THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GME - Q2 2014 GameStop Corp Earnings Call

EVENT DATE/TIME: AUGUST 21, 2014 / 9:00PM GMT

OVERVIEW:

GME reported 2Q14 consolidated global sales of $1.73b, consolidated global net earnings of $24.6m and diluted EPS of $0.22. Expects 2014 diluted EPS to be $3.40-3.70 and 3Q14 diluted EPS to be $0.58-0.64.

CORPORATE PARTICIPANTS

Tony Bartel *GameStop Corporation - President*

Rob Lloyd *GameStop Corporation - CFO*

Mike Mauler *GameStop Corporation - EVP of International*

Mike Hogan *GameStop Corporation - EVP - Strategic Business*

CONFERENCE CALL PARTICIPANTS

Tony Wible *Janney Capital Markets - Analyst*

David Magee *SunTrust Robinson Humphrey - Analyst*

Curtis Nagle *BofA Merrill Lynch - Analyst*

Brian Nagel *Oppenheimer & Co. - Analyst*

Arvind Bhatia *Sterne, Agee & Leach, Inc. - Analyst*

Edward Williams *BMO Capital Markets - Analyst*

Sean McGowan *Needham & Company - Analyst*

PRESENTATION

Operator

Good day, and welcome to GameStop's second-quarter 2014 earnings conference call.

(Operator Instructions)

I would like to remind you that this call is covered by the Safe Harbor disclosure containing GameStop's public documents, and is the property of GameStop. It is not for rebroadcast or use by any other party, without the prior written consent of GameStop. At this time, I would like to turn the call over to Tony Bartel, President of GameStop. Please go ahead, sir.

Tony Bartel - *GameStop Corporation - President*

Thank you, operator. Good afternoon, everyone, and welcome to GameStop's second-quarter earnings call. As always, we would like to start by expressing our gratitude to our associates around the world for their performance and dedication to customers, again this quarter. Whether they are in EB Games, Micromania, Spring Mobile, Game Informer, Kongregate, Simply Mac, GameStop, or Cricket, they are truly professionals at what they do, and the secret to GameStop's success.

Joining me today on the call are members of one of the most tenured management teams in all of consumer electronics retail. Rob Lloyd, Chief Financial Officer; Mike Mauler, Executive Vice President of International; Mike Hogan, Executive Vice President of Strategic Business; and Matt Hodges, our Vice President of Public and Investor Relations.

Paul Raines is not joining us, as he is recovering from his recent medical procedure. He is in good spirits as he continues his recovery, and as we previously communicated, the prognosis is very positive for a full recovery. We all wish him well, and look forward to having him back in the office in a few weeks.

We are executing against our vision of a family of specialty retail brands that makes your favorite technology affordable and simple. And today, we are going to share with you color around how all of our segments, physical gaming, multi-channel, digital, and technology brands, are working together to drive solid and diversified profit growth and returns to our shareholders.

The second quarter exceeded our expectations, with earnings per share beating the high-end of our guidance by $0.02. The new console cycle is gaining momentum, driving positive 21.9% comp sales, and total sales growth up 25%, driven by 125% growth in new hardware, and 16% growth in new software. We have now had four consecutive quarters of positive comps, and we expect that trend to continue for the foreseeable future. Our international business also had a strong quarter, which Mike Mauler will elaborate on further.

Another major contributor to the earnings beat came from our technology brands segment, which contributed $70.1 million of sales, and $7.1 million of operating profit, representing 19% of our operating profit for the quarter. This highlights the importance of evolving our business into mobile and consumer technology, by leveraging the core strengths of our vibrant PowerUp Rewards community, our unique buy/sell/trade model, our real estate expertise, and our human and capital strength. We are aggressively expanding this part of our business, as we added 49 stores during the quarter through acquisition and development, bringing our total store count to 319, a 46% increase since the beginning of the year.

It is hard to believe that it has been less than a year since we announced our initial investment in Simply Mac, our first foray into technology brands. We have learned much, and our relationships with AT&T and Apple are strong, and are leading to significant growth opportunities.

We have proven our ability to operate at high service levels, and provide relevant customer solutions, and this is resulting in an ever-expanding growth relationship. We have a robust pipeline of additional acquisitions and development opportunities in the tech brand space. Rob will have more comments on the positive impact that these businesses have on our financial performance.

For the quarter, our digital receipts rose 18%, with console digital increasing 13%, and PC digital increasing 24%. On a year-to-date basis, we have grown our digital receipts by 13%, which is essentially in line with the mid-teens digital growth rates of our top four publishers. We are pleased with our digital market share, which we estimate is in line with our overall market share.

Our knowledgeable associates, our proprietary digital delivery system, and our unique buy/sell/trade process give us a dominant share of digital retail sales, by driving discovery and affordability. Mike Hogan will provide more commentary on how Kongregate is helping to bring new developers to a crowded games market.

