EQUITY RESEARCH

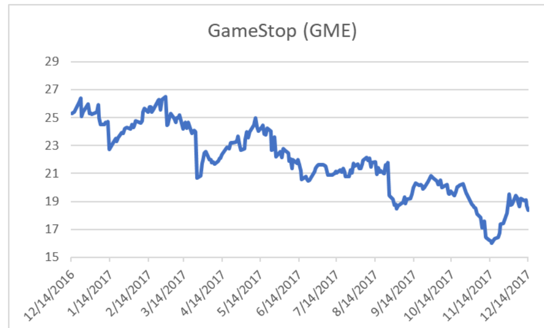
GameStop

December 14, 2017

Sector Outperform

Price Target USD 35.50

Our View: GameStop is priced on a near-term liquidation basis, despite management's progress towards shifting business strategies and diversifying revenue streams. We believe profitability and capital structure concerns are grossly overexaggerated, offering investors an attractive opportunity to lock-in an 8% dividend in a stock with substantial risk-adjusted upside.



Key Statistics			
Shares O/S (MM):	101.2	Market Cap (MM):	1889.4
Dividend:	1.52	EV (MM):	2714.4
Yield:	8.1%	P/E:	5.6
Short Interest:	38.0%	Institutional Ownership:	103.0%

Revenue (Millions USD)	1Q	2Q	3Q	4Q	Year
2014	1996	1731	2092	3477	9296
2015	2061	1762	2016	3525	9364
2016	1972	1632	1959	3045	8608
2017	2046	1688	1989	*3369*	***9092***
2018	***2029***	***1674***	***1972***	***3341***	***9016***
Earnings Per Share (USD)					
2014	0.59	0.22	0.57	2.15	3.47
2015	0.68	0.24	0.53	2.36	3.78
2016	0.63	0.27	0.49	2.04	3.4
2017	0.58	0.22	0.59	*1.93*	***3.32***
2018	***0.58***	***0.22***	***0.59***	***1.94***	***3.34***
Dividends Per Share (USD)					
2013	0.275	0.275	0.275	0.275	1.1
2014	0.33	0.33	0.33	0.33	1.32
2015	0.36	0.36	0.36	0.36	1.44
2016	0.37	0.37	0.37	0.37	1.48
2017	0.38	0.38	0.38	***0.38***	***1.52***
2018	***0.39***	***0.39***	***0.39***	***0.39***	***1.56***

Key Points:

Favorable Outlook. Our research indicates this will be GameStop's most successful holiday quarter in several years - both in brick and mortar locations and e-commerce sites - driven by heavy demand for collectibles and authorized merchandise, iPhone X and iPhone 8 launch, Nintendo Switch hardware and software, as well as downloadable content.

Unsustainable Multiples Compression. Price multiples compression stems from the 38% short interest on the stock. Given its high dividend yield and share repurchase history, as well as the favorable cyclical outlook for both consul gaming and mobile phones – GameStop's two largest sources of earnings – we believe these levels are unsustainable. Potential near-term catalysts that would result in a short squeeze include: (1) earnings beat due to higher than forecasted seasonal effects combined with 4Q2016 underperformance, (2) 5.6x earnings multiple offers an attractive repurchasing opportunity given the higher levels of cash on hand, (3) partnership announcements or favorable events for partners such as AT&T Time Warner deal.

Dividend Sustainability Concerns Lack Substance. The market is falsely concerned about GameStop's ability to continue its dividend policy due to yields approaching 8% on current market prices. The high rate is a result of the price drop, not because of archaic payouts. Our models indicate conservative dividend coverage on both an earnings and free cash flow basis - enough to fund repurchases and pay down all debt at maturity using cash on hand, never dipping into the revolver.

Large Beneficiary of Corporate Tax Change. A lower tax rate primarily benefits high earning, low leverage companies with a small amount of capitalized assets. Assuming no change in price multiples, our models show a 12.5% increase to our fair value estimate if tax reform goes into effect in 2018.

Limited Potential Downside. Max holding period loss is capped at 15% under a two-year controlled liquidation scenario. Holding shares have better risk-return characteristics and cheaper than purchasing a two-year, at the money call, with the added benefit of an 8% annual dividend.

