Company Name: **GameStop Corp**
Company Ticker: **GME**
Sector: **Services**
Industry: **Retail**

Event Description: **Q3 2015 Earnings Call**
Market Cap as of Event Date: **4.14B**
Price as of Event Date: **37.61**

Gamestop (GME) Earnings Report: Q3 2015 Conference Call Transcript

The following Gamestop conference call took place on November 23, 2015, 11:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Paul Raines; GameStop Corp. ; CEO
- Tony Bartel; GameStop Corp. ; COO
- Rob Lloyd; GameStop Corp. ; EVP & CFO

Other Participants

- Mike Olson; Piper Jaffray ; Analyst
- Arvind Bhatia; Sterne Agee ; Analyst
- Seth Sigmund; Credit Suisse ; Analyst
- Colin Sebastian; Robert W. Baird ; Analyst
- Brian Nagel; Oppenheimer & Co. ; Analyst
- Curtis Nagle; Bank of America Merrill Lynch ; Analyst
- David Magee; SunTrust Robinson Humphrey ; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to GameStop Corporation's third-quarter 2015 earnings conference call.

A supplemental slide presentation is available at investor.GameStop.com.

(Operator Instructions)

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

Paul Raines (CEO):

Thank you, operator. Welcome to the third-quarter earnings call for GameStop. We thank our associates around the world for their efforts this quarter and especially want to recognize our associates at Micromania in France for the challenges they are facing. All of GameStop stands with you. We are watching events in France and Europe carefully and we will react as events unfold.

Joining me today on our call our Rob Lloyd, Chief Financial Officer; Tony Bartel, Chief Operating Officer; Mike Mauler, President of International; Mike Hogan, Executive Vice President of Strategic Business; Mike Buskey, President of US Stores; and Matt Hodges, our Vice President of Public and Investor Relations.

While diluted earnings per share was within our range, the quarter was challenging due to underperformance of Halo and Assassin's Creed late in the quarter and lack of sales acceleration from hardware price cuts during the quarter. There has been some discussion of Halo being a large full game download title, but our research indicates it performed at about the same level as other titles. Tony will reconcile that data in his remarks.

On a more positive note, our pre-owned business had another good growth quarter at 4.9%, well ahead of overall software growth. In constant currency, this marks the seventh consecutive quarter of positive growth for pre-owned. We expect pre-owned to be at plan this year with solid growth in the fourth quarter.

Our digital business grew 13.8% in constant currency and is on track to achieve over $1 billion in receipts this year. Our collectibles or Loot business also had nice growth on track for reaching $300 million in sales this year and expanding our gross margin rate by 150 basis points in the other category. We also now have 22 Loot stores open around the world and two ThinkGeek stores in the US, one in Orlando, Florida and one in Palisades, New York. A third ThinkGeek store will open soon right here in Texas.

Tech Brands continues to expand rapidly as we invest to build toward our goal of $1.5 billion in revenues by 2019. During the quarter, sales grew 64% and helped drive gross profit dollar growth of 81% in the mobile and consumer electronics segment.

We acquired 21 AT&T reseller stores during this quarter and another 87 at the beginning of the fourth quarter. Reseller acquisitions for the year totaled 239 stores or $112 million. We continue to seize opportunities to grow this business by reinvesting into more acquisitions in the highly fragmented dealer space. Our relationships with AT&T and Apple are strong.

Overall, we believe GameStop's redeployment of cash flows from our video games businesses into adjacent retailing categories is the right strategy. This strategy builds on our core competencies in real estate, human talent, ability to deploy capital effectively, buy, sell, trade and PowerUp Rewards.

In total, revenues from non-physical gaming now comprise 17% of sales and 26% of gross profit, up from 23% last quarter and these areas continue to grow rapidly. Over the last couple of weeks, we have seen some disruption in our shares, but we encourage investors to stay the course. GameStop achieved record third-quarter gross profit and we expanded our gross margin 280 basis points on the strength of non-videogame categories.

