

Company Name: GameStop Corp. (GME)
Event: 2020 ICR Conference
Date: January 14, 2020

<<Allison Malkin, Analyst, ICR>>

Good morning. My name is Allison Malkin and I'm partner with ICR, gives me a great pleasure to introduce our next company presentation, GameStop, where we will have a fireside chat. With us today from GameStop are George Sherman, CEO; and Jim Bell, CFO. We'll start with some prepared remarks from George and then I'll kick it off with the questions.

<<George Sherman, Chief Executive Officer>>

All right, thanks Allison. I appreciate the time to do this and thank you everyone. Welcome. First of all, I want to call attention to our Safe Harbor statement before we go much further. I think you're all aware of this. So just want to make sure that that's in front of you. I am going to talk for a few minutes and thanks for coming to talk about GameStop's business. I've been with GameStop since March of last year. Jim since about a month later of last year, our new Chief Merchant, Chris Homeister, about a month after that last year. And I think we're all attracted to GameStop for the same basic reasons: 60 million member loyalty base, a global footprint, the leading market share in the industry and a macro that's actually quite strong. And we've said for some time now that the pivot that needed to happen on our part, certainly the industry is a healthy one.

GameStop is a place where gamers go to not just buy consoles and buy games, but learn about them and become better at gaming. And we think that's a key part of our futures giving them all the tools that they need to become the best, most competitive gamers that they can be and that service aspect of it will become a big part of our future. Today, we'd like you to take away four key points about GameStop that we think are important to land. First of all, GameStop was a powerful brand participating in a healthy industry with a significant loyalty base. Two, we are not a transactional retailer. We are an end-to-end customer life cycle retailer, which stops along every aspect of the journey for gamers. Third, while our industry is rapidly changing, we have a strategy in place to continue to evolve GameStop to capitalize on these shifting trends, including monetizing the digital world of gaming.

And fourth, GameStop has the talent infrastructure process and capital strength to bring about long-term profitable growth. Having said that, there's no mistaking that's our headwinds in the industry as well. Certainly, the first of which is impacting entire video game industry and while we feel it is temporary, it exists through the fact that we are operating in the late stage of the technological shift from generation eight to generation nine gaming consoles. Simply speaking, gamers are waiting for the new, more advanced versions to be introduced and that's particularly true with our customer base. Our customer base is the absolute most in depth, most sophisticated gamer and they're all keenly aware of what's going to happen late next year and they're waiting on that change. We're also fully cognizant of the fact that there's been a level of digital growth over the last seven years between consoles and that we need to kind of look at that as an

opportunity, turn a headwind into a tailwind by leaning deeper into digital and selling more aggressively the digital aspect of the gaming experience.

Supporting our thesis of the new consoles launching later this year, they will all have physical disk as part of them that certainly extends the physical aspect of gaming into the next generation for the next five, six, seven years and they'll be backwards compatible. So, all of the games that our gamers currently have will be able to be use on the new consoles moving forward. They are step changes in terms of technological shift. They're far more advanced consoles, better graphics, better sound, better haptics, better everything and certainly we think that that's going to be a big factor, but it's not going to be digital for everyone.

We're not leaning into availability of broadband as a strategy or as a growth platform, but it certainly is true that in some areas that is not as prevalent as it is in others certainly. We recognize the retail landscape has to and will evolve and we're making the necessary changes to our cost structure, evaluating our global footprint, our exposure, working on our operating costs. We've articulated a strategy to improve our operating profit on an annualized basis by \$200 million and we're standing by that and making great progress towards that.

As I've indicated since joining the company, our transformation will take some time, which is evidenced by the disappointing sales that we announced yesterday. We're in the last stage of the current gaming cycle. We look forward to the changes coming later this year and we're highly confident that they will come and that will play a meaningful part in that growth and that new introduction to the marketplace. Our strategy is really anchored on four key pillars and we've talked about this, but I'll just reiterate it, optimize the core. That's building a more effective core business as it exists today. That's looking at things like cost structure, that's looking at things like gross profit rate expansion, that's looking at an optimizing our store footprint across the world.