Although no credible market share source exists for digital receipts, a couple of external sources have recently validated our importance in driving this high-growth segment. Microsoft recently announced that over 40% of their digital receipts are sold at retail, and we believe that we felt the dominant portion of that revenue. Likewise, Ubisoft recently announced that 70% of their DLC sales from their Watch Dogs title came from retail locations. Again, we are dominant, especially at launch, at selling digital content. As Mike Hogan will share with you in his remarks, we expect to see continued double-digit digital category growth in the foreseeable future, and maintain our market share.

Looking ahead to the second half of the year in video gaming, we are excited about the unprecedented line-up of high-quality games this fall and holiday season. Even with titles like Battlefield Hardline, Evolve, and Batman: Arkham Knight moving out of our year, we have 24 high-quality games launching this season, including Activision's Destiny, Call of Duty: Advanced Warfare, and Skylanders Trap Team, Take-Two's GTA 5, NBA 2K15, and Borderlands: The Pre-Sequel. Ubisoft's Assassin's Creed: Unity and Far Cry 4, EA's Madden NFL 15, FIFA 15, and Dragon Age: Inquisition. And, Nintendo's Super Smash Bros., Amiibo, and Pokemon Alpha Sapphire Omega Ruby.

Our hardware and software market share continues to expand, and is now at an all-time high, as we go into the critical holiday season. We continue to sell over one-half of all PS4 and Xbox One titles. We face a challenging third quarter, as we roll over the Grand Theft Auto 5 launch, but expect to see significant software growth in the fourth quarter.

Our pre-owned business grew 5.5%, at a 47% margin. Our value initiative, which provides us with in-demand inventory from existing relationships, helped drive our growth, as we brought in over $30 million of product to replace out-of-stock value items.

Earlier this week, we rolled out a simplified trade-in pricing policy, to help customers better understand the value that they get for their games and electronic devices. It should be noted that this policy will not impact our overall pre-owned margins. This move simply creates better visibility to the true value that customers receive, using our trade center on the GameStop mobile app, GameStop.com, and in our stores. We continue to see little, if any, impact from other big box competition in the pre-owned game business.

In just two weeks we will have over 5,000 of our managers from all of our brands and all of our countries in Anaheim, California, to experience a week of immersion in the great slate of new games that we will be launching over the next few quarters. There is no doubt that we will again have the most knowledgeable sales force in the entire video game category. In addition, we'll also be hosting thousands of gaming fans to our gaming EXPO, and hosting our first annual developers conference.

We will continue to drive a high rate of internal change to keep GameStop ahead of the curve. We will continue to provide best-in-class customer service in video games, multi-channel, digital, and technology brands, and we remain committed to returning free cash flow to shareholders. I will now turn the call over to Rob.

Rob Lloyd - *GameStop Corporation - CFO*

Thanks, Tony. Hello, everyone. I'd like to begin by reviewing our second-quarter results, including highlights of 25% revenue growth, and EPS growth of 144%, up to $0.22 per share. GameStop's consolidated global sales were $1.73 billion, up over 25% from $1.38 billion in the prior-year quarter. Our comps were up 21.9%, up 19.7% in the US, and up 26.2% internationally.

For the last four quarters, our comp was 12.3%, demonstrating the power of the console cycle, and compelling titles like GTA 5 and Watch Dogs. Our same-store sales for the quarter exceeded the high end of the range we outlined in last quarter's call, due to strong next-gen hardware sales. We outperformed the US market, leading to a hardware share gain of 360 basis points. There were a few major releases in the quarter, but the success of Watch Dogs, Mario Kart 8, and The Last of Us for PlayStation 4 helped drive our new software sales up 15.6%, compared to an 8.5% increase in the US market.

Overall, we gained 240 basis points of new software market share in the quarter. Pre-owned and value sales grew 5.5% compared to the prior-year quarter. The US was up 5.3% and international was up 11%. Our GAAP digital sales totaled $52.3 million, a 5.9% increase over the second quarter of last year, with growth coming in PC digital. Our digital receipts, or non-GAAP revenue, totaled $179.2 million, a 17.6% increase over Q2 last year, with growth in both console and PC digital.

Our mobile revenues grew 85% to $112.1 million, from $60.6 million in the second quarter of last year. The technology brands business continues to grow rapidly, with revenues of $70.1 million, and operating profit of $7.1 million during the second quarter. Technology brands represented about 40% of the operating profit growth for the quarter. Life-to-date, the store contribution from the tech brands acquisitions and new stores is far ahead of our aggressive pro formas. We are well on our way to adding the 300 to 400 new tech brand stores we outlined earlier this year, and are aggressively seeking additional growth.

Consolidated global net earnings were $24.6 million, up 134% from $10.5 million a year ago. Diluted earnings per share for the quarter of $0.22 exceeded our guidance range, and grew 144% from $0.09 per share earned in the second quarter of last year. Gross margins for the quarter were 31.8%, which are down 300 basis points from Q2 last year, driven by the growth of console hardware, as a percentage of total sales. Gross margins in new hardware decreased 100 basis points, due to selling more next-gen consoles. New software margins increased slightly, when compared to the second quarter of 2013.