Since November 2013, our overall gross margin rate has expanded by 400 basis points. GameStop continues to have dominant share in the videogame space and we are focused on continuing to generate positive returns through diversification into other attractive segments. We have reconfirmed guidance for the fourth quarter and are fully prepared for the upcoming holiday season. I will now turn the call over to Rob.

Rob Lloyd (EVP & CFO):

Thank you, Paul. Good morning. We are in the room here getting a lot of air conditioner noise or heating noise. If that's coming through, I apologize for that. I will start today by covering the results of the third quarter. Sales decreased 3.6% in the quarter, but grew 1.2% excluding FX. Comparable store sales decreased 1.1% due primarily to slower-than-expected hardware sales. Gross margins expanded 280 basis points on the strength of growth and margin expansion in mobile and collectibles.

SG&A as a percentage of sales increased from 23.6% in the prior-year quarter to 26.1% due to investments supporting Tech Brands' expansion. I will provide more color on that shortly.

Interest expense increased $3.4 million because the $350 million in debt was outstanding for the entire quarter this year versus a few weeks last year. Adjusted net income decreased 11.4% and adjusted EPS decreased 5.3% due to the decrease in sales and gross profit in the videogame segment and due to investments supporting Tech Brands' expansion.

Foreign currency movement reduced sales by approximately $100 million and reduced EPS by $0.02 when compared to last year.

Now I will recap sales and margin during the quarter for some of the categories. Hardware sales decreased 20.4% or 15.4% excluding FX because of the reduction in price on the PS4 in October and the Xbox 1 late last year and because of the overlap of the Destiny bundle, which drove a 147% increase in new hardware in Q3 2014. Software sales declined 9.3%, or 4.2% excluding FX, because of the overlap of Destiny.

Pre-owned revenue grew 0.6% or plus 4.9%, excluding FX, as we saw continued growth in next-gen pre-owned hardware and software. Pre-owned margin rates were 46.0%, at the high end of the guidance we gave on our last call. Digital receipts on a non-GAAP basis grew 8.7%, or 13.8% excluding FX, to $228.6 million for the quarter. As we said in the release, growth was led by sales of digital content for Destiny The Taken King. GAAP digital revenues declined 27.1% year-over-year due to FX impact and because of accounting for Kongregate on a net commission basis. We will overlap that change in accounting for Kongregate in the fourth quarter.

Mobile revenues increased 31.1%, driven by a 64.2% growth in our Technology Brands revenues to $140.1 million. And gross margins increased from 40.1% in Q3 last year to 55.4% as Tech Brands becomes a greater portion of the mix in this category and as margin rates in the Tech Brands business continue to expand.

We continue to invest in Tech Brands' store growth. During the third quarter, we incurred $5.9 million in preopening costs for the 79 stores opened and the 40 or so stores to be opened during the fourth quarter. The RadioShack and GameStop conversions are taking longer than we anticipated to open and the payroll carrying costs, pre-opening rent and normal ramp to store profitability are impacting our Tech Brands results. As a result, the $6.5 million of operating income generated was less than we expected, an EPS impact of $0.02 to $0.03, but we expect significant profit growth from Tech Brands in the fourth quarter as the bulk of the openings and conversions are behind us.

Revenues in the other category increased 60.8% to $138.3 million, driven by sales of interactive toys and the growth of our collectibles business. Some other data points are as follows. We closed a net of 19 videogame stores around the world. We opened eight collectibles stores during the quarter. We repurchased $44.9 million in stock in the quarter, or 1.02 million shares at an average price of $43.85.

Now let's move onto fourth-quarter guidance. As stated in our earnings release, we expect same-store sales to range from negative 1% to plus 6% and revenue growth to range from flat to plus 6%. Changes in foreign currency rates are expected to negatively impact revenues by $120 million when compared to the fourth quarter of last year and will negatively impact EPS by approximately $0.02 to $0.03 more than we planned earlier this year. We expect to continue to expand gross margins compared to the prior-year quarter as our mobile and collectibles businesses continue to grow. As I stated earlier, operating earnings for Tech Brands are expected to grow significantly in the fourth quarter.