Second, create the social and cultural hub of gaming within each GameStop store. And again, we believe that that is an area that we have the right to play. We have the majority of gamers or at least the most serious gamers in the world coming to our stores and there is a social aspect that we can parlay into more traffic. Third, building a digital ecosystem to reach our customers wherever and whenever they want to shop and on the terms in which they want to shop. And then lastly, transforming our vendor relationships to extend lifetime value of customers and bring each of our partners' gaming ecosystems to market and we firmly believe that we are the distributed sales channel of the gaming industry. So those are the four things that we're driving upon and we think our growth will be based on, but we remain very, very about what's happening in the near-term at the end of this year while acknowledging a difficult sales environment leading up to that timeframe. Thanks, Allison.

<<Allison Malkin, Analyst, ICR>>

Great. We'll get started. George, can you share some of the initiatives behind the strategic priorities that you just provided to us? Where is the company in this journey today? And what do you see in the future that you would expect to stabilize some of the sales trends?

<<George Sherman, Chief Executive Officer>>

Yeah, thanks Allison. I think first of all, I start off with a reminder as to how important and how much of this industry hinges off the console sale. The console is the trigger point. It is the point at which there are follow on game sales, follow on accessory sales, follow on services sales. And when we see innovation and where we see innovation, our business remains quite strong. Today, that's most prevalent in Nintendo Switch sales, in Nintendo Switch related software. Here's a viable platform. It's early in its lifecycle still and it's doing quite well for us. Beyond that I go to the four growth strategies that I talked about. And obviously, we put most of our efforts in the near term behind optimize the core. We believe there's significant outcome that can happen there, so Jim and I and the entire team have been quite busy looking at our cost structure.

We've made necessary and difficult decisions on our staffing levels and our G&A within our company. We're making good progress on things like inventory control and just reducing our year-over-year inventory levels. We're making good progress on gross profit rate expansion and building up core fundamentals. We're making good progress on things like space allocation. And I think we've made no bones about it. We see our stores as over merchandised. We don't think it's necessary. We have a great relationship between a small number of very, very productive SKUs and the majority of sales that we deliver out of a store and we're making progress on that. On the technical or the digital aspect, we launched a new web platform towards the end of the summer that gave us a fundamental capability that we're missing, which is buy online pickup in store.

So you take it one step at a time that was a meaningful one for us as to get a better in this course sales force driven platform where we're able to parlay the need for immediate gratification or the one for immediate gratification and begin to drive buy online pickup in store sales. On the cultural aspects of gaming, we re-launched our loyalty platform. We've been very, very happy with the success that we've had. So again, you have tens of millions of customers worldwide that are part of this and we're seeing good growth, particularly within the PowerUp Rewards Pro, the paid membership and the most enthusiastic of all the gamers. And then on the front – on working with our vendor base that we set all along that will be the long tail and will be the most difficult portion of it and it's – I'd say we're pleased with the progress there.

<<Allison Malkin, Analyst, ICR>>

That's great. I mean, it sounds like a very solid strategy. But as a lot of the investors and analysts keep wondering when these new consoles are released, won't you continue to move share to digital. So, why do you believe that that won't occur or that your strategy will let you overcome that that issue if it does occur?

<<George Sherman, Chief Executive Officer>>

Yeah. Well, I think there's really two primary points to this. First of all, the physical aspects of gaming will exist and that's now confirmed that – that's now substantiated that there will be disks on both devices. So there will be a physical aspect of gaming well into the future and we tend to have absolute market share leadership in that space. The other part of it is the ability and the willingness and the awareness that we need to lean into digital. So we're quite capable of driving things like digital exclusives or quite capable of selling digital games in stores as part of that attachment, we're quite capable of funneling as we've always done in the past. And I think this is

a matter of one recognizing that there will be a digital markets out there with significant size deal – physical market out there with significant size deal, but a digital market that we can lean into that I'd say that we've probably tried to move the customer to physical when they wanted digital and we're going to sell them whatever they want now and whatever terms they wanted.

<<Allison Malkin, Analyst, ICR>>

Great. And then what about the pre-owned business? Can you talk about that? And is that a significant part of your overall business today? And where do you see that headed?