Gross margins on pre-owned and value were 47.0%, comparable to the same quarter of last year. As Tony said, we are not seeing an impact from competitors in the pre-owned business. Based on we learned from the simplified trade price program that we use in Australia, we implemented the new trade pricing policy in the US. This will simplify pricing for our customers and our associates, and will not impact margins going forward.

The digital gross margin rate was 65%, and the gross profit was $34 million, with slight declines compared to the prior-year quarter, due to the mix of underlying products. The gross margin in the mobile and consumer electronics category was 36.1%, with gross profit of $40.5 million, up from

$16.3 million in the second quarter of last year. This growth was primarily driven by the Spring Mobile and Simply Mac acquisitions, and store growth.

Total SG&A expense dollars increased $53.8 million, due primarily to the addition of technology brands, which accounted for $26.1 million of the increase. SG&A decreased as a percent of sales from 30.5% in the second quarter of 2013 to 27.5% this quarter, evidencing that we leveraged the increase in sales in the video game brands segments. Depreciation and amortization was also about 5% less than the prior-year quarter.

We ended the quarter with 6,698 stores, 4,197 US video game stores, 2,182 international video game stores and 319 technology brand stores. We opened six video game stores and closed 24 in the US, and opened four and closed 17 internationally. We added 26 tech brand stores through acquisitions and opened 23 more.

At the end of the second quarter, we had short-term debt of $214 million, with the increase over the prior year balance due to M&A activity, and additional cash returned to shareholders in the form of buybacks and dividends. As we indicated in the earnings release, our Board of Directors authorized the dividend of $0.33 per share for this quarter, to be paid on September 16.

We repurchased 1.9 million shares in the second quarter, at an average price of $39.67, for a total of $75.5 million. Year-to-date, we have repurchased $127.7 million, well on our way to the annual guidance we gave of $250 million to $300 million. Life-to-date, we have now bought back over 1.5 billion of our shares at an average price of $23.51. We have approximately $323 million remaining on our current buyback authorization.

Now, I'll turn to the third-quarter outlook. We are forecasting same-store sales to increase, ranging from plus 1% to plus 5%, once again driven by next-gen hardware sales. The third quarter title line-up is exciting, as Tony outlined; however, new software comparisons for the third quarter will be difficult, given the overlap of Grand Theft Auto 5. We sold well over 6 million units of GTA 5 in the third quarter of last year.

We expect diluted earnings per share to range from $0.58 to $0.64, representing flat to an increase of 10%, when compared with $0.58 for the third quarter last year. We're using weighted average fully-diluted shares outstanding of 114 million, following buyback through the second quarter. We are reaffirming our full-year comparable store sales guidance of plus 6% to plus 12%, and our previous full-year 2014 earnings-per-share guidance of $3.40 to $3.70, using weighted average fully diluted shares outstanding of 114.7 million, following buybacks through the second quarter. Earnings guidance does not include the effect of additional buybacks. Now, I'll turn it over to Mike Mauler for his comments.

Mike Mauler - *GameStop Corporation - EVP of International*

Thanks, Rob. Good afternoon, everyone. GameStop's international businesses had a very strong second quarter, exceeding expectations with a 26.2% same-store sales increase, and a significant improvement in operating results over 2013.

Triple-digit hardware growth drove strong same-store sales, as the install base of the next generation of consoles continued to increase faster than the previous cycle. During Q3, we also experienced a solid increase in new software sales, driven by new titles such as Ubisoft's Watch Dogs, Sony's The Last of Us: Remastered, and Nintendo's Mario Kart 8, which also helped drive a more than three-fold increase in Wii U hardware sales versus Q2 2013.

Investments in our multi-channel strategy continued to pay off, as our international e-commerce business entered into its fourth consecutive year of double-digit growth, increasing by more than 46% versus prior year. This growth was driven by an expanded product selection, and an ever-increasing number of customers utilizing cross channel purchasing features, such as web in-store and pick-up in-store. The international sales of digital products accelerated during the quarter, growing at 53% versus 2013, primarily driven by a strong DLC attach rate on new titles, and significant growth in Steam Wallet and POSA cards, such as League of Legends, Minecraft, and Blizzard.

GameStop's buy/sell/trade model continued to provide tremendous value to customers, as they upgraded to the next generation of consoles. This transition drove an increase in trades resulting in healthier pre-owned inventory. GameStop's improved pre-owned inventory position, the expansion, of our international loyalty programs, and a more efficient use of our CRM tools to engage customers, drove a pre-owned sales increase of 11.2% versus 2013, led by Australia's growth of 23%.

In addition to the over 28 million PowerUp Reward members in the United States, international loyalty programs topped 10 million members during the quarter across 15 countries. Improvements in our CRM capabilities to communicate with our vast membership base played a key role in the sales growth of digital, multi-channel, pre-owned and our expanding franchise marketing efforts on key titles. Video gaming and entertainment collectibles continued to grow at a fast pace during the quarter, as we increased our product offerings to meet the needs of our passionate customers.

As we have discussed on prior calls, we continue to test new concepts and product lines in different markets around the world. Over the last six months in Italy, we have been battling a partnership with Wind Telecommunications in some GameStop stores, under which we are selling Wind's phone products and pre-paid and post-paid services. During this pilot, we have seen synergies with our existing customer base, and an overall increase of store traffic in the test stores. We have been pleased with the result and our partnership with Wind, and we'll be expanding Wind's offerings to approximately 70 GameStop stores in the third quarter.

As we enter the second half of 2014, we are excited by the slate of new releases, and the strong growth we are seeing in next-generation consoles. GameStop's investments and subsequent progress in expanding multi-channel businesses, growing our worldwide loyalty membership, and the diversification into associated products and services positions us to fully leverage the profitability of this new console cycle, and to also grow our business in exciting new areas of adjacent technology. Now, I will turn it over to Mike Hogan for his comments.

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

Thanks, Mike. I will cover three topics this afternoon. First, an update on the overall video games market, including both physical and digital video games. Second, an update on the pre-owned business and our expanding presence in the value sub-category, and third, GameStop's multi-channel business and its contribution to overall Company growth.

From a total video games category perspective, we continue to see very strong growth, driven primarily by hardware. Sales of the new consoles continued to meet or exceed our initial estimates, further reinforcing our model projections for physical category growth in 2014 and in 2015. The attach rate is still building, as publishers release more new titles. GameStop's attach rate is now above 4, which is 75% higher than the rest of the category -- industry.

In the nine months since launch, category-wide sales of next-generation hardware are 70% higher than the same period following the PS3 and Xbox 360 launch, and GameStop sales are plus 140%. During the same timeframe, category-wide next-gen software sales are plus 26% versus prior generation launch, and GameStop's are plus 103%. We are clearly driving the growth of the next-generation console cycle.

Our PowerUp Rewards consumer research continues to show very strong purchase interest in the next-generation consoles. In our latest polls, 55% of PowerUp members surveyed indicate they are planning to purchase a next-generation console, but have not done so yet. This suggests significant ongoing demand for the new consoles, and it also suggests a coming wave of trades, as these consumers upgrade to a new generation of hardware and software. As Tony noted, we are seeing strong growth in console digital, and our model continues to project double digit growth for the foreseeable future. Our internal numbers show that GameStop digital is keeping pace with this growth in the overall category.

In addition to console and PC digital, the category is experiencing big growth in the mobile gaming segment. As you may recall, GameStop entered this growing market in 2013, with Kongregate Mobile Publishing. We are seeing extremely strong results to date. In the second quarter, Kongregate, our mobile and casual games platform, posted very strong results, growing plus 123% over the prior year. We currently have 12 games active on the iOS App Store and Google Play store, with a total of 20 games expected to be launched by year-end. We have multiple games running above a $10 million annual rate, and expect Kongregate to be a top-ten third-party mobile games publisher this year.

Through our efforts in the mobile publishing arena, we have learned a great deal about the needs of the development community. Kongregate is providing a value-added platform for mobile game developers, which to date has met with broad acceptance. In addition to customer acquisition, monetization, and analytics, Kongregate's $10 million mobile development fund provides much-needed resources for developers to deliver high-quality games. We will continue to focus on serving consumers by helping developers bring great new content into an increasingly-crowded mobile games market.

Pre-owned sales grew plus 5.5% for the quarter. This is an 11-point improvement versus the same quarter last year. This reflects the strength of the new console cycle, and consumer demand for pre-owned. It also reflects the early success of our value strategy, which we first outlined back in the spring. GameStop's pre-owned is clearly benefiting from the new console launches. Roughly 30% of our next-generation hardware and software to date has been purchased with the help of trade credits. Consumers continue to see trades as a great way to get the new technology they want.

Now, a word on the broader value opportunity and the results to date. We are leveraging our core competencies in category knowledge, customer relationships, buy/sell/trade expertise, and refurbishment to capture a broader sales opportunity in pre-owned games, as well as an expanded set of technology products. The results to date are very encouraging. We've seen significant interest from publishers and others in driving incremental sales from a select list of high-demand older games, accessories and technology. In the second quarter, we sourced over $30 million worth of value inventory, and this value inventory contributes significantly to our positive growth for the quarter.

Multi-channel has a very significant impact on GameStop's total business, with over 60% of our customers going to GameStop on the web or mobile, prior to making a purchase in our stores. Multi-channel continues to be a driver of total Company performance in Q2, posting plus 49% growth for the quarter. Leading that growth was our pick-up at store business.

Consumers can find the product they want online and guarantee availability when they pickup at a store, usually the same day. This also provides an excellent opportunity for the customer to bring additional trades into the store. Pick-up at store grew plus 141% of the quarter. This reinforces consumers' desire for the convenience of web shopping, combined with the GameStop in-store experience.

We continue to invest heavily in mobile, and we launched an updated mobile app this summer. We upgraded the entire customer experience, and added new functionality such as the trade center, where members can go to learn about trades, look up values, and see current promotions. This addresses the number-one customer request for mobile functionality.

The GameStop mobile app has become a key driver of our multi-channel business. We now have over 4.4 million installs, and average daily users are up 60% over prior year. Our mobile app users spend 81% more, trade 53% more and buy 79% more pre-owned than the average PowerUp Pro member. These are clearly our most engaged customers. I will now turn it back over to Tony.

Tony Bartel - *GameStop Corporation - President*

Thanks, Mike. We look forward to seeing all of our passionate managers in a couple of weeks for a full dose of gaming immersion. As their enthusiasm will attest, the gaming business is healthy and growing. Technology brands is providing relevant sales and profit growth, and we are excited about the growth path in front of us. We will now open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Tony Wible, Janney Capital Markets.

Tony Wible - *Janney Capital Markets - Analyst*

First and foremost I just wanted to pass my regards along to Paul, and hope the best for him.

Tony Bartel - *GameStop Corporation - President*

Thank you.

Tony Wible - *Janney Capital Markets - Analyst*

With regards to Simply Mac, what are you anticipating as far as an Apple line-up and product launches? What's embedded into the guidance that you have provided? And then, a little bit differently, can you give us a little bit of a sense on what you're seeing for pre-sale activity on the big 4Q titles, versus what you have seen in the past?

Tony Bartel - *GameStop Corporation - President*

Sure, Tony. I'll let Rob and Mike talk about the Simply Mac line-up. Although I will tell you, that with our relationship with Apple, we don't get a lot of visibility, internal visibility, as do I think most resellers for Apple. So, clearly they have a large event coming on September 9, where we'll have a lot more visibility. I'll let Rob indicate what we actually have in the forecast for Simply Mac.

Let me address your second question, though on pre-sales. What we are seeing on pre-sales, clearly after recent announcements, we've seen a significant increase in pre-sales, but they are down from what we've seen in the past, we think for couple of reasons. One, we think that people are still debating, as Mike shared with you earlier, what console they are going to buy the game on.

What we have seen is just because our pre-sales are down, it does not mean that our actual sales are down. And as Mike, they're actually over performing on all of the launches on Xbox One and PS4. So that's a trend we are continuing to see, so even though pre-sales are down a bit, we still believe they are the best barometer in the industry of what a game's actual demand will be. It's just that we have to buy a lot more relative to our pre-sales than what we had to do in the past.

So Rob, you want to talk about any products that we do have in the forecast? I don't think we've given specific details on that.

Rob Lloyd - *GameStop Corporation - CFO*

Yes, we haven't given specific details on that, and most of us have all heard the same things about what kind of products might be coming from Apple this fall, and we're excited about that. I can't specifically relate to how much of the guidance might be driven by those products, but we're excited about them, and we're going to get as much as we can to sell through when they get here.

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

I think the great thing, Tony, is the iPhone 6, which is obviously heavily rumored to launch this year. That's a great example of the diversified model. We'll obviously accept trades of other phones toward that in all of our concepts, like GameStop, Simply Mac, Cricket and Spring, and we'll be selling it in all of our Simply Mac and our Spring stores, and eventually in our Cricket stores, as a pre-owned product. So it's a great ecosystem that we've created, and we'll definitely benefit from any launches that they have.

Tony Wible - *Janney Capital Markets - Analyst*

Great, thanks for clearing that up.

Operator

David Magee, SunTrust.

David Magee - *SunTrust Robinson Humphrey - Analyst*

My sentiments also for Paul, and best wishes there. The question I have, a couple. One is, the holiday season has often been challenging for GameStop. I'm curious what you're seeing this year, what you're doing this year that might improve the visibility around that time of year?

Tony Bartel - *GameStop Corporation - President*

Well the holiday season for us is a great season. I mean it's -- this time there's 24 games that are going to be out there, the best line-up in history, so the key that we're focused on this year is affordability. We think that with all the great consoles that are out there, and with 24 great games that are out there, we think it's incredibly important that we do a great job of making them as affordable as possible.

So the simplified trade pricing that we put in made it very simple for people to understand the true value that they can get, and we are going to run buy/sell/trade, so that we can allow people to bring in their trades as additional currency towards the great games that they want, so we think a holiday like this is right in GameStop's wheelhouse. That, coupled with the fact that any launches that do happen to come out with an Apple announcement, are obviously going to be helpful to us as well, as we expand our tech brands.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Thanks, Tony. Can you give a little bit more color around the commentary that GameStop digital is keeping pace with the overall industry? Do you over index in certain aspects of that, and maybe under index in others? Or how are you able to keep pace in that regard?

Tony Bartel - *GameStop Corporation - President*

Sure, David. I'll start out, and then I'll let Mike share his thoughts from the market model and what we've seen. It really comes down to discoverability and affordability, like they always talk about. What's so powerful at GameStop is our ability to really create the market. DLC, we definitely way over index in DLC. I think you heard Ubisoft say that on Watch Dogs, 70% of DLC was sold at retail.

Clearly we sold the lion's share of that at retail, because our associates are out in the lines at our midnight launches informing people about that content, and that's a real key strategic weapon that we have. We're also driving a lot on the Kongregate side, as Mike talked about, so those are areas where we are over indexing from a growth perspective. Mike Mauler talked about Steam being such a strong growth engine globally, but Mike you want to share?

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

So Tony mentioned from a market model perspective, we're seeing double-digit growth in the category. We continue to expect that for the foreseeable future. The two segments in there, that are real drivers are going to be console digital, and mobile. And obviously, we're excited that we're participating heavily in both of those areas.

We talked I think a lot in a fair amount of detail about the -- what we've launched at Kongregate and the success of that. I think on the console side, just to echo some of Tony's comments, we're constantly in touch through PowerUp members, and seeing them participate, and talking about the reasons why they think retail has a strong role to play in this category. And it's everything from discoverability to affordability, ability to use trade credits, ability to take physical trades, apply them to digital product, and of course to get PowerUp points, as well as just the recommendations of GameStop associates. So we continue to see, from the consumer perspective, that our stores and our Associates and our PowerUp Rewards plays an important role in the digital category.

David Magee - *SunTrust Robinson Humphrey - Analyst*

Great, thank you, and congratulations on the numbers.

Operator

Curtis Nagle, Bank of America.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

So just a quick question on your software results, which were quite good, and certainly better than the market. What's driving it? Is it more very strong next-gen sales, or is it less impact from the prior gen ramp-down?

Tony Bartel - *GameStop Corporation - President*

I definitely think that we're way over performing on Xbox One and PS4 like we talked about, and we're selling over 50% of games. That's not just at launch, that's our market share continuously. Rob, do you have some other thoughts on where the software growth is coming from?

Rob Lloyd - *GameStop Corporation - CFO*

I'll just echo that the next-gen has been very strong for us. Obviously, that fits into our wheelhouse in launching games. The old gen is falling off, there's absolutely no doubt about that, but I think we're doing okay in terms of holding share there and definitely driving on the next-gen, such that our overall software share is climbing.

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

I would also add that you mentioned before, affordability, Tony, the buy/sell/trade model and the ability to trade in games, especially in places where there is economic challenges has really helped us a lot. Also, our increasing loyalty program. We're adding millions of members every year, and we're getting better at utilizing that data and talking to those customers, and getting them engaged, so that's certainly helping as well. And finally, I think multi-channel. As we give the customers more ways to purchase the product and easier ways to purchase the product, that helps with market share, as well.

Tony Bartel - *GameStop Corporation - President*

Curtis, the other thing that's happened is our hardware share has grown significantly. Like Mike said, we're up 140% versus the market at 70%. Then you factor in the fact that our attach rate, we do such a good job, our associates are so skilled at explaining what people need, to make sure they have a great experience when they get home, that our attach rate is up 75% over the balance of the market, so that's another factor that's driving it.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Thanks so much. That's very helpful. And just one quick follow-up, if I may.

Would you be able to discuss what your outlook for the Wii U is, given some pretty solid results this quarter? And finally some good first-party content coming out in the next year and a half or so?

Tony Bartel - *GameStop Corporation - President*

We've been very consistent every time we're asked about the Wii U here, that really what they needed was two things. They needed the strong first-party titles, which we think that they are getting, and they also needed to do a better job of explaining exactly what the connected tablet, as we like to call it, how you actually use that.

I think they're going to do a great job on both of those. Clearly, they've come out with some nice announcements at Gamescom, pre-orders really spiked when they came out on that, and we're very excited about that.

Mike, do you have any other color?

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

I agree.

Mario Kart 8, as I had mentioned, caused us to have our Wii U sales increase threefold internationally in the second quarter. We've got Smash Bros. coming up and some other titles, so I agree that the titles drives that platform, and we're starting to see it coming up.

Tony Bartel - *GameStop Corporation - President*

I would also not sell Amiibos short, either.

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

True.

Curtis Nagle - *BofA Merrill Lynch - Analyst*

Thanks so much.

Operator

Brian Nagel, Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Congratulations on a nice quarter, and best wishes to Paul. Question, if you're looking -- pretty easy to beat guidance here, and a nice quarter. Why not lift guidance for the year? What's the discussion, as you look towards the guidance you've had out there for 2014, why not lift on the heels of this better Q2?

Tony Bartel - *GameStop Corporation - President*

Rob, I'll let you take that.

Rob Lloyd - *GameStop Corporation - CFO*

Sure. Brian, I understand the question, but as we looked at it, the second quarter, very nice results in the second quarter, but historically our second-quarter is very small relative to our entire year. And as we look at how our year lays out, there is still 80% or so of the year remaining, in terms of our profit generation, and as Tony mentioned, we had some pretty significant titles that moved out of the year. That's the approach we took on the annual guidance affirmation.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Got it. And as we look toward the holiday, and keeping in context a lot the past couple holidays, is your discussion with your partners now, holiday sales, is there going to be any bigger effort to protect pricing? As I look around retail, and I think we're going to be once again in a holiday where there's not too many categories working, but gaming is going to be a hot category, and I think there's always the potential for others to use it as a promotional effort to get people in their stores. Is there any more -- as you discuss with your vendors, are they going to be more protective of pricing this year?

Tony Bartel - *GameStop Corporation - President*

We never have or very rarely have a conversation with a vendor where we put downward pressure on prices, because we are going to be the last people to ever put downward pressure on prices. So, Mike you might want to talk about some of things we're doing to really drive affordability of the games through some of our trade-in deals that were going on?

Mike Hogan - *GameStop Corporation - EVP - Strategic Business*

Sure. I think to Tony's point, obviously we don't -- we're not looking for category-wide discounting. I think one of the things we found consistently is that with the value we offer through bundling and buy/sell/trade, we are consistently the best value in the market, in the eyes our consumers. I think an example would be, even just the simplified trade price we're doing, we're doing a number of things to expand the communication around our program, explain it to more consumers so they can understand how they can get the best value. Because what we find is the people who understand that and utilize it, consistently rate GameStop as the best value to buy hardware and software.

Tony Bartel - *GameStop Corporation - President*

Brian, I think it's a powerful statement when the person that is selling more than half of the product that we are going to be selling is saying we don't need price reductions. I think that will be -- that speaks volumes to the publisher community.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Thank you.

Operator

Arvind Bhatia, Sterne Agee.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

My congratulations on the quarter, and also would like to wish Paul a quick recovery. Two quick questions.

One, the 6% to 12% comp number for the full year, just wanted to see if you could give us some color on what that means for new software in Q4, in light of two things. One is your outperformance so far, and the tough comp in Q3, what does it imply for Q4 new software growth? And then, as you get more involved in direct downloads overall, are your margins fairly consistent to what you get in the packaged software side?

Tony Bartel - *GameStop Corporation - President*

Rob, I'll take the second one and let you take the first one. As we've always said, Arvind, direct downloads are very comparable to software-like margins, and so we're consistent in that position. Yes. And you do recognize, or you did recognize that we are a market maker in the digital side, not just the physical side as well. So Rob, I'll let you talk to the 6% to 12% comp.

Rob Lloyd - *GameStop Corporation - CFO*

Yes we typically don't give a lot of guidance, Arvind, on the categories, and what our expectations are for those within quarters. So I'll have to hold you off on that one.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Okay let me just try another one. On tie ratios can you talk about that, real quick? I know you said four, but I thought you had said it was higher than that in the past. Maybe, if you can provide a breakdown between packaged versus digital, and how, on a combined basis your tie ratios look like right now?

Tony Bartel - *GameStop Corporation - President*

Very similar to what we said in the prior two quarters, what we're seeing is a slight reduction versus the prior launch in physical goods, but it's more than made up in a digital attach that we're seeing. So it's slightly lower on the physical side, but then when you add the digital test that we are seeing, we actually see it as an increased attach rate.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

One last one them. The online subscription service announced by one of the publishers, wondered what your views are on that, and if you see that as a model that might become more prevalent?

Tony Bartel - *GameStop Corporation - President*

Sure, thank you, Arvind, I'll address that.

I think what you're going to see is publishers and platform holders are constantly going to be looking for new ways to reach the gamers. I think what we're showing is, especially with our DLC performance, what we're showing is that we are market makers, not only on the physical side, but also on the digital side.

So we always say we're for the gamer, so if the gamer wants an online subscription service, then we'll sell them an online subscription service. If the customer wants to buy a physical game, we'll obviously do that. If they want to buy a digital download, we will sell them that.

So when it comes to the customer, we're agnostic in terms of what they're going to buy, and we just want to give them the best service. So as these roll out, we haven't heard of others that are getting into this business, but if this rolls out, we'll make it available, and we'll be part of the value chain, as well.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Great, thank you.

Operator

Edward Williams, BMO Capital Markets.

Edward Williams - *BMO Capital Markets - Analyst*

Best wishes to Paul for a quick recovery.

I have a couple questions, simple modeling questions first of all. Rob, can you talk a little bit about the tax rate in the quarter, what we should look for on a going forward basis? Second question is, shares outstanding as of today, what's the base number right now? And the third one is the number of tech stores that we can look for by the end of the year? And then I have another quick question for Tony.

Tony Bartel - *GameStop Corporation - President*

Rob, I'll let you take those questions.

