HILLIARD LYONS

Entertainment & Leisure
Analyst: Jeffrey S. Thomison, CFA
502.588.9137 / JThomison@hilliard.com
Institutional Sales Desk: George Moorin
502.588.9141 / GMoorin@hilliard.com
J.J.B. Hilliard, W.L. Lyons, LLC
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COMPANY UPDATE / ESTIMATE CHANGE

GameStop Corp.

GME — NYSE — Neutral-4

3Q Results Were Better Than Expected

Key Metrics

GME - NYSE (as of 11/24/17)		$17.42
Price Target		N/A
52-Week Range		$15.85 - $26.84
Shares Outstanding (mil)		101.4
Market Cap. ($mil)		$1,766
3-Mo. Average Daily Volume		2,810,000
Institutional Ownership		99%
Total Debt/Total Capital (10/17)		26%
ROE (TTM ended 10/17)		17%
Book Value/Share (10/17)		$22.82
Price/Book Value		0.8x
Annual Dividend Rate & Yield	$1.52	8.7%
EBITDA Margin (TTM ended 10/17)		8%

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		$0.15	A		
3Q	$0.49		$0.54	A		
4Q	$2.38	$2.02	$1.93			
Year	$3.77	$3.20	$3.25		$3.30	$3.10
P/E ~	4.6x		5.4x			5.6x

*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		$1,688	A		
3Q	$1,959		$1,989	A		
4Q	$3,045	$3,040	$3,178			
Year	$8,608	$8,700	$8,900		$8,625	$8,700

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 over 7,500 total stores in 14 countries. This included 3,869 U.S. videogame stores, 1,985 international videogame stores, 1,506 technology brand stores, and 102 collectible stores.*

Investment Highlights

- **There were pros and cons to 3Q sales, in our view.** Net sales increased 1.5% from the year ago period to $1.989 billion, better than the street consensus expectation of flat sales. Videogame hardware sales rose due largely to Nintendo's popular *Switch* console, while videogame software rebounded from past declines with a solid gain due perhaps to better game releases. Non-videogame segments were mixed, with lower results from the Technology Brands stores and considerable growth from the Collectibles business.
- **Profits exceeded expectations.** Gross margin declined due to a shift in the sales mix (more hardware) and lower profitability at the Technology Brands segment. SG&A expenses were well contained, in our view. Adjusted EPS, excluding nonrecurring items, were $0.54 compared to $0.49 a year ago. The street consensus estimate was $0.42, while our estimate was $0.40. However, a lower tax rate added $0.11 to the recent EPS figure.
- **Earnings guidance for FY17 was maintained.** This includes projected EPS of $3.10-$3.40. We have fine-tuned our financial outlook, which includes a projected 19% EPS decline for the remaining quarter of the fiscal year. This reflects some challenges related to supply constraints and expenses at the Technology Brands stores as well as pressure on physical videogame sales (new and pre-owned) due to ongoing industry trends.
- **We maintain our Neutral rating.** Given the low valuation and high dividend yield, we are somewhat attracted to GME shares. However, offsetting factors to us include industry trends related to consumers' growing comfort in downloading videogame content (entire games and incremental follow-on content) and mixed results from the business diversification strategy. We consider the dividend, currently yielding 8.7%, adequately covered by cash flow at this time.