We are guiding EPS for the fourth quarter to range from $2.12 to $2.32 per share and reiterating our full-year guidance of $3.66 to $3.86 per share. You should model 106 million shares outstanding for the fourth quarter and 107 million for the full year based on buybacks through the end of the third quarter. For the full year, total revenues are now expected to range from flat to positive 3% and same-store sales are now expected to range from positive 2% to positive 6%. I will now turn it over to Tony for his comments.

Tony Bartel (COO):

Thank you, Rob. As Paul mentioned, new hardware sales slowed in the final month of the quarter causing us to miss our comp guidance. We have seen that rebound in the week since as consumers waited for games such as Activision's Call of Duty

The recent launches of Activision's Call of Duty Black Ops 3 and Bethesda's Fallout 4 met our initial expectations while EA's Star Wars Battlefront fell short of expectations. Our pre-owned sales grew 4.9% during the quarter before the impact of FX, outpacing overall sales by 3.7 points and new software sales by 9.1 points. In addition, we accomplished this growth with minimal promotional activity, generating a higher-than-expected 46% margin rate for our pre-owned business.

We have provided slide 15 in our investor packet, which shows the variance in growth rates of the new and pre-owned US segments for next-generation and current generation software. As you can see, pre-owned sales growth on next-generation software of 88% outpaced new software growth of 38%. Likewise, the sales decline on current generation pre-owned software of 27% was less than the decline in new software of 65%.

Consumers are using our trade promotions to fund their purchases of new software and hardware, providing us with a strong inventory position of in-demand games and hardware. Our PS4 and Xbox 1 pre-owned inventory has grown 44% compared to where it was this time last year. This gives us the opportunity to provide more value through promotions in the fourth quarter. We expect to end the year with pre-owned growth in the mid-single digits before FX for the full year.

Our non-GAAP digital receipts grew 13.8% prior to FX and 8.7% after FX and we remain on track to deliver $1 billion of digital receipts for the full year. Downloadable content of Destiny The Taken King and Steam Wallet revenues provided the majority of the growth during the quarter.

The Microsoft announcement that they had sold $400 million of Halo 5, coupled with an NPD report that only reported $119 million of US Halo merchandise, has caused some to posit that digital sales were much higher on this title than on other previous launches. We are in constant discussion with all publishers and platform holders and we believe that all major full game titles launched in this quarter were in line with previously announced digital download levels.

The variance to NPD is reconciled by global sales not reported by NPD, a broader inclusion of SKUs beyond those tracked by NPD, two additional days of sales in Microsoft's announcement period versus NPD's reporting period and sales that were reported by publishers, but not reported by retailers.

I will now share some data and color about the performance of our non-gaming segments. Our high-growth categories such as digital, Loot and Technology Brands grew convincingly during the quarter and now represent more than one quarter of our Q3 gross margin dollars. In the quarter, Loot was our fastest-growing sales category with global sales increasing by 384% versus prior year. Loot also helped drive an increase in store traffic, customer basket size and gross margin rate. We expect this category to grow to $300 million in sales for the fiscal year.

This rapid growth is being driven by leveraging our newly acquired ThinkGeek business, securing a growing number of exclusive products and having a broad assortment of well-known IP such as Star Wars, Call of Duty and Fallout that have strong appeal with our customer base.

During the quarter, we made great strides in integrating ThinkGeek's capabilities into GameStop's growing omnichannel business. And we continue to expand Zing stores internationally and in the US under the ThinkGeek brand name, ending the quarter with 22 stores, including one in the US. We expect to end fiscal 2015 with approximately 37 stores worldwide.

Our Technology Brands stores are offering the hottest technology this holiday season and providing great service. In addition to our rapid growth, we continue to be the most productive AT&T dealer, as well as a top-performing authorized Apple reseller. As of the end of the third quarter, we had 834 Technology Brands stores, an increase of 104% over Q3 of 2014. Including two acquisitions that we closed on November 1, we've opened 193 new stores consisting of RadioShack conversions, GameStop conversions and greenfield stores and acquired 239 stores year-to-date.