Rob Lloyd - *GameStop Corporation - CFO*

In terms of the tax rate, we benefited in the quarter from a couple of things. One is a shift in mix amongst the various jurisdictions, in which we operate, that benefited us, in terms of our estimate of the overall annual rate. I would say overall, we expect that annual rate to be at the lower end of that 36.5% to, I think it was 37.5% rate guidance we gave back in March.

So look at the lower end of that. And then in terms of the share count, I'll have to get back to you with exactly what it is, but again, we're anticipating 114 million in terms of the weighted average shares for the third quarter.

Edward Williams - *BMO Capital Markets - Analyst*

Okay and then --

Rob Lloyd - *GameStop Corporation - CFO*

Sorry could you repeat the question on the tech stores?

Edward Williams - *BMO Capital Markets - Analyst*

How many at the end of the year?

Rob Lloyd - *GameStop Corporation - CFO*

We started the year with 218, we guided to 300 to 400, and as I stated in my remarks, we're well on our way to hitting that 300 to 400. So, I would say that's anywhere between 500 and 600 with a little rounding in there for the teams.

Edward Williams - *BMO Capital Markets - Analyst*

Okay. And then Tony, the question I had for you is, are you seeing any differences in the duration of how games are selling post the release? Are we experiencing a shorter window of games selling very well, or if you of look post release, are the games performing as well as they did in prior cycles?

Tony Bartel - *GameStop Corporation - President*

I would say what we're seeing is that you are -- we're seeing, like I shared earlier, that they're selling much higher relative to their reservation rate, and for the reasons I articulated there. But then when we see is that we see a longer tail, especially with the advent of DLC. DLC is coming out quarterly, even though we sell a lot of it the day of launch, and we think that's the best practice. Every time DLC comes out there is a huge bump that we haven't seen in the past when DLC wasn't around. That's probably the biggest thing that has shifted in terms of gaming.

Now, we've never had 24 titles like we're about ready to have, so I'm not sure that I can comment on what's going to happen this holiday. It's all about affordability, and we think we're going to be the best at that.

Edward Williams - *BMO Capital Markets - Analyst*

Okay, great. Thanks a lot, and congratulations on your quarter.

Operator

Sean McGowan, Needham and Company.

Sean McGowan - *Needham & Company - Analyst*

Couple questions. First on the-- you talk about attach rate, I assume you're talking about software only. Could you talk about attach rates for accessories and how that's comparing to the last cycle?

And then a bigger question. You made a big deal a couple years ago about the relative advantage of buying a game in the store, because of how long it would take to download. But there are ways of doing that now that you kind of get 99% of the game and the last mile comes at that 11th hour, so could you address that and how you're see yourselves positioned with that on the horizon?

Tony Bartel - *GameStop Corporation - President*

Sure, we'll look for the accessory number, we don't have that right at our fingertips, but we'll look for that. Sean, let me address the download number. I think that a couple of things.

First of all, you're right, that speeds are getting quicker. Game sizes are also getting larger, it's not atypical to see a game at 50 gigs. But the main point I would say is that it really comes down to portability and value, like Mike was talking about earlier.

Again, we're agnostic. If people want to buy digital games, we'll let them buy digital games, we'll make a market for digital games. But there is, I also think that you have to understand that there is a financial issue here with the consumer, in that a digital game does not have, today, a residual value, like a physical game, which has a perceived $20 residual value.

And, from a portability issue, you can't take that game and move it from one console to another without re-downloading it, so even though download speeds are getting quicker, game sizes are also getting bigger. So I would say that while that's not a barrier that cannot be overcome, I do think there are other issues that you have to think about. Again, that being said, and we said it before, when it comes to digital, we are on offense. We're creating markets for digital, and Rob, were you able to get your hands on the accessory attach?

Rob Lloyd - *GameStop Corporation - CFO*

I was able to, and accessory attach rate looks like it's running about a unit or so behind where it was in the last cycle. And it's about -- we're at about 1.3 units, I think, a little higher than the overall market.

Sean McGowan - *Needham & Company - Analyst*

Do you expect that to pick up closer to the holiday season?

Rob Lloyd - *GameStop Corporation - CFO*

I think some of accessories that you see, particularly what we carry in our stores, headsets, for example, are great accessories and great holiday buys, and so as the gift giving time rolls around, we should see an uptick in that.

Tony Bartel - *GameStop Corporation - President*

And remember, Sean, that Xbox One launched without a headset, a premium headset, so that's definitely going to increase through the holiday season.

Sean McGowan - *Needham & Company - Analyst*

Great. Thank you.

Tony Bartel - *GameStop Corporation - President*

Thank you. First I would like to thank all of you for your concern for Paul, and we will definitely pass that on.

We are very excited about the growth ahead that we have, tech brands is outperforming, video games are growing, and we are looking forward to a great conference. Thank you all for your continued support.

Operator

This does conclude the conference. We thank you for your participation.