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			39 Weeks Ended		
	10/28/17	10/29/16	% chg.	10/28/17	10/29/16	% chg.
Net Sales	1,988.6	1,959.2	1.5%	5,722.1	5,562.5	2.9%
Cost of Sales	1,299.2	1,251.0	3.9%	3,706.5	3,561.1	4.1%
Gross Profit	689.4	708.2	(2.7%)	2,015.6	2,001.4	0.7%
Selling, Gen. & Admin. Exp.	565.1	567.1	(0.4%)	1,671.0	1,606.3	4.0%
Depreciation & Amort.	36.7	42.3	(13.2%)	112.3	124.0	(9.4%)
Operating Income	87.6	98.8	(11.3%)	232.3	271.1	(14.3%)
Interest Expense, net	13.9	14.8	(6.1%)	42.2	39.2	7.7%
Income Before Taxes	73.7	84.0	(12.3%)	190.1	231.9	(18.0%)
Taxes	14.3	33.2	(56.9%)	49.5	87.4	(43.4%)
Net Income	59.4	50.8	16.9%	140.6	144.5	(2.7%)
GAAP Diluted EPS	$0.59	$0.49	19.8%	$1.39	$1.39	(0.1%)
Non-GAAP Diluted EPS	**$0.54**	**$0.49**	**10.2%**	**$1.32**	**$1.41**	**(6.4%)**
Diluted Shares Outst.	101.5	104.0	(2.4%)	101.5	104.2	(2.6%)
As a % of Net Sales:						
Gross Profit	34.67%	36.15%	(148)	35.22%	35.98%	(76)
Selling, Gen. & Admin. Exp.	28.42%	28.95%	(53)	29.20%	28.88%	33
Depreciation & Amort.	1.85%	2.16%	(31)	1.96%	2.23%	(27)
Operating Income	4.41%	5.04%	(64)	4.06%	4.87%	(81)
Net Income	2.99%	2.59%	39	2.46%	2.60%	(14)
Tax Rate	19.40%	39.52%	(2,012)	26.04%	37.69%	(1,165)

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

Additional comments on recent results. The 3Q period produced improved sales from the core videogame categories, including new hardware and software. We feel this reflects successful new product releases in each category. The high-margin pre-owned software category was down in sales and profits. On the hardware side, sales were likely positively impacted by continued success of Nintendo's *Switch* device, which debuted in March 2017. This likely helped generate a 1.9% increase in comparable store sales for the quarter (positive in both the U.S. and internationally).

Representing a major diversification initiative, the Technology Brands segment posted a 10.2% decline in sales and an 11.4% drop in gross profit. This 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). Challenges in the quarter included a later-than-expected release of Apple's iPhone X, resulting in lower store traffic, and a change in AT&T's dealer compensation structure. Excluding nonrecurring items, such as acquisition-related costs and store closure costs, adjusted operating earnings from the Technology Brands segment declined 52% in the quarter to $11.2 million.

The nascent Collectibles segment (recently 102 stores) continued on a growth trajectory, with 3Q sales increasing 26.5% and gross profit up 32.7%. This business includes licensed-based interactive toys, apparel, and pop culture collectibles sold online and in physical retail stores, with a meaningful portion of the product line represented by exclusive licenses. The online effort includes ThinkGeek/Geeknet, a business acquired by GME in 2015.

Exhibit 2
3Q FY17 - Segment Analysis (figures in millions except percentages)

	13 Weeks Ended		
	10/28/17	**10/29/16**	**% chg.**
Sales Mix:			
New Videogame Hardware	$309.5	$284.4	8.8%
New Videogame Software	649.9	616.6	5.4%
Pre-owned & Value	458.5	470.0	(2.4%)
Videogame Accessories	136.4	156.0	(12.6%)
Digital	37.2	44.7	(16.8%)
Technology Brands	194.2	216.3	(10.2%)
Collectibles	138.4	109.4	26.5%
Other	64.5	61.8	4.4%
Total	$1,988.6	$1,959.2	1.5%
Gross Profit Mix:			
New Videogame Hardware	$36.8	$37.3	(1.3%)
New Videogame Software	155.9	150.0	3.9%
Pre-owned & Value	199.7	218.0	(8.4%)
Videogame Accessories	48.5	49.6	(2.2%)
Digital	34.1	35.0	(2.6%)
Technology Brands	141.4	159.6	(11.4%)
Collectibles	52.7	39.7	32.7%
Other	20.3	19.0	6.8%
Total	$689.4	$708.2	(2.7%)
Margin Analysis:			**bp chg.**
New Videogame Hardware	11.89%	13.12%	(123)
New Videogame Software	23.99%	24.33%	(34)
Pre-owned & Value	43.56%	46.38%	(283)
Videogame Accessories	35.56%	31.79%	376
Digital	91.67%	78.30%	1,337
Technology Brands	72.81%	73.79%	(97)
Collectibles	38.08%	36.29%	179
Other	31.47%	30.74%	73
Total	34.67%	36.15%	(148)