Given the constantly changing nature of compensation programs from our partners, the best way to understand growth in the Technology Brands segment is to look at gross profit dollars. During Q3, Tech Brands drove the 81% gross profit dollar growth in the mobile and CE category. We expect for gross profit dollars to increase between 85% and 95% in the fourth quarter.

In closing, we see solid demand for our videogame products during the fourth quarter and are digital, Loot and Technology Brands businesses will provide sales and profit growth, giving us confidence to achieve our fourth-quarter guidance and to provide strong growth for 2016 as well. With that, I will turn the call back to you, Paul.

Paul Raines (CEO):

Thank you, Tony and with that, operator, I would say let's open up the call to questions and answers.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Mike Olson, Piper Jaffray.

Mike Olson (Analyst - Piper Jaffray):

One quick question, really.

You mentioned some weakness for certain titles versus other titles kind of coming in plan so far. Could you specifically quantify the weakness of the Star Wars launch relative to your expectations, or at least kind of qualitatively?

Was it materially below what you were expecting? Or just slightly below what you were expecting?

Paul Raines (CEO):

Sure. Tony.

Tony Bartel (COO):

Mike, we are not going to quantify it in actual numbers, but we had high expectations that diminished somewhat as it got closer and then it failed to hit those lowered expectations.

Mike Olson (Analyst - Piper Jaffray):

Okay, got it. And then I guess while I have you, just on the digital front, it sounds like what you are saying it's Halo, those numbers that we were hearing of maybe 50% of the game coming in digital may not be accurate. And then you mentioned that you think it is coming in more with what we've seen average for other titles. By average, are you talking about kind of the 20% or 25%-ish numbers that we've been hearing for some of the other titles?

Paul Raines (CEO):

Yes, I think that would be very similar to what we've heard in the other titles. Tony has got some information on this I think you ought to hear as well.

Tony Bartel (COO):

Yes, I have more information than I can share, but let me reiterate that we constantly talk with platform holders and with publishers and we have a very good read and understanding of all titles at launch. We can't share that specific information.

Here's what I would say though. In the past, we know that certain publishers and platform holders have reported sell-in and some have even reported sell-in at retail. I'm not saying that that has happened in this case, but that has happened in the past. And so I think I would definitely go back and talk to Microsoft about their announcement as they are the only ones who can comment on that.

Second, they definitely understand exactly what their digital percentage was. They know exactly what they sold and they know exactly what was sold digitally. So again, I would encourage you to go back and ask Microsoft to disclose that number. But, again, we talk with platform holders and publishers constantly. We have again this quarter and we are in full understanding and full belief that there is no game that was launched this quarter that was materially above a normal digital percent at launch.

Mike Olson (Analyst - Piper Jaffray):

Thank you.

Operator:

Arvind Bhatia, Sterne Agee.

Arvind Bhatia (Analyst - Sterne Agee):

Okay, thank you very much. I guess taking that line of thinking a little bit further, what do you think is your marketshare in Vista downloads? And then how do you become more of a destination place for digital downloads just as you have in so many other categories over the years? Particularly in downloadable content, you guys have done so well. How do you convert that success into digital downloads?

And then also looking further out to 2016 -- again, maybe this is for Tony -- how do we think about the titles that are coming out? What are your thoughts on hardware, just the industry in general and then also tying it back to the digital question, how do you see that progressing? Thank you.

Paul Raines (CEO):

Let me start us off here, Arvind. I would say that remember that we are a player in digital downloads. You don't do $228 million of digital receipts without having technologies, APIs, relationships and all those things that you need to sell digital downloads. Tony, maybe you want to talk about some of the intelligence you have in DFC on this subject?

Tony Bartel (COO):

Sure. Yes, let me share some of that, Arvind. We don't give out specific marketshare of digital downloads or digital receipts simply because it's really difficult to find that information out. But let me give you some information from DFC, which we've quoted before. We find it to be one of the most credible sources when we go to look at digital share. According to DFC, in the third quarter, digital AAA sales for $60 game releases increased 6% over last year. So 6% in total and it represented only 9% of the total AAA sales mix. So that's coming from a source that we find very credible, so it grew 6% off of a very small base. So that's some of the information that we see. So we don't have our marketshare specifically, but again we do have a good understanding from talking with the publishers and the platform holders and we seem to be -- that seems to be in line with this information.

