would build. And when we were a similar time, less than six months out from launch, that 27% purchase interest was a number that we saw on the Xbox One, and it is absolutely true, we're seeing similar purchase interest in the Nintendo Switch.

THOMSON REUTERS

So I think it's fair to say that bodes well for the launch and the success of this product, keeping in mind that we don't even have specific details and price points in the market. I think we're going to be doing the survey again in mid-January after all the details are out, and I think we will have a much better read on it at that time. But for right now, everything we're seeing is very, very encouraging.

Paul Raines - *GameStop Corporation - CEO*

And remember, Ray, the other thing that is important to understand, if you think back to when we launched the PS4, which seems like a long time ago, I don't think it was, but it seems like a long time ago. When we launched that item, a full 46% or 47%, Tony, of the transactions during the launch cycle had a trade associated with them and a full 24%, 25% were paid for in full with trade credit. So that's the reason we dominated the launch of that console, and I think that's the same reason we will dominate this Nintendo Switch launch. But we will know more in January, once they announce specifics.

Ray Stochel - *Consumer Edge Research - Analyst*

That's great, and just a quick follow-up. Since you are having this demand for the switch, and all of this new hardware is coming out and being talked about in the news, are you able to quantify any impact from delays of sales, simply due to these new hardware announcements?

Paul Raines - *GameStop Corporation - CEO*

I think it's early for us to plan that out, but we don't have a lot of knowledge yet. Just to share a little bit of what we did, we were at Nintendo with a group of us, maybe three or four weeks ago, and they have historically struggled, right? On delivery of product and so forth. They appear to be more focused on planning the launch, but I don't think we will know, until we know in January. We can quantify a lot of things, but I think it is too early and maybe premature.

Tony Bartel - *GameStop Corporation - COO*

There was definitely a slowdown of sales of PS4 prior to the PS4 Pro. There was definitely. But the PS4 Pro, once launched, took right back off again, so that was clear.

Ray Stochel - *Consumer Edge Research - Analyst*

Great. Thanks so much.

Operator

Colin Sebastian, Robert Baird.

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

A couple of follow-ups first off, and then a longer-term question. On the current video game environment, it sounds like you are expecting more or less ongoing soft selling through the balance of the holiday period. So I'm wondering how much you think consumers may just be conditions to wait for bigger discounts on products from the Black Friday period onward? And then you clarify, on some of the discounts we're seeing now, such as Call of Duty for $1, how much of that and of the discounts in the channel are being funded by retail, or by the publishers? Understanding that there is cooperation from both sides at this time of year.

Paul Raines - *GameStop Corporation - CEO*

I will let Tony take those, but you've seen our financials. We don't do a lot of funding. So Tony, want to take the current video game environment?

Tony Bartel - *GameStop Corporation - COO*

Sure. Colin, we expect it to be just as competitive as it has been from a discounting standpoint, and so, we definitely expect that during the holiday, you've seen everybody's Black Friday ads, including ours. Interesting though, in our Black Friday ad, you will see a lot of the IP that we have talked about, a lot of collectibles in there, which differentiates us from the pack. It's exclusive content that you can only get at GameStop as opposed to just price, although we are very price competitive, as well.

I suspect that you will continue to see a level of promotions that is similar to what we've seen in the past during the holiday season, and I do believe that there is some waiting until Black Friday, which is why we launched our $1 promotion to pull some of that forward, to be able to take some of that demand off on our stores on Friday. So that is definitely out there.

And the second question had to do with the funding. So definitely, like Paul said, we work very closely with all of our partners, and so the beauty of the buy-sell-trade program is basically the value of the trade is an unfunded discount to the publisher, which is, the trade credit is something that we take into inventory, and so that part obviously we take, and then the rest of that, obviously we work very closely with our publishing partners.

Paul Raines - *GameStop Corporation - CEO*

And our view, Colin, is that we operate thousands of stores around the world, we are the market share leader. We fund payroll, we pay our occupancy, we pay the light bill, and we let you work with our PowerUp Pro team to create specific targeted promotions, and so that is a significant amount of funding, and it's hard to get that from anybody else.

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

Okay. Thanks. And then looking a little bit longer term, the question is on the transformation both inside the store and through the diversification. It sounds like you are on track with the three-year outlook for the non-gaming segments, but wondering if recent trends in the video game category would change your view or strategy on the pace of investments and the pace of rollout of these newer businesses? Thanks.

Paul Raines - *GameStop Corporation - CEO*

Colin, I think that and I will let maybe Mike Hogan can also comment on this, but I think that our strategy was set for transformation and diversification of our business, in light of what we've seen in the cycle. I think that is still true. I think it's early, but there is a significant modeling that goes on here, and I'm not sure were ready to really get off our original model, but Mike?