Note: 39-week results are not immediately available due to recent segment reclassifications

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

Below the operating income line, the 3Q period benefited from an unusually low tax rate that reflected the settlement of discrete tax items. In addition, the weighted average share count was 2.4% lower due to past repurchases. We expect buybacks to continue in future quarters.

Financial condition. The balance sheet remained in decent shape, in our view. Cash and equivalents at October 28, 2017 were $454.7 million. Inventories and receivables were at higher levels than one year ago, a function of the industry cycle and a compelling array of products. There was $817.2 million in total debt, or 26% of total capitalization. Stockholders' equity at 3Q period end was $2.313 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). At the recent quarter's end, the company operated 5,854 videogame stores and 1,506 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. However, as experienced in 3Q, performance from these stores can be erratic due to industry factors such as the timing of new product releases and supply constraints (especially with new iPhone models).

Dividends. In 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 47% based on our FY17 EPS estimate of $3.25. The current yield is 8.7%. The company initiated dividends in 2012 and has raised the rate each year since, recently in March of each year. However, we believe the current rate may be maintained when the Board next addresses the dividend in March 2018. At this time, we consider the dividend sufficiently covered by cash flow and believe management and the Board will continue to place a high priority on dividend policy.

Outlook. Management's updated financial guidance included comparable stores sales gain in the low-to-mid single digit range (improved from previous guidance) and adjusted EPS of $3.10-$3.40 (unchanged from previous guidance). This reflects a likely EPS decline in 4Q due to the videogame release schedule in December (softer than last year), trends of content downloading at home, and continuing challenges with the Technology Brands stores.

We have fine-tuned our estimates, which are featured in Exhibit 3. Our FY17 revenue estimate is raised by $200 million higher based primarily on 3Q results and a brighter holiday outlook for the Collectibles business. Our annual EPS estimate is increased by $0.05 to $3.25. We anticipate the company's transformation strategy (fewer videogames stores, more mobile device and collectible stores) progressing but at a declining pace following the past aggressive build-up of the Technology Brands retail operation and recent challenges. We still advocate the pursuit of the transformation strategy, however.

We have also updated our FY18 estimates, which include a $75 million increase to our sales estimate mainly due to greater assumptions in the Collectibles business segment. However, our EPS estimate is lowered by $0.20 to $3.10 after updates to our expense and margin forecast, particularly with the videogame retail business and the Technology Brands stores.

We project free cash flow of roughly $300 million in FY17. This is after interest payments, taxes, and capital expenditures. This would give GME significant amounts available for dividends (we project $153 million in total payments), share repurchases (company spent $75 million last year), and other options such as debt reduction, cash build-up, or acquisitions. A line of credit is available, and was recently amended with improved terms, a longer maturity, and increased capacity.

Valuation. GME is currently trading at 5.5x our estimate of forward twelve-month earnings. This is a bit lower than the stock's median forward multiple over the past few years, but not extensively. 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), the potential for a downward trend in annual earnings, and uncertainties associated with diversification attempts. Such uncertainties could relate to deviating from core competencies, managing new businesses, and forming expectations regarding contributions from those businesses.

Opinion. We maintain our Neutral rating on GME. We recognize the low stock valuation and high dividend yield; however, we are mindful of significant challenges such as the strengthening trend of downloading videogame content and challenges of transforming the company to become more diversified.