Paul Raines (CEO):

And you know the difficulty, of course, here is that digital is a complex animal and people -- every publisher measures it in slightly different ways, etc. So Rob, you have something you want to add on this?

Rob Lloyd (EVP & CFO):

2016?

Paul Raines (CEO):

Oh, the 2016 titles, right?

Tony Bartel (COO):

I can talk about -- the titles that are coming up, we've got -- very excited about Street Fighter 5 and The Division, Uncharted 4. So those are some that we are very excited about. We've got Star Fox Zero coming out as well. Those are the ones that we can kind of see and are pretty well locked. I am very excited about that. We anticipate that digital is going to continue to grow and remember that we grew 14% before FX, which is right in line with where the publishers grew. So we continue to see our digital continue to march forward at about the same rate that the publishers have seen their digital grow.

Arvind Bhatia (Analyst - Sterne Agee):

Then one last one from me. As you looked at your full-year guidance, given some of the weakness you cited on the titles, I was wondering what went into your thinking and not kind of giving yourself some more room and maybe tightening up the guidance a little bit now that we are a week away from Thanksgiving, I guess and you have a fairly good idea of the traffic trends, etc. Just wondering just the confidence level and the forecast for Q4.

Tony Bartel (COO):

Just to clarify, first of all, Arvind, we mentioned two titles that met our expectations and one that fell below. So I would not say that we feel like there's general weakness in the titles. I will let Rob comment on the guidance.

Rob Lloyd (EVP & CFO):

Yes, I think it's important to remember that the results of the third quarter, while $0.05 below consensus, really for us amounts to about $5 million. With 60% or so of our earnings to be made in the fourth quarter, we believe it's not that difficult to make up that $5 million. And so that's, I think, the principle reason behind the guidance range we gave.

Arvind Bhatia (Analyst - Sterne Agee):

Okay, great. Thank you, guys and all the best.

Operator:

Seth Sigmund, Credit Suisse.

Seth Sigmund (Analyst - Credit Suisse):

Okay, thanks for taking the question. A couple questions here, mostly focused on the investments you are making as you try to diversify the business. I guess one, just trying to understand the core SG&A growth this quarter, how to think about that over the medium term. So when I look at SG&A this quarter, it was up over 9%. What would that look like if you exclude Tech Brands and ThinkGeek?

Paul Raines (CEO):

That's a good question and you can imagine, Seth, for us, a company that's in the transformation of the kind we are in, it's a trade-off every day, how do we disinvest in the core as the core becomes a smaller part of our business and how do we invest in these new businesses and we've had our struggles on some of these. And Rob, I don't know if you want to take that, but that's a key question for us and we are attacking it very aggressively. Rob.

Rob Lloyd (EVP & CFO):

Yes, I think if you were to -- let me put it to you this way. The growth in SG&A year-over-year is almost solely attributed to Tech Brands. Obviously, you had some currency impact that work for us, but, ex that, Tech Brands is the bulk of that addition and as we indicated, there are costs that we invested into the openings that impacted the overall Tech Brands numbers.

So I would say that the bulk of those costs are behind us. We would not expect to go into next year with the type of store opening cadence that we talked about, Tony mentioned 190 plus stores that were opened this year. And so we would not expect to see the same level of investment necessary next year. And of course, with the store base that we now have as we move forward, whatever investments we do make come on a much larger base.

Paul Raines (CEO):

And Rob's -- just so you know, Seth, one of Rob's primary missions for this budget season is to tighten up our core SG&A separate from all the new stuff, how do we tighten up the core videogames business that we know very well, have been at a long time, understand all the different metrics. We've just got to tighten that up a little harder than we have in the past given the fact that it's less a part of our business than it has been. And I think we can do that.

Seth Sigmund (Analyst - Credit Suisse):

Okay, to follow up on Tech Brands, is there a way to elaborate on the performance on some of the more mature stores? It's hard to see just given all the noise with the investments. If you just simply look at sales per store, it is down year-over-year. I'm not sure that tells the whole story. Anything else you can talk about maybe from a comp perspective or four-wall EBITDA on some of the more mature stores to give investors comfort that you are starting to see a return on some of those more mature stores?

Rob Lloyd (EVP & CFO):

Yes, we watch the Tech Brands performance in several categories, including from the core stores that we acquired, stores that were added as whitespace or conversion stores, by type of store, meaning the RadioShack versus other whitespace versus GameStop conversions. We analyze those by year of opening. We analyze each of the acquisitions individually against the pro formas that were created behind them and other than the store opening cadence being slower than we had anticipated and the conversion cadence, we are very pleased with the base stores. We are very pleased with the whitespace stores that were opened in late 2013 and in 2014. We are pleased with the performance of the stores we've opened in 2015; it's just that they are growing slower than we expected and we remain very pleased with the performance of the acquisitions that we've made as well. Again, when we acquire a reseller, we can typically increase the productivity by 30% plus and that continues as we move forward.

Paul Raines (CEO):

Tony, you may want to share with Seth some of the exciting stuff that AT&T is doing because that's a big part of our growth here is our DIRECTV plan and (multiple speakers).

Tony Bartel (COO):

Yes, sure. First of all, we are selling all of the hot new products, like you will get the iPad Pro in all of our Tech Brands stores right now. We've got the Apple Watch in all of our Simply Mac stores and then with AT&T , we are selling DIRECTV in all of our Spring Mobile stores as well, which has been an added source of revenue. So all of these programs that AT&T is rolling out and all of the hot new tech that is going to be very popular this holiday season, we are selling that both in our Simply Mac stores, as well as our Spring Mobile stores.

Seth Sigmund (Analyst - Credit Suisse):

Okay. Just one final question, just following up on Arvind's before. So Rob, you talked about making up that $5 million shortfall in the fourth quarter. Where do you think you get that back? You also talked about FX being more impactful and a couple other minor drivers there. Where do you think you can make that up in the fourth quarter?

Rob Lloyd (EVP & CFO):

Well, I think we can see it by the videogames business with demand through the holiday season. We definitely see it in the Loot category. As you know, with the launch of the Star Wars game and movie, Star Wars collectible products are pretty hot right now, as well as performance within our Tech Brands segment.

Seth Sigmund (Analyst - Credit Suisse):

Thank you.

Operator:

Colin Sebastian, Robert Baird.

Colin Sebastian (Analyst - Robert W. Baird):

Thanks. I have a couple of questions, mostly as follow-ups, but, first, maybe to try to put a finer point on some of the concerns around console downloads. I wonder if you can talk about your observations of GameStop customers specifically in terms of their purchases of physical games, maybe attach rates. And then, secondly, whether you are actively adjusting trade-in values to keep this group loyal to the physical product? And I have one follow-up.

Paul Raines (CEO):

I think this is something we look at almost every day, Tony. So do you want to take that on?

Tony Bartel (COO):

Sure, in terms of attach, we still have -- we are seeing strong attach well outpace -- we are about double the rest of the industry in terms of attach rates of physical games to our consoles. We are seeing that and when you look at the entire launch, plus we add back our digital attach, plus our physical attach, we are roughly in line with previous launches. So there's no doubt that our digital attach is much higher than the last time it was launched when we launched 360 and PS3, but combined we are at similar levels to what we were at this time in the cycle last launch.

In terms of trade-in pricing, no, actually we are finding that we do not need to increase our trade-in pricing. We have been promotional, but it's within our trade pricing. I think what you are seeing is that consumers are finding those trade prices. We are using PowerUp Rewards in a very powerful way to make sure that people are aware of that and we've had some very successful promotions that have gotten us flush with in-demand Xbox 1 and PS4 inventory for the fourth quarter. So we are excited that we were able to do that without increasing trade-in prices.

Colin Sebastian (Analyst - Robert W. Baird):

Okay, thanks. And Rob, hate to keep pestering you on this, but just given some of the questions we are getting, to put the Q4 guidance into further context, would you say that it's appropriately conservative given some of the moving parts that Tony talked about, or is there still some risk to those numbers if Star Wars does not improve?