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

Yes. I would say that we don't see any huge change. I think two points are worth mentioning. One is, our diversification efforts are going very well, and you have seen the strong growth in collectibles and in tech brands. And of course, as we have said, we are continuing to look for additional opportunities, and we will see growth there.

The other thing that is important to mention, and we really haven't touched on it, is there is a lot of growth coming potentially in the console category, as well. We've got really three or four significant new innovations now, that are hitting over the next year, between VR and innovation from Microsoft and Sony, as well as Nintendo. So I think it would be too early to suggest that there is not some positive growth out there, in various external -- although we have not issued a forecast for it, various sources out there have given multi billion-dollar forecasts for each of these, including VR and new consoles.

Paul Raines - *GameStop Corporation - CEO*

The other point that needs to be made, I think, and there needs to be more discussion on is this debate over the full game downloads versus weak title debate. It goes back to last year, if you remember Star Wars Battlefront, we just didn't sell as many at launch as we had hoped, and that happened this year, as well.

Our partners tend to migrate towards the digital is taking over. We have a model, it includes a significant amount of full game downloads, 25 to 30 going up 5 a year. We still stick to that model.

We think it makes sense. As we said, nobody but Sony and Microsoft really knows what is happening in the full game download segment, so you have to be careful with that, but as Mike says, I think we see optimism for next year.

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

Thanks again.

Operator

Mike Olson, Piper Jaffray.

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

This came up a bit in the question on promotional activity, but you described some weakness in titles launched at the end of October, obviously. How would you describe how the titles in November have performed so far, versus your expectations?

Paul Raines - *GameStop Corporation - CEO*

Tony, do you want to take that?

Tony Bartel - *GameStop Corporation - COO*

I would say that I think Rob hit on it, but I would say that Pokemon Sun and Moon, like I shared with you, was the largest launch title. It was -- we had more preorders than we have had in five years, so it was a fantastic launch for us. Call of Duty underperformed our expectations, and the last few games that have launched recently have been pretty well ahead of our expectations.

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

Okay, and then you talked about Nintendo Switch as potentially having strong demand. Is it your expectation that the Switch will expand the market to some degree, like we saw with the Wii, or will it take share from the two major platforms? Thanks.

Paul Raines - *GameStop Corporation - CEO*

The Switch is a very interesting device, and I debated with our guys on whether I need to go on this trip, and so forth. By the way, I did not see any other retail CEOs there, so I was privileged to be there, I guess. Nintendo Switch has the potential to expand, I think, incrementally, the audience.

The reasons are the IP is more compelling for families than the other types of IP, so Mario, all those things, a movement related game is more fun for kids. Taking those accessories off -- I forget what they call them, the wings, and then the master controller, you can really do a lot of interesting things with that in game play.

And the last thing I will say is they have got a unique portability to them. If you watch that video, that is all they have put out, I think, they have that unique portability. So you can play it as a console at home, but you take it out and take it with you wherever you go, and then kids can play, and it's the right size.

So I think it's really got tremendous potential as a game changer. So we will have to wait and see, like everything else in this industry, the consumers will vote with their dollars. I think it is interesting.

Mike, do you want to talk about back in the day of Nintendo Wii? There's a lot of different consumers, right?

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

Yes, yes. If you look, if you go back and take the category all the way back to 2008, and you look at where the category is today, frankly the biggest decline that you have seen in the category is really a lot of those people who came in because of things like Nintendo Wii, and to some extent things like Guitar Hero.

And we do think there is an opportunity to get this back. Tony talked about the research earlier, and one of the things that we have the ability to do is of course just to go and survey the market, including people who are more hard-core gamers, and people who are more broad market family gamers. And it's fair to say that we are seeing a strong interest amongst a broad group of consumers here. So we're very optimistic about the possibilities.

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

Thank you.

Operator

Seth Sigman, Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

I wanted to follow up on the decline in pre-owned sales. Is that more a function of unit declines, or are you seeing a decline in average selling prices, as well?

Tony Bartel - *GameStop Corporation - COO*

More a decline in units.

Paul Raines - *GameStop Corporation - CEO*

We're seeing things are still healthy, average selling price --

---

Tony Bartel - *GameStop Corporation - COO*

I think we didn't report on it this quarter, but we continue to outperform new games over pre-owned games, so that continues to be healthy growth differential. So ASPs are fine. It's strong demand, and we're chasing titles at this point.