For income investors, we believe GME continues to have merit. The current yield of 8.7% considerably exceeds comparable industry, sector, and market yields. Importantly, we consider dividend coverage adequate at this time. The payout ratio is 47% based on our FY17 EPS estimate. In addition, projected total payments of $153 million for the current fiscal year compares to roughly $300 million in projected free cash flow. Finally, we note the recent cash balance of $454 million.

We do not anticipate much capital appreciation potential for the stock in the year ahead, unless earnings can break from projected low or no growth conditions. 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; cyclicality 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	*$8,900.0*	*$8,700.0*
Cost of Sales	6,520.1	6,445.5	5,598.6	*5,850.9*	*5,728.1*
Gross Profit	2,775.9	2,918.3	3,009.3	*3,049.1*	*2,971.9*
Nonrecurring Items	2.2	4.6	33.8	*(6.0)*	*0.0*
SG&A Exp.	2,001.0	2,108.9	2,252.6	*2,360.0*	*2,304.0*
EBITDA	772.7	804.8	722.9	*695.1*	*667.9*
Deprec. & Amort.	154.4	156.6	165.2	*153.0*	*150.0*
Operating Income	618.3	648.2	557.7	*542.1*	*517.9*
Interest Inc. & Other (Exp.), net	10.0	23.0	53.0	*59.0*	*56.0*
Income Before Taxes	608.3	625.2	504.7	*483.1*	*461.9*
Provision for Taxes	215.2	222.4	151.5	*149.8*	*152.4*
Net Income, GAAP	393.1	402.8	353.2	*333.4*	*309.5*
Non-GAAP Adjustments, net	(0.7)	12.8	37.7	*(4.0)*	*0.0*
Net Income, Adjusted	$392.4	$415.6	$390.9	*$329.4*	*$309.5*
Diluted EPS, Adjusted	**$3.47**	**$3.90**	**$3.77**	***$3.25***	***$3.10***
Wtd. Diluted Shares Outst.	113.2	106.7	103.8	*101.3*	*99.8*
As a % of Net Sales					
Gross Profit	29.86%	31.17%	34.96%	*34.26%*	*34.16%*
SG&A Exp.	21.53%	22.52%	26.17%	*26.52%*	*26.48%*
EBITDA	8.31%	8.59%	8.40%	*7.81%*	*7.68%*
Operating Income	6.65%	6.92%	6.48%	*6.09%*	*5.95%*
Net Income, Adjusted	4.22%	4.44%	4.54%	*3.70%*	*3.56%*
Tax Rate	35.38%	35.57%	30.02%	*31.00%*	*33.00%*
Yr-Over-Yr Growth Rates:					
Net Sales	2.8%	0.7%	(8.1%)	*3.4%*	*(2.2%)*
Gross Profit	4.3%	5.1%	3.1%	*1.3%*	*(2.5%)*
EBITDA	0.5%	4.2%	(10.2%)	*(3.8%)*	*(3.9%)*
Operating Income		4.8%	(14.0%)	*(2.8%)*	*(4.5%)*
Net Income, Adjusted	10.2%	5.9%	(5.9%)	*(15.7%)*	*(6.0%)*
Diluted EPS, Adjusted	15.3%	12.4%	(3.3%)	*(13.7%)*	*(4.6%)*
Store Count:					
Videogame Stores, period end	6,211	6,064	5,927	5,830	5,725
Yr-over-yr store count % chg.	(5.9%)	(2.4%)	(2.3%)	(1.6%)	(1.8%)
Comparable-store sales % chg.	3.4%	4.3%	(11.0%)	3.0%	(2.0%)
Tech-based stores, period end	484	1,036	1,522	1,525	1,550
Collectibles stores, period end			86	110	140

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 - $174.97 - Long-term Buy
AT&T Inc. - T - $34.81 - Buy
Nintendo Co. Ltd - NTDOY - $52.55

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

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	29%	13%	88%
Hold/Neutral	73	65%	7%	93%
Sell	7	6%	0%	100%

As of 8 November 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

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