Rob Lloyd (EVP & CFO):

We expect Star Wars to be one of the strongest titles for the holiday season, so sort of move beyond launch and think about Star Wars as a brand with the movie coming out. So we expect it to get back towards our -- or on track for our expectations. So we think as we talked about the guidance internally as a team prior to issuing the release, we think the guidance is appropriate.

Colin Sebastian (Analyst - Robert W. Baird):

Okay, thank you.

Operator:

Brian Nagel, Oppenheimer.

Brian Nagel (Analyst - Oppenheimer & Co.):

Good morning. So my question -- I think it's very much going to be a follow-up to some of the prior questions, but with respect to the new software sales -- so if we look at the results today and even the trends for a while now at GameStop and step back, I guess one of the concerns out there that weighs upon (inaudible) with your stock is that, at this point in this product cycle, I guess one would think that software sales would be much more robust. And at time of launch, you'd sell a lot better.

The question I have -- and maybe you could opine just on that thought -- but also, as we look into the holiday, given your history in the videogame business, given your history in this point in the cycles, what gives you the confidence that names that -- like this is a follow-up to the prior question -- a Star Wars name that there will be a reacceleration, a further acceleration in sales, or even some of the other titles that have not performed quite as well as we thought from the onset?

Paul Raines (CEO):

I think in terms of new software sales, we are surprised a little bit by it too. As you know, we expect growth in that category. Holiday behaves very differently and we've got to understand -- we've been at this a long time. We know that there are certain things -- Tony, anything you want to --?

Tony Bartel (COO):

Sure. And I think when it comes to Star Wars, let me reiterate what Rob said. I think the Star Wars wallet got off to a slow start. We anticipate -- given the buzz around the movie, we anticipate that this game is going to be a very strong game when the movie launches in mid-December, not to mention the fact that we have it prominently displayed in our Black Friday ads. In fact, we are the only retailer that has it with significant discount, which is also going to drive sales. So while Star Wars is off to a bit of a slow start, we do think that it is going to rally very strong as we get closer to the movie. And I think from a holiday perspective, our Black Friday ad has been out there. We've got a lot of exclusive content. Loot gives us a whole new way to bring in new customers. So we are excited about the holiday season.

Paul Raines (CEO):

The other thing too is that the installed base on hardware is so much greater than it has been. You've got to believe there's going to be people chasing software for that installed base. They can't all be streaming Netflix . There's got to be some people playing video games on all those consoles. So that gives us a little bit of optimism.

Rob Lloyd (EVP & CFO):

I will point out too that our Black Friday ad leaked before the launch of Star Wars and given the pricing that we've got in the Black Friday ad, we are really not clear as to what impact that may have had on our results during the launch.

Brian Nagel (Analyst - Oppenheimer & Co.):

Okay. As somewhat of a follow-up to that, you mentioned your Black Friday ad. A lot of other retailers have already discussed or put out their Black Friday specials. Are you seeing anything in the environment this year that would suggest that retailers other than GameStop may be taking a more aggressive tack or aggressive stance toward the video gaming category or even in some cases in pricing?

Tony Bartel (COO):

No, Brian, we are not. There's obviously always discounting during the holidays, but we actually view our Black Friday ad as one of the most competitive out there this year.

Brian Nagel (Analyst - Oppenheimer & Co.):

Okay. And then if I could sneak one more in on a different topic, margins. You addressed this in your prepared comments, but we saw nice margin growth in the business driven by -- I think it was largely the Tech Brands and new (inaudible) stores. Just quickly how do we think about the sustainability of that going forward?

Paul Raines (CEO):

That's a product of the diversification of the business because remember GameStop historically was a lower margin business and we've increased -- I think I said in my remarks, we've increased it 400 basis points in three or four years. We think that's very sustainable because it's the contribution of these new categories, which are richer categories. The real question you should be asking is can we reel in the SG&A costs in a way that we can bring more of that margin dollar to the bottom line. Fair to say, Rob?