<<George Sherman, Chief Executive Officer>>

Yeah, it's been a significant part of our business for as long as GameStop has been around – still is. It feels the same natural sales pressure and its cycle is every other aspect of the business does. When you don't know what's going to happen next, there tend to be less sales, when you're mentally pivoting toward a new console, there tends to be some pent-up demand that is going to come later in the year or into next year. And that's the same with pre-owned, but it's a good healthy business. It's an acquired skill. There is a market for sure. There will be as the trade-ins begin for PS4 and for the Xboxs into the new consoles and we'll be there for it and we know how to do it properly. There's a lot of operational process behind it. And it's a good secondary marketplace for us that we think will have a natural resurgence just like the rest of the core business will when the new consoles' launch.

<<Allison Malkin, Analyst, ICR>>

And I think in terms of the new consoles, I don't know if we got out everything about them, but it seems that those new consoles have attributes to them that will be really helpful for you too. Can you share that in terms of the fact that there a lot for backwards compatibility?

<<George Sherman, Chief Executive Officer>>

Yeah. Yeah, look I think that – if you think about the attributes of the new consoles that we were clearly waiting on with beta breadth, one was would it have the disk drive going forward and it does, the second part is backwards compatibility. So that ability for all the games from previous generations to work on the new console is there. So I think, there's still a little bit of education process going on with the customer right now. It's what backwards compatibility means. Our gaming zealots understand that well. They know exactly what that means. But we think that there's going to be a resurgence that happens with the new console now that the words out that your game is going to work. It's not throwaway money. It's going to be something that you can clearly use on your new device.

<<James Bell, EVP and Chief Financial Officer>>

It also brings more support for the pre-owned library as you go forward. And so that's another aspect that continues the higher margin business line for us.

<<Allison Malkin, Analyst, ICR>>

And then given that you're the clear market leader, you have such knowledgeable associates. How do you really try to leverage that to create more traffic to your locations and then just create higher sales per transaction?

<<George Sherman, Chief Executive Officer>>

Yeah, it's a great – I mean, we're in a market right now. We're at a stage in the cycle now where it's clearly commoditized and these are clearly value and price point driven purchases at this point. You're in the seventh year. Our core customers not buying a gaming console in the near-term. They're waiting for the new one. So these are second devices, third devices per household. These are late adopters coming into the marketplace. We look at our sales force as a clear competitive advantage going into the new console cycle. We're great at early adoption. That's our sweet spot. There's a choice to be made versus functionality to understand and nobody does that better than GameStop does.

So if you look at two competing consoles coming out and you want to understand what's different from one to the other, we're not only the best place to go, I'd argue that we're the only place to go where you're going to get a level of knowledgeable advice an agnostic point of view from a sales team as to which different and why you would want to go to the left versus to the right and make a decision along the way. So we clearly see this playing into our sweet spot. We believe that we are the distributed sales channel of the gaming industry. We're purists. We feel the pressure of that right now when sales are tough, but we'll feel the benefits of that in a different kind of way when sales are robust again.

<<Allison Malkin, Analyst, ICR>>

Sure. And then I think there's a great segue into your new test market in Tulsa. Can you talk about how those stores are differentiated versus the rest of the base? And really what you're trying to achieve with those locations?

<<George Sherman, Chief Executive Officer>>

Yeah. For context, we took 12 stores in the Tulsa, Oklahoma market and we remodeled them and put some new concepts in place and it's very much a laboratory for us. We chose Tulsa first of all because number one, it was easy to isolate from a marketing standpoint; and two, because it's kind of classic Middle America demographics. When we put new concepts in place, like a GameStop social store, which is a large scale gaming arena, over 30 gaming stations, you can have large team competition inside the stores, you can have league play inside the stores. And then we took the best performers of our SKUs and still represented them within. The majority of what we did in Tulsa is called GameStop 2.0. It's a new format that has a small scale gaming arena in the back of the store, but most of the footprint of products still available and then endless aisle for the rest.

So, screen-based sales where it's either in store and back or it's in the marketplace or we can certainly ship from store or ship to store. So we've tried some different things. I think really when you look at the primary things that we're trying to test are try before you buy. What does it look like to have an environment within gaming where you can come in and try whatever console you want to try, try the games you like to play and sit down and experience it. And we think that that's an internet busting strategy to be able to do that and have that kind of environment and there is no pressure to get out of the store, you sit down, it's actually a couch,

there you play the game. And we're pleased with the conversion that happens when that happens inside one of our stores.