Seth Sigman - *Credit Suisse - Analyst*

Got it. Okay. Then a question on tech brands. The operating profit improvement is obviously very encouraging. Can you give us a sense of what is actually driving that, and how we should be modeling that going forward?

Paul Raines - *GameStop Corporation - CEO*

Jason Ellis is here. Jason, you want to take that question?

Jason Ellis - *GameStop Corporation - President of Tech Brands*

You bet. So Seth, thanks for the question. We're obviously driving incremental productivity out of the retail stores. We feel like we have a really unique system, that allows us to do that, and we've done it 35 times now. So on average, we're improving the productivity by about 30%, and that's good for AT&T, because we are generating a lot of new revenue for them, and a lot of new revenue for us.

This quarter may be a little more difficult, because -- in terms of modeling, because of some of the headwind we saw with the Samsung Note recall. But outside of that, I think you can take a look at the baseline business in the second quarter of this year, and move it across a much broader footprint of retail stores, and that should get you a nice model, at least for the next two years.

Seth Sigman - *Credit Suisse - Analyst*

So when I look at the last few quarters, sales per store have been down pretty meaningfully year over year. How do I reconcile that with the productivity improvements that you are seeing as you acquire these stores. Are they just coming off of a lower base? Are they less productive initially, or is that the recalls, or is there something else that would be causing that?

Jason Ellis - *GameStop Corporation - President of Tech Brands*

Yes. I think, Seth, one of the things that we have laid out, even at investor day, is we use gross profit in this format instead of sales, just because of some of the accounting treatment, and the way that the commission modeling moves around with AT&T.

I think that if you look at what is happening on the gross margin part of the business and the profit per store category, you're going to see the type of improvement that you would like to see. And there's no question that as we grow with the scale that we've grown, we're going to get some fixed cost leverage out of the business, which will drive more to the bottom line.

We're also going to get better at this business, as we intake what has been 800, 900 retail stores in less than a year. So expect that we're going to get better at selling and closing in the stores, margin, close rate, all of that stuff should get better. We're also very excited about the new products at AT&T has continued to innovate.

So I think if you look at their roadmap and where they are making their investments, arguably some of the biggest investments in our country right now. And we're going to be right at the forefront of selling those products to customers. We're pretty excited about that.

Rob Lloyd - *GameStop Corporation - EVP and CFO*

Seth, this is Rob. To back up Jason's point there, if you look at the margin rates in the tech brands category across the quarters from the beginning of 2015 until now, they have crept up from the low 50% to over 70%. So that really speaks to that it is the gross profit and the gross margin that are more important indicators than the revenue line is.

Seth Sigman - *Credit Suisse - Analyst*

So Rob, what is the right way to think about gross profit comps going forward?

Rob Lloyd - *GameStop Corporation - EVP and CFO*

In terms of the stat we have been giving out, the gross profit comp on the stores that we've owned and operated for a year, we gave some guidance on that earlier this year. The third quarter was difficult relative to that because the things that Tony talked about, supply and the Note problem. I think that you should probably think about the fourth quarter as being similar to slightly improved, and then we will talk about 2017 when we give our guidance in the spring.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thank you.

Operator

We have time for two more questions. Ben Schachter, Macquarie.

Ben Schachter - *Macquarie Research - Analyst*

A few for you. On the Call of Duty underperformance, can you help quantify that versus last year? And also the $1 promotion, can you put that in context versus previous discounting? And overall, how is that Call of Duty, that particular title, impacting on the overall business, given how big it's been in the past?

And then Paul, just given where the stock is, are you still thinking about acquisitions, or should we expect you to focus on buying back your own stock before looking at other acquisitions? Thanks.

Paul Raines - *GameStop Corporation - CEO*

Well, okay. That's a lot, Ben. Let me see if I got them all down here. Let me start with the capital allocation so forth, and then Tony maybe you can take what are we going to do with Call of Duty.

Our strategy, remember, is to create a diversified business. We've got technology brands, we've got a digital business and a collectible business, and we are actively seeking other formats to expand our business. We talked about licensing, that is an organic growth vehicle for us, and we think it's very productive. It's not going to require a lot of CapEx, but it does leverage our assets that we acquired with ThinkGeek.com.

So I would not say that we're actively looking for acquisitions today. I think we want to try to fill in what we've got, and digest it, as Jason said. And of course, we are very focused on buybacks.

I think it's $1.9 billion we've bought back. We expect to continue buying back. We filed the plan, we have guidance for this year. Rob, what is our guidance on the buyback side?

Rob Lloyd - *GameStop Corporation - EVP and CFO*

$75 million to $125 million.