Rob Lloyd (EVP & CFO):

Yes, I think that is fair to say. It's also -- I think it's probably fair to say that, within the Tech Brands, we are seeing continued margin expansion and that's as a result of the overlap of the Next program. And as it's continued to increase as a percentage of the activity within the store, it is beneficial to margins.

Paul Raines (CEO):

It's important to do -- the reason we are in these categories, if you go back to our strategic work, the reason we are in these categories is because they are higher margin than video gaming. It would be hard to find categories, by the way, that are lower margin than video gaming by the time you add in the hardware. So Tech Brands, Apple and AT&T , as well as Loot are additive to our gross margin, so that's going to create more profitability. Our issue is we've got to control costs on these transitions. That's really the biggest part of it and the Company is in transformation. We've studied a lot of cases, companies in transformation go through short-term cost pressures like this.

Brian Nagel (Analyst - Oppenheimer & Co.):

Well, thank you.

Operator:

Curtis Nagle, Bank of America .

Curtis Nagle (Analyst - Bank of America Merrill Lynch):

Good morning, thanks for taking the call. So just I guess not to pick on gross margin too much, in terms of the Tech Brands, understood, like you said, it's coming from Next in a bigger proportion, but is there anything else that's contributing to it that perhaps helps some vendors because it was just such a big acceleration at least on a rate basis quarter to quarter?

Rob Lloyd (EVP & CFO):

Well, I probably should've clarified that if you look at the store counts quarter over quarter over quarter, where the growth is coming from is in the AT&T store base. Cricket and Simply Mac are relatively steady state for us. And so the AT&T stores drive the highest margin. As those grow as a percentage of the Tech Brand category, that is also having a dramatic impact.

Curtis Nagle (Analyst - Bank of America Merrill Lynch):

Great. Okay. And then just maybe somewhat of a philosophical question, but just thinking about software, I understood what's already been said about digital. Do you think maybe what's going on here is just a transition in terms of franchises where you have some very big ones plateauing or winding down? The ones that you have coming in just aren't big enough and could that be a big, I guess, part of the weakness that we are seeing right now?

Paul Raines (CEO):

Yes, Tony, what do you think?

Tony Bartel (COO):

What I think is that we have some very strong performance in the franchises that are coming out. What is different this consoles cycle versus last console cycle is the fact that old gen, or what we call current-gen now, 360 and PS3, are significantly down more than what we had anticipated when we did our original market model. So that's really the change, so it's not the new games are not producing as much as we anticipated that they were. The difference is that the older generation has eroded more quickly.

Rob Lloyd (EVP & CFO):

And many of these titles are not available on the older generation.

Curtis Nagle (Analyst - Bank of America Merrill Lynch):

Okay. Thanks very much.

Operator:

David Magee, SunTrust.

David Magee (Analyst - SunTrust Robinson Humphrey):

Good morning, everybody. One question on the back of the last question. Old gen is sort of winding down and I think that next year, it gets to be a lot smaller as a percent of the overall sector total. And just thinking about that and how hardware has reacted to recent price cuts and the software attach rates, at this point in time, are you prepared to say that we will see growth next year net-net in the videogame business in 2016?

Paul Raines (CEO):

Hard to say at this point, David. We are doing a lot of modeling. I don't think we are prepared for saying anything about 2016 yet, guys.

Rob Lloyd (EVP & CFO):

Yes, I think the holiday season is important as a data set to incorporate into our modeling and we will be prepared to talk about that, I think, as spring rolls around.

David Magee (Analyst - SunTrust Robinson Humphrey):

Okay, great. Thank you and have a good holiday.

Paul Raines (CEO):

By the way, David, I will say this. I will say telecommunications, Loot and digital will grow very aggressively in 2016. I would say that is not going to change. You will continue to see that. Our business that we are trying to manage is the core videogame business, trying to understand it, because it is, as you know, fairly volatile.

David Magee (Analyst - SunTrust Robinson Humphrey):

Right. Great. Thanks, guys.

Paul Raines (CEO):

Okay. Well, thank you for your support of GameStop. We appreciate you dialing in today and we look forward to speaking with you soon. Thanks.

Operator:

Ladies and gentlemen, that does conclude today's conference.