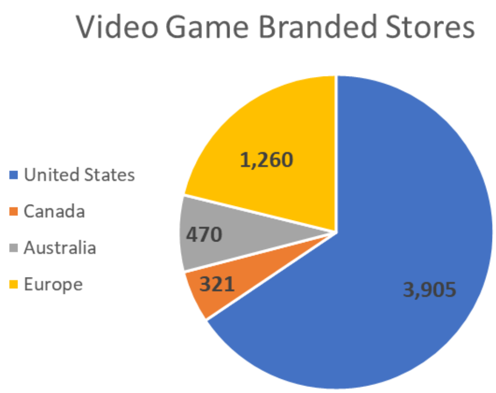
Christopher Perugini
christopher.perugini@uconn.edu

John Lundeen
john.lundeen@biz.uconn.edu

Sergio Garcia
sergio.garcia@biz.uconn.edu

Video Game Brands

Their 5,956 stores and e-commerce sites operate under the brand names GameStop, EB Games, Micromania and ThinkGeek. They engage in the sale of new and pre-owned video game hardware, software and accessories, as well as various digital products including downloadable content (DLC), downloadable software, network points cards, prepaid digital and subscription cards. They are rapidly expanding into the licensed collectible and merchandise business, an untapped market with promising growth potential.



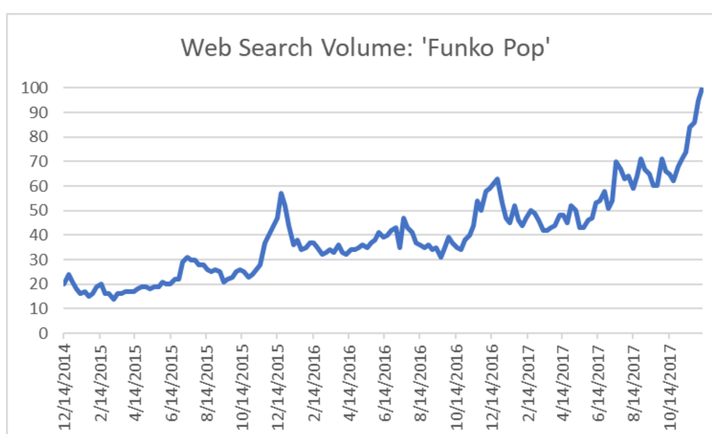
Through their omnichannel sales process, customers can reserve and purchase merchandise online and pick it up the same day or have it delivered to their house for the next day. GameStop's wide network of stores and vendor agreements allows them to deliver new releases to customer doorsteps the day of a release, a competitive advantage over other brick and mortar stores and e-commerce sites such as Best Buy, Wal-Mart, and Amazon.

In recent quarters, management made a strategic decision to refocus its vision for its Video Game Branded Stores. Recognizing the inevitable shift in customer preference towards digital downloads and growing demand for authorized collectibles and merchandise, stores will reallocate square footage to a 50/50 split by 2018. While software sales will still contribute meaningfully to their bottom line, GameStop is aiming for this contribution to be less than 50% by 2019.

Through exclusive partnerships with vendors such as Funko Pop! And Nintendo, GameStop is able to provide a unique assortment of products only available at their stores or through their websites. These exclusive releases have built such a fanbase and instilled customer loyalty. Foot traffic has gained momentum as a result of the shifted focus. Customers regularly travel to different stores in search of hidden gems. Many GameStop employees state having to hold limited releases in the back for their regulars because of how quickly product moves.

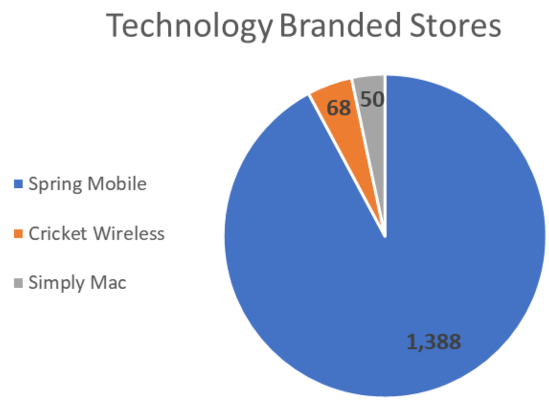
GameStop is also making a conscious effort to expand its digital growth strategy both in-store and online. The company is working with vendors to provide exclusive DLC, allowing players to distinguish themselves in game and GameStop among its competitors. For example, Nintendo's Pokemon Go is built around getting players out of the house and experience the outside world. They partnered with GameStop by seeding legendary in-game creatures at their stores. The strategy aims to lure customers into the store and emotionally entice them with new collectibles and merchandise centered around the creature they just caught.

These exclusive partnerships benefit not only GameStop, but also the vendor. For example, during prerelease events, GameStop offers authorized collectibles and merchandise themed around the video game. They also offer DLC such as season passes, something vendors often have trouble selling on their own. Our research shows the attachment rates for these purchases during prerelease events reach upwards of 25%. Not only is GameStop able to



differentiate itself by offering an emotionally-driven purchase, both companies improve their monetization efficiency. It's a rare situation where both parties win.

Technology Brands



In 2014, management made a strategic decision to diversify its revenue streams fueled through acquisitions. They now own 1,506 stores operating under the brands Spring Mobile, Cricket Wireless and Simply Mac. Spring Mobile and Cricket Wireless are both AT&T branded stores authorized to sell both prepaid and postpaid AT&T services, DIRECTV service and wireless products, as well as related accessories and other consumer electronics. Simply Mac stores are authorized retailers of Apple products and employees are trained and certified for warranty and repair services.

We feel the market is discrediting the true value of the Spring Mobile chain due to the name. These stores operate as if they were an AT&T owned store. In many cases the customer doesn't even know they're visiting a Spring Mobile store, nor should they care. We believe the iPhone refresh cycle offers substantial upside potential over the near term. AT&T's eventual acquisition of Time Warner promises to unlock long-term growth potential as a more appealing product line develops.

Assigning a conservative 8x multiple on 2017 EBIT, we believe the Technology Branded Segment is worth at least $1.0B on a standalone basis. Forecasting out to 2019 and it could be worth more than GameStop's current market cap.

4Q17 Predictions

We are forecasting for $3.37B in sales (+10.6% yoy) for the quarter. Improved results will be driven largely by new hardware sales from the Nintendo Switch, iPhone X & 8 launch as well as collectibles and authorized merchandise. The sales uptick will be slightly offset by lower demand for pre-owned video games due to new system cycle.

Gross profits will increase slightly to $1.07B, reflecting gross margin shrinkage (31.7%) inherent to new hardware sales, as well as in the pre-owned segment. Sales from Digital and Technology Brands segments will offload some of this compression.

Net income is estimated at $196M ($1.93/share), a 5.4% decrease over last year. This is due to a higher tax rate for the year, as well as margin shrinkage.

FYE17 Predictions

We are forecasting for $9.09B in sales (+5.6% yoy) for the year. Results will be driven by new hardware sales from the Nintendo Switch, as well as collectibles and authorized merchandise. The sales uptick will be slightly offset by lower demand for pre-owned video games due to new system cycle.

Gross profits will increase slightly to $3.08B, reflecting gross margin shrinkage (33.9%) inherent to new hardware sales, as well as in the pre-owned segment. Sales from Digital and Technology Brands segments will offload some of this compression.

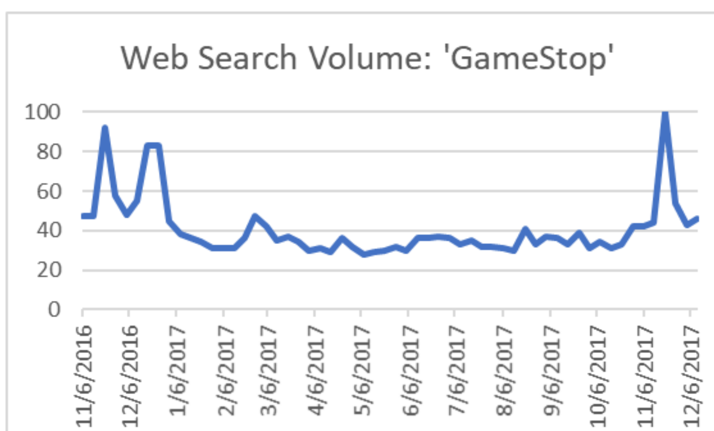
Net income is estimated at $333M ($3.32/share), a 2.3% decrease over last year. This is due to a higher tax rate for the year, as well as margin shrinkage.

Speculative Predictions

Management guided very lightly going into Q4, despite last year's comparables being horrific. Our research indicates heavy pre-stock on collectibles and merchandise going into the Black Friday week. We have reason to believe their promotions were a huge success and their decision to open on Thanksgiving likely brought sales to levels unseen in many years.

Many employees reported selling out nearly all their inventory before they even opened on Black Friday. Many stated via social media that they exceeded 3x sales goals for the week. An internal email from the CEO also surfaced, thanking employees for the most successful Black Friday event they've ever had.

Our research also indicates that web search volume spiked to the highest level in company history and is up in aggregate in Q4 so far.



Establishing a Price Floor

GAMESTOP - Controlled Liquidation Scenario					
ASSETS	**3Q17**	**Multiplier**	**V_Liquid**		
Current assets:					
Cash and cash equivalents	454.7	1.00	454.7		
Receivables, net	195.8	0.95	186.0		
Merchandise inventories, net	1,822.5	0.90	1,640.3		
Prepaid expenses and other current assets	198.0	0.00	0.0		
Total current assets	**2,671.0**		**2,281.0**		
Property and equipment:					
Land	19.2	1.50	28.8		
Buildings and leasehold improvements	752.9	0.65	489.4		
Fixtures and equipment	986.7	0.20	197.3		
Total property and equipment	1,758.8		715.5		
Less accumulated depreciation	(1,300.9)		0.0		
Net property and equipment	**457.9**		**715.5**		
Additional non-current assets:					
Goodwill	1,693.2	0.50	846.6		
Other intangible assets, net	512.1	0.50	256.1		
Other noncurrent assets	139.8	0.00	0.0		
Total additional non-current assets	**2,345.1**		**1,102.7**		
Total assets	**5,474.0**		**4,099.1**		
LIABILITIES					
Current liabilities:					
Accounts payable	1,285.1	1.00	1,285.1		
Accrued liabilities	914.9	0.75	686.2		
Income taxes payable	17.5	1.00	17.5		
Total current liabilities	**2,217.5**		**1,988.8**		
Long-term liabilities:					
Long-term debt, net	817.2	1.00	817.2		
Other long-term liabilities	125.6	1.00	125.6		
Total long-term liabilities	**942.8**		**942.8**		
Total liabilities	**3,160.3**		**2,931.6**		
Total Equity	**2,313.7**		**1,167.6**	**1,167.6**	**1,167.6**
Common Shares Outstanding	101.3		101.3	96.2	91.4
				+1 Year	+2 Years
Value / Share	**$22.84**		**$11.52**	**$12.13**	**$12.77**
Total Dividend Received				$1.52	$3.04
Aggregate Value / Share			**$11.52**	**$13.65**	**$15.81**

Many people assume GameStop will go bankrupt over the next few years similarly to Blockbuster. Although we don't agree with this nearsighted view - given GameStop's diversification efforts, healthy balance sheet and ability to consistently generate positive EVA – we decided to model the scenario as a worst case. Doing so shows just how deep the shallow end really is for those who can't swim.

We made the pessimistic assumption GameStop would liquidate the company in a controlled state over the next two years. During this time, earnings will just cover dividend distributions and share repurchases. No benefits are assumed from proposed corporate tax overhaul, although GameStop will be a huge beneficiary.

Given these conditions, GameStop shares are still worth $15.81, a 15% discount to today's market price. *Viewed in a different light, investors are purchasing a two-year, at the money call for a 15% premium. The actual option would cost 22% and relinquished the 8% dividend benefit.*

GameStop®

Discounted Cash Flow Model for GameStop

General assumptions	
Share price as of last close	$18.67
Latest closing share price date	12/13/2017
Latest basic share count	101
Weighted average cost of capital	8.1%

Free cash flow buildup								
Fiscal year	**2014A**	**2015A**	**2016A**	**2017P**	**2018P**	**2019P**	**2020P**	**2021P**
Fiscal year end date	*2/1/15*	*1/31/16*	*1/30/17*	*1/31/18*	*1/31/19*	*1/31/20*	*1/31/21*	*1/31/22*
EBITDA	796	836	742	725	752	756	764	766
EBIT	618	648	558	533	560	565	570	572
tax rate	*35.4%*	*35.6%*	*30.0%*	*31.0%*	*35.5%*	*35.5%*	*35.5%*	*35.5%*
EBIAT (NOPAT)	**400**	**418**	**390**	**368**	**361**	**364**	**368**	**369**
Depreciation & amortization (inc amt in cost of sales)				171	171	171	175	176
Impairments (enter as +)				0	0	0	0	0
Stock based compensation				21	21	20	19	19
Receivables, net				(28)	2	9	9	10
Merchandise inventories				(80)	22	57	54	57
Accounts payable				9	(11)	(30)	(28)	(30)
Accrued liabilities				61	(9)	(43)	(40)	(45)
Prepaid expenses and other current assets				0	0	0	0	0
Deferred income tax assets				0	0	0	0	0
Other noncurrent assets				0	0	0	0	0
Income taxes payable				0	0	0	0	0
Deferred income tax liabilities				0	0	0	0	0
Other long-term liabilities				0	0	0	0	0
Other								
Unlevered CFO				**522**	**556**	**548**	**556**	**555**
Less: Capital expenditures				(120)	(135)	(147)	(159)	(168)
Less: Purchases of intangible assets				(50)	(50)	(50)	(50)	(50)
Unlevered FCF				**352**	**371**	**351**	**347**	**337**
% growth					5.3%	(5.4%)	(1.0%)	(2.9%)
Discount factor				*13%*	*113%*	*213%*	*313%*	*413%*
Present value of Unlevered FCF				**348**	**340**	**297**	**272**	**245**

Perpetuity approach	
Unlevered FCF in last forecast period (t)	337
FCF^{t+1}	0.0%
Long term growth rate (g)	0.0%
Terminal value	4,178
Present value of terminal value	3,031
Present value of stage 1 cash flows	1,502
Enterprise value	**4,534**
Less: Long-term debt	(825)
Intrinsic value of equity	**3,709**
(per share)	*$36.64*

Exit EBITDA multiple approach	
Terminal year EBITDA	766
Terminal value EBITDA multiple	5.0x
Terminal value	3,831
Present value of terminal value	2,779
Present value of stage 1 cash flows	1,502
Enterprise value	**4,282**
Less: Long-term debt	(825)
Intrinsic value of equity	**3,457**
(per share)	*$34.16*

WACC	
Long-term debt	825
Weighted average interest rate	6.2%
Tax rate	31.0%
After-tax cost of debt	4.3%
Market Value of Equity	1,890
Beta	1.24
Risk Free Rate (10-Year Treasury Rate)	2.4%
Equity Risk Premium	5.9%
Cost of Equity	9.7%
Weighted average cost of capital	**8.1%**

Financial Health

DEBT SAFETY NET								
Fiscal year	2014A	2015A	2016A	2017P	2018P	2019P	2020P	2021P
Fiscal year end date	*2/1/15*	*1/31/16*	*1/30/17*	*1/31/18*	*1/31/19*	*1/31/20*	*1/31/21*	*1/31/22*
Debt to Equity		0.2	0.4	0.3	0.3	0.2	0.2	0.0
Financial Leverage		2.1	2.2	2.2	2.1	1.9	1.8	1.6
Interest Coverage Ratio	57.8	27.7	10.4	10.4	10.9	10.8	17.8	17.8
DIVIDEND SUSTAINABILITY								
Dividend Payout	38.6%	38.1%	43.9%	46.7%	47.3%	46.9%	44.7%	44.6%
(Div+Repurchase)/NI	122.8%	86.3%	61.8%	59.9%	60.7%	60.2%	57.3%	57.2%
Free Cash Flow Payout	63.3%	52.7%	-257.2%	49.0%	45.9%	48.9%	47.5%	49.0%
(Div+Repurchase)/FCF	201.5%	119.5%	-361.9%	62.8%	58.9%	62.7%	60.9%	62.8%

Financial Statement Models

INCOME STATEMENT								
Fiscal year	2014A	2015A	2016A	2017P	2018P	2019P	2020P	2021P
Fiscal year end date	*2/1/15*	*1/31/16*	*1/30/17*	*1/31/18*	*1/31/19*	*1/31/20*	*1/31/21*	*1/31/22*
Revenue	9,296	9,364	8,608	9,091	9,016	8,673	8,355	8,001
Cost of sales (enter as -)	(6,520)	(6,446)	(5,599)	(6,008)	(5,899)	(5,616)	(5,348)	(5,063)
Gross Profit	**2,776**	**2,918**	**3,009**	**3,083**	**3,117**	**3,057**	**3,007**	**2,937**
Selling, general & administrative (enter as -)	(2,001)	(2,109)	(2,253)	(2,379)	(2,387)	(2,322)	(2,262)	(2,190)
Depreciation and amortization (enter as -)	(154)	(157)	(165)	(171)	(171)	(171)	(175)	(176)
Impairments (enter as -)	(2)	(5)	(34)	0	0	0	0	0
Operating profit (EBIT)	**618**	**648**	**558**	**533**	**560**	**565**	**570**	**572**
Interest income (enter as +)	1	0	1	1	1	1	1	1
Interest expense (enter as -)	(11)	(23)	(54)	(51)	(51)	(52)	(32)	(32)
Pretax profit	**608**	**625**	**505**	**482**	**509**	**514**	**539**	**541**
Taxes (enter expense as -)	(215)	(222)	(152)	(150)	(181)	(182)	(191)	(192)
Net income	**393**	**403**	**353**	**333**	**329**	**331**	**348**	**349**
Basic shares outstanding	112	106	103	100	98	97	95	93
Impact of dilutive securities	1	1	0	0	0	0	0	0
Diluted shares outstanding	113	107	104	101	99	97	95	94
Basic EPS	\$3.50	\$3.80	\$3.42	\$3.32	\$3.34	\$3.43	\$3.66	\$3.73
Diluted EPS	**\$3.47**	**\$3.78**	**\$3.40**	**\$3.31**	**\$3.32**	**\$3.41**	**\$3.64**	**\$3.72**
Growth rates & margins								
Revenue Growth	NA	0.7%	(8.1%)	5.6%	(0.8%)	(3.8%)	(3.7%)	(4.2%)
Gross Profit Margin	29.9%	31.2%	35.0%	33.9%	34.6%	35.3%	36.0%	36.7%
SG&A Margin	21.5%	22.5%	26.2%	26.2%	26.5%	26.8%	27.1%	27.4%
EBIT Margin	6.7%	6.9%	6.5%	5.9%	6.2%	6.5%	6.8%	7.1%
EBT Margin	6.5%	6.7%	5.9%	5.3%	5.7%	5.9%	6.5%	6.8%
Tax rate	35.4%	35.6%	30.0%	31.0%	35.5%	35.5%	35.5%	35.5%
EBITDA reconciliation								
Depreciation & amortization (inc amt in cost of sales)	157	158	167	171	171	171	175	176
Stock based compensation	22	30	18	21	21	20	19	19
EBITDA	**796**	**836**	**742**	**725**	**752**	**756**	**764**	**766**

BALANCE SHEET								
Fiscal year	**2014A**	**2015A**	**2016A**	**2017P**	**2018P**	**2019P**	**2020P**	**2021P**
Fiscal year end date	*2/1/2015*	*1/31/2016*	*1/30/2017*	*1/31/2018*	*1/31/2019*	*1/31/2020*	*1/31/2021*	*1/31/2022*
Cash and cash equivalents		450	669	787	926	695	823	466
Receivables, net		177	221	249	247	238	229	219
Merchandise inventories, net		1,163	1,122	1,202	1,180	1,123	1,070	1,013
Prepaid expenses and other current assets		152	139	139	139	139	139	139
Net property and equipment		485	471	435	415	407	407	416
Deferred income taxes		39	59	59	59	59	59	59
Goodwill and net intangible assets		1,807	2,232	2,267	2,302	2,336	2,370	2,404
Other noncurrent assets		62	73	73	73	73	73	73
Total Assets		**4,335**	**4,986**	**5,211**	**5,340**	**5,070**	**5,170**	**4,788**
Accounts payable		632	617	626	614	585	557	527
Accrued liabilities		1,041	1,091	1,152	1,143	1,099	1,059	1,014
Income taxes payable		121	54	54	54	54	54	54
Deferred income taxes		30	23	23	23	23	23	23
Revolver		0	0	0	0	0	0	0
Long-term debt		350	825	825	825	475	475	0
Other long-term liabilities		80	122	122	122	122	122	122
Total Liabilities		**2,254**	**2,732**	**2,802**	**2,781**	**2,358**	**2,290**	**1,740**
Common stock / additional paid in capital		0	0	(23)	(45)	(69)	(94)	(119)
Accumulated other comprehensive income (loss)		(89)	(47)	(47)	(47)	(47)	(47)	(47)
Retained earnings		2,170	2,301	2,479	2,652	2,828	3,021	3,214
Total Equity		**2,081**	**2,254**	**2,409**	**2,559**	**2,712**	**2,880**	**3,048**
Balance Check		*0*	*0*	*0*	*(0)*	*(0)*	*(0)*	*(0)*
Ratios								
Net debt		(100)	156	38	(101)	(220)	(348)	(466)
Asset turnover (Revenue / Total assets)		2.16x	1.73x	1.74x	1.69x	1.71x	1.62x	1.67x
Net profit margin		4.3%	4.1%	3.7%	3.6%	3.8%	4.2%	4.4%
Return on assets (ROA)		9.3%	7.1%	6.4%	6.2%	6.5%	6.7%	7.3%
Return on book equity (ROE)		19.4%	15.7%	13.8%	12.8%	12.2%	12.1%	11.4%

CASH FLOW STATEMENT								
Fiscal year	2014A	2015A	2016A	2017P	2018P	2019P	2020P	2021P
Fiscal year end date	*2/1/2015*	*1/31/2016*	*1/30/2017*	*1/31/2018*	*1/31/2019*	*1/31/2020*	*1/31/2021*	*1/31/2022*
Net income				333	329	331	348	349
Depreciation & amortization (inc amt in cost of sales)				171	171	171	175	176
Impairments (enter as +)				0	0	0	0	0
Stock based compensation				21	21	20	19	19
Receivables, net				(28)	2	9	9	10
Merchandise inventories				(80)	22	57	54	57
Accounts payable				9	(11)	(30)	(28)	(30)
Accrued liabilities				61	(9)	(43)	(40)	(45)
Prepaid expenses and other current assets				0	0	0	0	0
Deferred income tax assets				0	0	0	0	0
Other noncurrent assets				0	0	0	0	0
Income taxes payable				0	0	0	0	0
Deferred income tax liabilities				0	0	0	0	0
Other long-term liabilities				0	0	0	0	0
Non-cash (PIK) interest				0	0	0	0	0
Cash from operating activities				**487**	**524**	**515**	**536**	**535**
Capital expenditures				(120)	(135)	(147)	(159)	(168)
Purchases of intangible assets				(50)	(50)	(50)	(50)	(50)
Cash from investing activities				**(170)**	**(185)**	**(197)**	**(209)**	**(218)**
Long term debt				0	0	(350)	0	(475)
Common dividends				(155)	(155)	(155)	(155)	(155)
New share issuances				0	0	0	0	0
Share repurchases				(44)	(44)	(44)	(44)	(44)
Other comprehensive income / (loss)				0	0	0	0	0
Revolver				0	0	0	0	0
Cash from financing activities				**(199)**	**(199)**	**(549)**	**(199)**	**(674)**
Net change in cash during period				**118**	**139**	**(232)**	**128**	**(357)**

PLEASE REVIEW:

GME_VALUATION(12-13-2017) WORKBOOK FOR INDIVIDUAL BREAKOUT OF FINANCIAL STATEMENT COMPONENTS, SUPPORTING RATIOS AND SEGMENT ANALYSIS.

GME_RVG WORKBOOK FOR RELATIVE VALUE OF GROWTH ANALYSIS.