Paul Raines - *GameStop Corporation - CEO*

So you can expect us to meet that by the end of the fiscal year. So I don't think any of that has changed. Of course, if something were to pop up, we would attack it opportunistically, things like Cricket inside our GameStop stores.

Those are no-brainers, and they have been successful for us. But no, we don't see anything looming on the horizon. Tony, do you want to talk about Call of Duty?

Tony Bartel - *GameStop Corporation - COO*

Sure. So we don't give, we're not going to talk about specific title performance, I was asked what underperformed, and I'll go that far. I think you can look and realize that when we have an outperformance to the extent that we did on Pokemon, and November is still down 20% that Rob talked about, I think you can still judge the magnitude of where Call of Duty come out. So that's all I want to say on that.

And then to the $1 question again. I would say, for us, that's taking advantage of two things. We're taking advantage of some aggressive offers that Activision is offering, but also our buy-sell-trade program which is very lucrative. And again, it's an unfunded discount to the publisher.

So we partner with the publisher to get the discount, and we give them the unfunded discount, and it ends up being $1. So it's a great deal for the customer, it's a great deal for us, because it is margin neutral for us, or it's the same margin that we would get otherwise, and we partner with Activision and sell a lot of their games, so it's really win-win-win.

Paul Raines - *GameStop Corporation - CEO*

And it's highly differentiated for our PowerUp members, because they are the only ones getting this deal. So it brings Black Friday right into Tuesday, Wednesday, so that's been very favorable for our PowerUp community.

Operator

David Magee, SunTrust.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Just a couple questions here. One is on the comment that November might be down 20%, which I'm guessing is a sector comment, is that a number that includes the downloaded titles?

Paul Raines - *GameStop Corporation - CEO*

Rob, you want take that?

Rob Lloyd - *GameStop Corporation - EVP and CFO*

Yes, I was speaking of November in terms of what we expected for the industry. The industry measurement that we're typically talking about is NPD, which is physical. So I would say no, just to clarify that.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Okay. And then when you talk about the sector shift going on 5 points a year, to downloads, have you changed your thinking about what that, at what level the number stabilizes?

Paul Raines - *GameStop Corporation - CEO*

What do you think, Mike?

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

I would say our thinking hasn't really changed. All the information that we have access to suggests that the numbers are pretty close to what we modeled, and we have modeled scenarios in which it gets to a pretty high number. Higher than we would even think it would get to.

Paul Raines - *GameStop Corporation - CEO*

The other point here, David, that is important is that we've modeled a lot of scenarios, including some that are highly unlikely. But the good news is through all those scenarios, we're pretty safe from a free cash flow and an earnings perspective. So I think we're safe with that. We have a point of view that says it will unfold along the lines of what we have seen in the last year or two, and we'll continue to diversify the business, just to ensure ourselves.

David Magee - *SunTrust Robinson Humphrey - Analyst*

And just lastly, maybe Rob, any thoughts about what real estate might do next year in terms of square footage growth, or contraction, I should say, for 2017 at this point?

Rob Lloyd - *GameStop Corporation - EVP and CFO*

Well, absent the guidance that we will give you in March, I will say how I've been answering that question when it's come from investors across this year, is that you can think about in the same 2% to 3% decline in video game stores that we been demonstrating across, I think, the past six years. So, that's about optimizing footprint, and using the PowerUp Rewards program to drive the sales down the road, and those things that we talked about in the past.

Probably a little early to talk about what we expect to see in terms of store growth from either the tech brands division or the collectibles only stores. I will say that we have laid out the longer roadmap on technology brands, increasing the store count. And at this point, I'd say that looks similar to what we have done before 2016. In other words, it will be a mix of opening stores, and still some other retailer acquisitions we can continue to do, but no specific numbers yet.

Paul Raines - *GameStop Corporation - CEO*

And David again, and you know this, because you have followed us, but it's another power of our PowerUp Rewards program. We can close, right there in Atlanta, we can close the Lenox Square store, and consolidate all that customer base over to the Market Boulevard store, and have greater profitability in one store than we had previously in the combined footprint. So those opportunities are still out there for us, and we will continue to pursue them.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Great. Thanks, and happy Thanksgiving to you.

Paul Raines - *GameStop Corporation - CEO*

Okay operator, I guess we are ready to wrap up. I would like to thank all of you for your support, and for following us. We've got a host of promotional activity starting Saturday -- last Saturday, and then going all the way through the holiday season. We hope that everyone has a tremendous enjoyable Thanksgiving holiday with your families.

We will not be open, so don't shop us on Thanksgiving day. We want our Associates to be at home, but please come see us on Black Friday, and we will look forward to talking with you on the next call. Goodbye.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation.