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Studies in Applied Finance

INVESTMENT THESIS FOR GAMESTOP CORP. (NYSE: GME)

Gui Hubner

Johns Hopkins Institute for Applied Economics,
Global Health, and Study of Business Enterprise

Investment Thesis for GameStop Corp. (NYSE: GME)

By Guilherme Hubner

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About the Series

The Studies in Applied Finance series is under the general direction of Professor Steve H. Hanke, Co-Director of The Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise (hanke@jhu.edu) and Dr. Hesam Motlagh (hnekoor1@jhu.edu), a Fellow at The Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise.

This working paper is one in a series on applied financial economics, which focuses on company valuations. The authors are mainly students at the Johns Hopkins University in Baltimore who have conducted their work at the Institute as undergraduate researchers.

About the Author

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Summary

This working paper is an in-depth analysis of GameStop Corporation, a US Based Gaming and Technology retailer. Our analysis examines the economic factors that impact GameStop's underlying business and how GameStop has adapted to these ever-changing factors. This economic analysis is then combined with our proprietary, Hanke-Guttridge Discounted Cash Flow (HG-DCF) model to determine GameStop's financial position. The HG-DCF model will be presented along-side Monte-Carlo simulations to reveal the distribution of probable free cash flows and the likelihood of future earnings. In addition to these quantitative factors, we also examine the compensation plans of GameStop's executives to assess alignment with shareholders. At the conclusion of this analysis, it is our intention for readers to understand GameStop's business plan and the company's financial standing to arrive at a sound investment decision.

Acknowledgements

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Keywords: Financial Modelling, GameStop Corp., Discounted Cash Flow, Free Cash Flow, Monte-Carlo Simulation, Investment Thesis, Management Compensation.

GameStop
POWER TO THE PLAYERS®

Rating – STRONG BUY– Avg. Free Cash Flow per Share: $40.64

Company Name:	GameStop Corp.
Date:	5/13/2016
Fiscal year ends:	January 31st
Current price:	$28.73
52-week high:	$47.82 (08/14/2015)
52-week low:	$24.33 (01/20/2016)
Market Cap:	$2,986M Million
Enterprise Value:	$2,918.3 Million
Total Debt:	$350.4 Million
Cash:	$450.4 Million
Dividend Yield:	5.01%
Diluted Shares Outstanding:	105.0 Million
Current P/E:	7.31
2012 EPS:	-$2.13
2013 EPS:	$3.02
2014 EPS:	$3.50
2015 EPS:	$3.80
2016 P/E (EPS):	7.13x ($4.03*)
2017 P/E (EPS):	6.73x ($4.27*)

* Consensus Estimates as of the time of this writing

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Executive Summary

GameStop Corp (NYSE:GME) operates as a multichannel video game, consumer electronics, and wireless services retailers; offering customers the most popular games, hardware and game accessories for next generation video game systems and the PC. Based on historical averages, management guidance, and conservative estimates due to competitive industry environment, our Hanke-Guttridge Discounted Cash Flow (HG-DCF) model in conjunction with Monte Carlo simulations reveal that GME's probable free cash flow generation is approximately $40.64 per share. Our model takes into account the declining sales of video game hardware and software, while also incorporating strong growth in the Company's higher margin segments such as Tech Brands and "Other" through active M&A activity. Management has also indicated a significant shift towards non-physical gaming business, and expects to have 50% of profits coming from sources other than physical gaming by 2019. This commitment to diversification is also seen in the Company's compensation policy. Nonetheless, the market still values the Company as a, "Blockbuster," or a last player in a dying industry. In fact, the equivalent to 42% of GME's equity float are shorted stocks[1]. As of May 13th, 2016 GME shares are trading at $28.73, a 41.5% discount to our model estimates. We believe GME is well positioned to diversify its business and improve profitability in coming years. As a result, we rate GME a STRONG BUY.

Catalysts and Risks

- Traditional segments benefiting from Virtual Reality headsets and new consoles
- Continued growth of GameStop's alternative revenue streams (non-physical gaming)
- Slower than expected shift to Digital download gaming environment
- Foreign exchange rates attenuating sales and earnings growth
- Realization of successful M&A and opening of tech stores

Company Description and Historical Performance

GameStop Corp ("GameStop", "GME") is the world's largest videogame retailer, the largest AT&T authorized reseller, and the largest Apple certified products reseller. In addition, the Company is a Cricket Wireless reseller (an AT&T brand) and the owner of www.thinkgeek.com, one of the world's largest sellers of collectible pop-culture themed products. As of January 2016, GameStop's retail network of brands included 7,117 company-operated stores in the United States, Australia, and Canada. The Company sells new and pre-owned video game hardware, physical and digital video game software, accessories, PC entertainment software, new and pre-owned mobile and consumer electronics products, and other merchandise. It operates electronic commerce web sites under the names www.gamestop.com, www.ebgames.com.au, and www.micromania.fr. The Company also sells various types of digital products, including downloadable content, network point cards, prepaid digital and

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[1] From Yahoo Finance, Key Statistics of GME. Accessed on June 4th, 2016.

online timecards, and digitally downloadable software. Its mobile business consists primarily of pre-owned mobile devices, tablets and related accessories. GameStop was founded in June 2000 and is headquartered in Grapevine, TX.

GME controls the market share of the video game industry in 13 countries. Videogame sales for 2016 are expected to total $8B. Digital sales are projected at $1B. Technology brands and collectibles are projected at $0.85B and $0.5 B respectively. Despite its exposure to a declining physical gaming sales environment, GameStop has been able to drive up average store contribution by 23% in the past two years. They have accomplished this by increasing Digital Sales, adding loot, and investing in a rewards program which currently services over 46 million global members[2].

Business Segments

The Company is broken down into two main business segments: Video Game Brands and Technology Brands. Video Game Brands, as the core segment, is in turn divided geographically between United States, Canada, Australia, and Europe.

1. The Video Game Brands segments include 6,081 stores, 4,013 of which are included in the United States segment. There are 325, 444, and 1,299 stores in the Canadian, Australian and European segments, respectively.
2. The Technology Brands segment includes our Spring Mobile and Simply Mac businesses. Spring Mobile operates 890 AT&T branded wireless retail stores and 70 Cricket branded pre-paid wireless stores. The AT&T branded stores sell both pre and post-paid AT&T services, DirecTV service and wireless products, as well as related accessories and other consumer electronics products. Pre-paid AT&T services, wireless devices and related accessories are sold through the Cricket branded stores. Simply Mac operates 76 Simply Mac© branded stores which sell Apple products, including desktop computers, laptops, tablets and smart phones and related accessories, and other consumer electronics products. As an authorized Apple reseller, Simply Mac also offers certified training, warranty and repair services to its customers.

GME's strategy is to become a family of retail brands selling many of the world's most popular technologies and pop-culture products. The Company categorizes and reports their sales of products and services as follows:

1. *New Video Game Hardware*: Video Game Platforms of all major manufacturers
    a. Sony: PlayStation 4, PlayStation 3, PlayStation Vita
    b. Microsoft Xbox One, Xbox 360, Kinect
    c. Nintendo Wii U, Wii, DS Line
2. *New Video Game Software*: Purchasing and selling of video game software from leading manufactures such as Sony, Nintendo, and Microsoft, as well as other major third-party publishers such as Electronic Arts, Activision, Ubisoft.
3. *Pre-owned Video Game Products*: Customers have an opportunity to trade in pre-owned video game products in exchange for store credits. GME then resells these pre-owned games that generate significantly higher gross margins than new video game products.

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[2] GameStop 2016 Investor Day Powerpoint Presentation. Web Access, May 25th, 2016.

4. *Video Game Accessories*: Video game accessories consist primarily of controllers, gaming headsets, memory cards, and other add-ons for use with video game hardware and software.
5. *Digital*: Online players demand subscriptions, time and point cards (digital currency), and downloadable content. GameStop is one of the leading retailers of digital currency and downloadable content for Xbox Live and PlayStation Network.
6. *Mobile and Consumer Products*: Consists of revenue generated in the Technology Brands segment through Spring Mobile managed AT&T and Cricket branded stores, Simply Mac stores from the sale of wireless products, and Apple and other consumer electronics.
7. *Other Products*: Sales of licensed merchandise and collectibles primarily related to the video game, television and movie industries through GME's video game stores, ThinkGeek stores, Zip Pop Culture stores, and the online website www.thinkgeek.com. This segment also includes PC entertainment software and strategy guides, magazines, and gaming-related toys.

Historical Performance

Over the past five years, total revenue has been fluctuating between $8.8 and $9.6 billion, but has not shown consistent overall growth. The volatility of GME's performance comes from the nature of the industry, where sales are driven by the release of new video games platforms and titles. The Company has refocused its strategy in diversifying its revenue stream by penetrating the wireless devices and services market, as well as collectibles (See Table 1 Below).

