



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

GME - NYSE (as of 5/25/17)	\$23.62
Price Target	N/A
52-Week Range	\$20.10 - \$32.67
Shares Outstanding (mil)	101.3
Market Cap. (\$mil)	\$2,393
3-Mo. Average Daily Volume	3,095,000
Institutional Ownership	99%
Total Debt/Total Capital (4/17)	26%
ROE (TTM ended 4/17)	16%
Book Value/Share (4/17)	\$22.40
Price/Book Value	1.1x
Annual Dividend Rate & Yield	\$1.52 6.4%
EBITDA Margin (TTM ended 4/17)	8.6%

EPS FY 1/31* (excludes nonrecurring items)

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.66		\$0.63	A	
2Q	\$0.27		\$0.17		
3Q	\$0.49		\$0.40		
4Q	\$2.38		\$1.99		
Year	\$3.77	\$3.20	\$3.19		\$3.22
P/E ~	6.3x		7.4x		7.3x

*Fiscal year ends Saturday closest to January 31 of the following year.
Quarterly EPS figures may not add to annual figure due to rounding and changes in the share count from quarter to quarter.

Revenue (\$mm)

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$1,971		\$2,046	A	
2Q	\$1,632		\$1,589		
3Q	\$1,959		\$1,909		
4Q	\$3,045		\$3,051		
Year	\$8,608	\$8,550	\$8,595		\$8,500

Company Description: *GameStop Corp. is the world's largest multi-channel videogame retailer. The company sells new and pre-owned software, hardware, and accessories for current gaming systems and the PC. Recent diversification efforts have led to a smartphone/mobile device retail sales & service presence that includes AT&T Wireless/Spring Mobile, Simply Mac, and Cricket stores, collectively referred to as technology brand stores. GME recently operated just over 7,500 total stores in 14 countries. This included 3,902 U.S. videogame stores, 1,998 international videogame stores, 1,508 technology brand stores, and 95 collectible stores.*

GameStop Corp.

GME — NYSE — Neutral-4

Positive Surprise to 1Q Results, But Challenges Remain With Transformation Strategy

Investment Highlights

- **1Q results were better than expected.** Net sales increased 3.8% to \$2.046 billion, ending a streak of four consecutive quarterly sales declines. The quarter reflected weakness in videogame software and growth in non-videogame segments such as Technology Brands (includes store brands AT&T Wireless/Spring Mobile, Simply Mac, and Cricket) and Collectibles (online and physical stores). One unique aspect to the quarter was the videogame hardware category, which posted a 24.6% sales gain due to the successful launch of a new gaming console, Nintendo's Switch, in March.
- **The sales gain was negated by higher expenses.** Gross margin was comparable to last year, but higher expenses in the Technology Brands stores (chiefly AT&T Wireless/Spring Mobile) led to an 8.2% drop in adjusted operating income (excluding nonrecurring items) and an approximate 70 basis point drop in adjusted operating margin. Adjusted EPS of \$0.63 fell short of \$0.66 a year ago, but was above the street consensus estimate of \$0.51.
- **Guidance for fiscal 2017 was maintained, despite the 1Q beat.** This includes projected EPS of \$3.10-\$3.40. We have fine-tuned our financial outlook, which includes EPS declines for the remaining three quarters of the fiscal year. However, we do not have a great deal of confidence in our figures due to dynamics at hand, such as steady pressure on physical videogame sales and integration of non-videogame businesses.
- **We maintain our Neutral rating.** Given the low valuation and high dividend yield, we have some attraction to the stock. However, offsetting factors to us include industry trends for videogame software sales and some concern over GME's business diversification strategy. We consider the dividend, currently yielding 6.4%, adequately covered by cash flow.

**Note Important Disclosures on Pages 7-8.
Note Analyst Certification on Page 7.**

Exhibit 1**Consolidated Statements of Income** (figures in millions except percentages and per share data)

	13 Weeks Ended		% chg.
	Ended 04/29/17	Ended 04/30/16	
Sales	\$2,045.9	\$1,971.5	3.8%
Cost of Sales	1,343.4	1,296.0	3.7%
Gross Profit	702.5	675.5	4.0%
Selling, Gen. & Admin. Exp.	563.5	520.8	8.2%
Depreciation & Amort.	37.9	40.7	(6.9%)
Operating Income	101.1	114.0	(11.3%)
Interest Expense, net	13.9	10.8	28.7%
Income Before Taxes	87.2	103.2	(15.5%)
Taxes	28.2	37.4	(24.6%)
Net Income	\$59.0	\$65.8	(10.3%)
Adjustments:			
Store Closure Costs	7.3	0.0	
Impact of Business Divestitures, net	0.0	4.1	
Tax Effect of non-GAAP Adjust.	(2.7)	(1.5)	
Non-GAAP Net Income	\$63.6	\$68.4	(7.0%)
Non-GAAP Diluted EPS	\$0.63	\$0.66	(4.4%)
Diluted Shares Outst.	101.4	104.2	(2.7%)
As a % of Net Sales:			
Gross Profit	34.34%	34.26%	7
Selling, Gen. & Admin. Exp.	27.54%	26.42%	113
Depreciation & Amort.	1.85%	2.06%	(21)
Operating Income, GAAP	4.94%	5.78%	(84)
Net Income, GAAP	2.88%	3.34%	(45)
Net Income, non-GAAP	3.11%	3.47%	(36)
Tax Rate	32.34%	36.24%	(390)

Source: GameStop Corp.

Note: Fiscal year ends on Saturday closest to Jan. 31

Additional comments on recent results. The 1Q period continued recent company trends regarding the traditional videogame business, as sales in the new software and pre-owned categories declined 8.2% and 6.2%, respectively. This likely represented the growing acceptance of digital downloading by customers (rather than making store visits to buy physical discs) as well as a less potent game release schedule compared to the prior year period. On the hardware side, sales were boosted by the March release of a new gaming console, the Nintendo Switch. The long-awaited device has been met with encouraging demand and generally favorable reviews, in our opinion. This helped generate greater store traffic and a 2.3% increase in comparable store sales for the quarter. However, this good news had an associated challenge, as allocation and supply issues for the Switch likely restrained sales somewhat.

Reflective of diversification efforts, the Technology Brands segment posted a 21.5% sales gain, with gross profit rising 31.8%. The segment includes stores such as *Spring Mobile* (authorized retailer of AT&T wireless services), *Simply Mac* (retailer of Apple products), and *Cricket* (pre-paid AT&T services and devices), as well as the wholly owned buymytronics.com online business (consumer electronics trade-in). However, store expenses related to strategic changes (such as a greater sales focus on AT&T's *DIRECTV* product) led to lower operating income compared to a year ago. This surprised us and has resulted in our lowered assumption regarding the segment's annual profit contribution and margin.

The nascent Collectibles segment continued on a growth trajectory, with 1Q sales increasing 39.1% and gross profit up 23.1%. The margin decline for the segment represented some post-holiday promotions to clear out excess inventory, among other factors. This business includes licensed-based interactive toys, apparel, and pop culture collectibles sold online and in physical retail stores. The online effort includes Geeknet, a business acquired by GME in 2015.

The segments closely related to the traditional videogame business (hardware, software, pre-owned games, accessories, and digital sales) collectively generated 70.8% of 1Q gross profit, while the newer, faster growing businesses (including the Technology Brand stores) contributed 29.2%. Moreover, reflective of the trend toward digital sales, businesses based on non-physical products and services grew to 36.1% of 1Q operating income, potentially on its way to the company's goal of 50.0% by 2019. This could have a beneficial impact on overall profit margins, in our view.

Exhibit 2**Segment Analysis** (figures in millions except percentages)

	13 Weeks Ended		% chg.
	<u>4/29/17</u>	<u>4/30/16</u>	
Sales Mix:			
New videogame hardware	\$389.9	\$312.9	24.6%
New videogame software	520.5	567.2	(8.2%)
Pre-owned videogame products	526.2	560.9	(6.2%)
Videogame accessories	176.1	162.7	8.2%
Digital	44.1	42.8	3.0%
Technology Brands stores	201.4	165.8	21.5%
Collectibles	114.5	82.3	39.1%
Other	73.2	76.9	(4.8%)
Total	<u>\$2,045.9</u>	<u>\$1,971.5</u>	3.8%
Gross Profit Mix:			
New videogame hardware	\$38.1	\$28.3	34.6%
New videogame software	113.7	127.9	(11.1%)
Pre-owned videogame products	253.7	263.2	(3.6%)
Videogame accessories	55.9	57.1	(2.1%)
Digital	36.1	37.0	(2.4%)
Technology Brands stores	144.6	109.7	31.8%
Collectibles	35.2	28.6	23.1%
Other	25.2	23.7	6.3%
Total	<u>\$702.5</u>	<u>\$675.5</u>	4.0%
Margin Analysis:			<u>bp chg.</u>
New videogame hardware	9.77%	9.04%	73
New videogame software	21.84%	22.55%	(70)
Pre-owned videogame products	48.21%	46.92%	129
Videogame accessories	31.74%	35.10%	(335)
Digital	81.86%	86.45%	(459)
Technology Brands stores	71.80%	66.16%	563
Collectibles	30.74%	34.75%	(401)
Other	34.43%	30.82%	361
Total	34.34%	34.26%	7

Source: GameStop Corp.

Note: Fiscal year ends on Saturday closest to Jan. 31

Below the operating income line, the 1Q period had a negative impact from higher interest expense and positive impacts from a lower share count and a lower tax rate. Higher interest expense reflects a March 2016 debt issue to help fund growth (primarily in the Technology Brands segment), while the share count drop reflects repurchases over the past twelve months. A share repurchase authorization remains in place; management has often noted the importance it places on this use of cash flow.

Financial condition. The balance sheet remained in decent shape, in our view. Cash and equivalents at April 29, 2017 were \$311.9 million. Inventories were at a slightly lower level than one year ago, while receivables were slightly higher. There was \$815.0 million in total debt, or 26% of total capitalization. Stockholders' equity at 1Q period end was \$2.268 billion.

Business mix transition. In fiscal 2013, GME ended the year with 6,600 videogame stores and essentially no "technology-based" stores (smartphone and mobile devices retailer and reseller). Three years later, at fiscal 2016 year end, the company operated 5,927 videogame stores and 1,522 technology-based stores. We expect this mix to continue shifting in favor of the technology stores, including more AT&T Wireless/Spring Mobile, Cricket Wireless, and Simply Mac (Apple products) stores. We support this strategy as we believe there will generally be greater demand for mobile devices (new and used) than videogames over the long term. Non-physical gaming businesses (mainly the technology brand businesses and a pop culture collectible merchandise business) produced about 40% of GME's earnings in FY16 and are expected to represent roughly 50% by FY19.

Dividends. In early March 2017, GME announced a 2.7% increase to its quarterly dividend, raising the rate a penny to \$0.38 per share. The annualized rate of \$1.52 per share represents a payout ratio of 48% based on our FY17 EPS estimate. The current yield is 6.4%. The company initiated dividends in 2012 and has raised the rate each year since. We consider the dividend well-covered by cash flow and believe management and the Board continue to place a high priority on dividend policy.

Outlook. Financial guidance for FY17 was kept at the recent level despite better than expected 1Q results. We believe this reflects several issues, including the recent change in release date of a major videogame (Take-Two Interactive Software's *Red Dead Redemption 2*) from fall 2017 to spring 2018. Other factors include higher expenses related to a strategic change in AT&T mobile stores (selling more entertainment/media services such as DIRECTV) and GME's preference for a conservative forecasting approach. Total sales are expected to be in a range of +2% to -2% compared to FY16, while comparable store sales are expected to be flat to down 5%. Diluted EPS are still expected in the range of \$3.10-\$3.40, the mid-point of which also represents a 14% decline from the FY16 figure.