And obviously, it's incumbent upon our team to take that customer off the market when they've made a decision and we think we're doing that pretty effectively. So try before you buy is one of the things that we're trying. I think it's important to emphasize that Tulsa is not a pre rollout. It's not a package prototype that we think is necessarily appropriate for the entire country or the entire world, it's a series of tests and try before you buy is one of them, arena gaming is one of them and it's not just the arena gaming, but I'd say first of all, if you can build regular traffic into a GameStop store, if it's Broken Arrow, Oklahoma versus Owasso, Oklahoma and they're playing and they build rivalries and you begin to have regular traffic into the stores, that's good for us. We certainly believe that there'll be revenues as part of the league. There'll be revenues based on consumption of use of the arena gaming and there'll be footsteps into the store and follow on collectable sales or accessory sales that go along with that.

We've tried experiences like Dungeons & Dragons stations in the stores that's been surprisingly successful. So you have a group of four, six, eight that will come in and they'll spend hours inside the store and they come in on a regular basis. So there's just a number of things that we've tried that we think are very, very different. It's an uncluttered, very clean presentation as well. So I think almost the level of jaw dropping when you're walking and you'll see three, six gaming stations and you see a clean, very different looking GameStop store. So it's a variety of things that we're trying.

Arena gaming is one of them. Try before you buy is one of them. League play is one of them. I think an interesting story. We did training in Tulsa on game programming. So it was targeted to kids, who want to be game coders when they grew up. We had a class on that sold out, got multiple letters from parents thanking us for it. And it's just another use of how you can use gaming stations in the store is to make gamers better or help them experience something that they're interested in and kind of stoke the fire of it.

<<Allison Malkin, Analyst, ICR>>

Another thing that I think is really interesting about the company is the ability to leverage the partnerships that you have such as that, well, it's like Microsoft and Sony, can you talk about how you may be able to create that leverage in the future?

<<George Sherman, Chief Executive Officer>>

Yeah, I mean, I think Microsoft, Sony, Nintendo, it goes to the publishers as well. I think there's very good recognition within the industry that the GameStop is very much needed that it is the place where customer acquisition and customer retention happens. And I'd say walk a mile in the shoes of both Sony and Microsoft going into a new console launch, those are the operative words that they're focusing on right now: customer acquisition, customer retention, generation, the generation movement. And obviously, there's a digital component to that where you're going to have that customer for years and years ahead of time.

So that puts a pretty big premium on what we do. And again, what we do is provide a better explanation of what these devices can do, what subscriptions exist within them, what games can be played on them, what accessories should be attached to them and just give the full breadth of both product and services that revolve around that business. We attach accessories at a higher level. We attach games at a far higher level. So when you look at just the sheer sales productivity of the gaming industry at retail, we're the high watermark in terms of what attachment looks like and that's important to our partners.

<<Allison Malkin, Analyst, ICR>>

And you have the strong loyalty base as well too.

<<George Sherman, Chief Executive Officer>>

We absolutely do. We have a strong loyalty base. And again, we saw some nice growth in it over the course of the holiday with a new offer around it. But it's an advantage to us and it's an advantage to our partners just in terms of insights. If you look at our database, we can pretty well judge propensity to buy. We know who is on a PlayStation 3. We know who is on a PlayStation 4. We know who is on previous versions of each and we know who's likely to buy. And we can target that in terms of one to one marketing, but it is a data share potential with our vendor base that's very important to them as well.

<<George Sherman, Chief Executive Officer>>

All right, Jim, I don't want to not give you any questions, so they'll give you a couple.

<<James Bell, EVP and Chief Financial Officer>>

I will get.

<<Allison Malkin, Analyst, ICR>>

Can you provide probably the priorities for capital allocations?

<<James Bell, EVP and Chief Financial Officer>>

Yeah, I think really we've taken a pretty balanced approach. We'll continue to do, that would be very pragmatic. At the core of that is, is a very solid, a very strong balance sheet and cash flow generation as business. And just indicative of that and then coming off of the 2018 timeframe throughout 2019 already through third quarter, we've retired over \$400 million in debt. We've returned almost \$220 million for shareholders through both buybacks and dividends and finding the right balance of that.

As we continue to strengthen the balance sheet, in particular George talked about inventory management and the working capital efficiencies that we're focused on as part of our optimizing the core of the business, there'll be more of that and how we find the right balance of investing in the business on a go forward basis. But I'd say that that's probably fourth, among the list of four, the fourth, the other one being, and probably third is again continue to maintain a very strong balance sheet is important as we can navigate through a business that's underpinned by a consumer cyclical, the console.