We have fine-tuned our estimates, which are featured in Exhibit 3. Our revenue estimate is slightly higher based primarily on the Nintendo Switch success, offset to some degree by the delay of *Red Dead Redemption 2*. Our EPS estimate is lowered by a penny in a fine-tuning measure related to margins. We anticipate the company's transformation strategy (less videogames stores, more mobile device and collectible stores) progressing but at a declining pace following the aggressive build-up of the Technology Brand retail operation over the past year or so. We still advocate the pursuit of the transformation strategy, however. We have also initiated FY18 estimates, which include a 1% decline in sales and a modest increase in EPS, with some help from assumed share repurchases.

We project free cash flow of \$300 million for all of FY17. This is after interest payments, taxes, and capital expenditures. This would give GME significant amounts available for dividends (we project \$155 million in total payments), share repurchases (company spent \$75 million last year), and other options such as debt reduction or cash build-up. A line of credit is available should acquisitions enter the picture.

Valuation. GME is currently trading at 7.4x our FY17 EPS estimate, which is approximately the median forward multiple over the past five years. We attribute the recent history of low valuations to several factors, including concerns about future distribution of videogames (i.e. a threat to GME's core physical goods business) and uncertainties about diversification attempts (deviating from core competencies and the pace of expected contributions).

Opinion. We maintain our Neutral rating on GME. We recognize the low stock valuation and high dividend yield; however, we have been disappointed in videogame software sales for several quarters and profit contributions from the Technology Brand businesses have been a bit below our expectations.

We view GME as an important partner to videogame publishers, offering important distribution capabilities for physical goods. Navigating industry conditions has been challenging, in our view. The *Spring Mobile*, *Simply Mac*, *Cricket* and collectible merchandise stores add diversification, decent margins, and growth potential, in our view. However, the videogame business still represents the majority of revenues and profits at this point, and results there have been below our expectation for several years, with particular weakness in recent quarters. We believe the consumer trend toward digital purchasing continues to gain traction, which would seem to be a headwind for GME going forward.

For income investors, we believe GME continues to have merit. The current yield of 6.4% considerably exceeds applicable industry, sector, and market yields. Importantly, we consider dividend coverage adequate at this time. The payout ratio is 48% based on our FY17 EPS estimate. In addition, projected total payments of \$155 million for the current year compares to \$300 million in projected free cash flow. Finally, we note the recent cash balance of \$311 million.

GME shares are down 18% over the past twelve months compared to a 16% rise for the S&P 500, as investors have reacted to the challenges at hand. We do not anticipate much capital appreciation for the stock in the coming year, at least until the Technology Brands retail segment improves its cost structure and grows as a percentage of the total company.

Asset value, and the related price-to-book value multiple, could offer some support to GME at current levels, in our view. However, future asset values could change to some degree should impairment charges (potentially those related to store rationalization) occur, as they did last year.

Suitability. Our Suitability rating on GME is 4 (on a 1-to-4 scale with 1=most conservative and 4=most aggressive). This reflects consumer buying behavior trends in a digital world, the related impact on GME's store traffic, and the company's integration of, and growth plans for, non-videogame businesses. Our rating also reflects a recent debt issue.

Risks. Competitive entry in the used game business and digital downloading of content by consumers have been common concerns among investors in the past. To date, management has not seen an adverse impact from competitive entry into the used game business. Digital downloading of videogames is likely to continue growing each year, in our view, thus causing pressure on the company's traditional physical goods business. GME and the industry's major game publishers continue to work together to develop the retailer's role in the marketing and selling of both physical and digital content.

Planned declines in the company's sizable videogame retailing store base with a concurrent increase in the smartphone/mobile device/satellite retailing business represents a change in focus from GME's background. There is no assurance that the company's acumen in the former will transfer to the latter.

Other risk factors associated with investments in GameStop include changes or delays in publishers' release schedules; relationships with publishers, distributors, and hardware manufacturers; lease terms for stores; cyclicity of industry sales; macroeconomic risk; dependence on holiday sales; ability to negotiate and integrate acquisitions; and geopolitical risks to international operations.

Exhibit 3**Consolidated Statements of Income** (figures in millions except per share data and percentages)

	2014	2015	2016	2017E	2018E
Net Sales	\$9,296.0	\$9,363.8	\$8,607.9	\$8,595.0	\$8,500.0
Cost of Sales	6,520.1	6,445.5	5,598.6	5,572.0	5,495.0
Gross Profit	2,775.9	2,918.3	3,009.3	3,023.0	3,005.0
Asset Impairment	2.2	4.6	33.8	0.0	0.0
SG&A Exp.	2,001.0	2,108.9	2,252.6	2,320.0	2,297.0
EBITDA	772.7	804.8	722.9	703.0	708.0
Deprec. & Amort.	154.4	156.6	165.2	154.0	156.0
Operating Income	618.3	648.2	557.7	549.0	552.0
Interest Inc. & Other (Exp.), net	10.0	23.0	53.0	59.0	57.0
Income Before Taxes	608.3	625.2	504.7	490.0	495.0
Provision for Taxes	215.2	222.4	151.5	172.7	174.5
Net Income, GAAP	393.1	402.8	353.2	317.3	320.5
Non-GAAP Adjustments	(0.7)	12.8	37.7	5.0	0.0
Net Income, Adjusted	\$392.4	\$415.6	\$390.9	\$322.3	\$320.5
Diluted EPS, Adjusted	\$3.47	\$3.90	\$3.77	\$3.19	\$3.22
Wtd. Diluted Shares Outst.	113.2	106.7	103.8	101.0	99.5
As a % of Net Sales					
Gross Profit	29.86%	31.17%	34.96%	35.17%	35.35%
SG&A Exp.	21.53%	22.52%	26.17%	26.99%	27.02%
EBITDA	8.31%	8.59%	8.40%	8.18%	8.33%
Operating Income	6.65%	6.92%	6.48%	6.39%	6.49%
Net Income, Adjusted	4.22%	4.44%	4.54%	3.75%	3.77%
Tax Rate	35.38%	35.57%	30.02%	35.25%	35.25%
Yr-Over-Yr Growth Rates:					
Net Sales	2.8%	0.7%	(8.1%)	(0.1%)	(1.1%)
Gross Profit	4.3%	5.1%	3.1%	0.5%	(0.6%)
EBITDA	0.5%	4.2%	(10.2%)	(2.8%)	0.7%
Operating Income		4.8%	(14.0%)	(1.6%)	0.5%
Net Income, Adjusted	10.2%	5.9%	(5.9%)	(17.6%)	(0.5%)
Diluted EPS, Adjusted	15.3%	12.4%	(3.3%)	(15.3%)	1.0%
Store Count:					
Videogame Stores, period end	6,211	6,064	5,927	5,800	5,700
Yr-over-yr store count % chg.	(5.9%)	(2.4%)	(2.3%)	(2.1%)	(1.7%)
Comparable-store sales % chg.	3.4%	4.3%	(11.0%)	(3.0%)	(2.5%)
Tech-based stores, period end	484	1,036	1,522	1,590	1,700
Collectibles stores, period end			86	120	150

Source: GameStop Corp. and Hilliard Lyons estimates

Note: Fiscal year ends on Saturday closest to Jan. 31

Additional information is available upon request.

Prices of other stocks mentioned: Apple Inc. - AAPL - \$153.87 - Long-term Buy
 AT&T Inc. - T - \$38.23 - Buy
 Nintendo Co. Ltd - NTDOY - \$35.95
 Take-Two Interactive Software - \$78.53 - Neutral

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history

2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	26%	13%	88%
Hold/Neutral	79	64%	8%	92%
Sell	12	10%	0%	100%

As of 8 May 2017



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities. Reproduction is forbidden unless authorized. All rights reserved.