<<Allison Malkin, Analyst, ICR>>

Great. And then where do you see optimal margins? Would you expect to get back to historical peaks? I mean what does the future hold for margins for the business?

<<James Bell, EVP and Chief Financial Officer>>

Yeah, it's a great question. And I'm not going to quantify today or sort of put a spectrum on the timeframe, but suffice to say, if you think about everything George talked about here this morning and what we've been discussing over the last several quarters since we've been here at this business in optimizing it is, is there's a couple of important aspects and that is optimizing the gross margins and really in the product gross margins. And that's a big aspect. I want to hit a lot on that. The other element though is de-densifying our store fleet. We have a portfolio that was a well over 6,000 as peak.

It was built through both organic and inorganic growth. And in many cases there are stores that are literally within a block or two of each other. So that's a big part of the legacy retail thought process in building the top line. And that's great during that timeframe, but it doesn't give us the ability to have a highly leverageable model as we see a console return going forward. And so really optimizing the store portfolio over the course of the next year or two is another key aspect to returning growth in our operating margins.

<<Allison Malkin, Analyst, ICR>>

What do you see as the optimal store base for the company?

<<James Bell, EVP and Chief Financial Officer>>

Yeah, again, we haven't quantified it, but suffice it to say, I think we've, for the last several years, have closed over 200, 225, 230 stores. That's pretty typical and we see that. There's an opportunity to potentially accelerate that a little bit. But again, I want to emphasize the point. This is about de-densifying a fleet and here is why. Over 95% of our stores are four-wall EBITDA positive even when you feel – with the field where we're at. And so it's a very productive fleet. But the issue is that we have stores that are on top of each other. And our ability to capture transfer sales and profit is proven to be significant and that's really where the optimizing the margins come from is getting more out of your fleet and those customers that are already exist with you, just having them walk across the street to go to one store instead of two.

<<Allison Malkin, Analyst, ICR>>

Okay.

<<George Sherman, Chief Executive Officer>>

And I separate work streams a bit and really two things that Jim is focusing on in his team. One is businesses that simply don't work for us. They're not core to us or they're not productive businesses.

<<James Bell, EVP and Chief Financial Officer>>

Yes.

<<George Sherman, Chief Executive Officer>>

So we sold off our Simply Mac business toward the end of this year. We announced we're closing the Nordics for our core store base. It just wasn't a profitable business. In the case of Simply Mac, it's just not core to what we do. We're focusing all in on gaming. In the case of the Nordics, they weren't productive stores, for us it just wasn't a profitable market. So that's one screen that we're very focused on. The others what Jim is talking about is this company was built via acquisition number one and built under the premise that it was a convenience play that you needed to have a lot of locations out there to be the quickest solution for the customer. And that obviously creates the growth of omnichannel. So the rules have changed around that one quite a bit. So, thereby the focus on de-densification and just optimize the profitability of the source that we have from the geographic area.

<<James Bell, EVP and Chief Financial Officer>>

And the omnichannel support...

<<Allison Malkin, Analyst, ICR>>

We only have like a couple of seconds, so we're going to wrap it up. But is there anything that you wanted to say before I do a little wrap up?

<<George Sherman, Chief Executive Officer>>

Yeah, I probably re-emphasize that we have a very exciting gaming console launch coming at the end of the year. We don't know the date any more than you do. We see the same speculation. We see the same buzz on it. We know that they're great devices. We know that they're technological step changes. This isn't an evolution that is going to bring far, far more capability and excitement to gaming. And we firmly believe the story – the thesis for us holds. We recognize the tough sales we announced yesterday. We recognize the tough sales ahead of us, but we also recognize that we're doing a lot of work around the hygiene of the business, our expense structure, our store footprint, so that we can really parlay the opportunity coming our way at the end of the year, which we again believe is heading the GameStop stores.

<<Allison Malkin, Analyst, ICR>>

Great. Thank you. The company has a breakout at Mediterranean 4 at 1:30 p.m. today. Thank you very much.

<<George Sherman, Chief Executive Officer>>

Thanks very much.

<<James Bell, EVP and Chief Financial Officer>>

Thank you.