Table 1: GameStop's Revenue Mix and Segment Growth

Historical Revenue Growth by Product Category	**2012**	**2013**	**2014**	**2015**	**2016**
New video game hardware	1,611.6	1,333.4	1,730.0	2,028.7	1,944.7
% growth rate	*-6.30%*	*-17.26%*	*29.74%*	*17.27%*	*-4.14%*
New video game software	4,048.2	3,582.4	3,480.9	3,089.0	2,905.1
% growth rate	*2.00%*	*-11.51%*	*-2.83%*	*-11.26%*	*-5.95%*
Pre-owned and value video games	2,620.2	2,430.5	2,329.8	2,389.3	2,374.7
% growth rate	*6.09%*	*-7.24%*	*-4.14%*	*2.55%*	*-0.61%*
Video game and accessories	661.1	611.8	560.6	653.6	703.0
% growth rate		*-7.46%*	*-8.37%*	*16.59%*	*7.56%*
Digital	143.0	208.4	217.7	216.3	188.3
% growth rate		*45.73%*	*4.46%*	*-0.64%*	*-12.94%*
Mobile & Consumer Electronics	12.8	200.3	303.7	518.8	652.8
% growth rate		*1464.84%*	*51.62%*	*70.83%*	*25.83%*
Other	453.6	519.9	416.8	400.3	595.2
% growth rate		*14.62%*	*-19.83%*	*-3.96%*	*48.69%*
Total	9,550.50	8,886.70	9,039.50	9,296.00	9,363.80
% growth rate	*0.81%*	*-6.95%*	*1.72%*	*2.84%*	*0.73%*

The key point to this table is that since 2012-2013 GameStop has emphasized a significant push towards its Digital, Mobile & Consumer Electronics and "Other" segments. Source: GME SEC-10K's

The Company's gross margin has benefited from this strategy since the *Mobile and Consumer Electronics*, *Digital* and *Other* have better margins than physical gaming products and services (See Figure 1). As a result, GME's overall costs of goods sold (COGS) has been cut from 73.2% in 2012 to 68.8% in 2016. We incorporate this successful margin expansion into our model assumptions in the following sections.

	52 Weeks Ended January 30, 2016		
		Gross Profit	Gross Profit Percent
Gross Profit:			
New video game hardware(1)	$	175.5	9.0%
New video game software		689.3	23.7%
Pre-owned and value video game products		1,114.5	46.9%
Video game accessories		255.5	36.3%
Digital		149.6	79.4%
Mobile and consumer electronics		328.6	50.3%
Other(2)		205.3	34.5%
Total	$	2,918.3	31.2%

Figure 1: Gross profit margins for GME by product category
This figure displays the higher-margin potential of non-physical gaming segments
Source: GameStop Corp. 2016 SEC 10-K, page F-32

The only note to the Balance Sheet and Income Statement is the negative results of 2013 despite high revenue. These results were caused by an impairment of goodwill expense when GME ceased the acquisition plans and had to write-off about $700 million of goodwill.

Model Assumptions

Our HG-DCF-MC models utilize historic averages and standard deviations of growth and margins as a baseline for our projections. Typically, we use historic averages for revenue growth, cost structure, working capital, and capital expenditures (Cap-Ex). Historic long-term asset turns are also referenced as a litmus test for our model assumptions and projections to ensure we are not forecasting productivity that is unsustainable in the long run as we project the company into the future. We can deviate from these historic averages if management provides material information that will impact their business or have reason to believe.

GameStop's HG-DCF is most sensitive to product category growth rates and respective gross margins. During the most recent earnings call (4th Quarter 2015-16), GME's CFO Robert Lloyd laid out management guidance for each reportable segment's revenue growth in 2016:

1. Video Game Hardware: -10% before currency, given third year of consoles' cycle translating into lower sales. No new platforms are expected to come out in the near future. Model inputs were -5% growth for the first three years, and a flat 0% onward. We believe the introduction of Virtual Reality devices will offset declines in this segment.
2. Video Game Software: negative impact between -5% and -10% due to limited title line-up. Model inputs are the same as hardware, following that the increasing variety of games is driving down prices.
3. Pre-owned: growth between -2% and 2%. Model input: a conservative 0% reflecting what may be a saturated market.

4. Video Game Accessories: No guidance. Model input: 2%, in line with its historical average. It seems that accessories for new generation consoles are priced higher, and often have high turnover which drives consumer demand even while hardware sales are decreasing.
5. Digital: No guidance. Model input: 0%, reflecting slow digital adoption, competitive environment.
6. Mobile & Consumer Electronics: Tied to Tech Brands Sales. Stores are expected to increase from 1,036 to 1,500 in 2016, increasing revenue by about 40% in the first year. Model inputs: 30% growth for the first year, followed by 8% in the next ten years. As discussed in the Proxy Analysis, management is being paid to achieve this growth and we therefore, we believe it is sustainable.
7. Other: Increase of 45% on sales of Collectibles in the first year. Model input: 8%. Industry cumulative average growth rate (CAGR) for collectibles is 10%, and it is the primary driver for this segment sales.

Value Drivers (HG-CF) Tab

These results are contained in the 'Value Drivers' tab of the accompanying spreadsheet

To determine GME's historical performance for forecasting, we examined the historical margins in addition to the value drivers of the company. Upon inspection of these statistics, a few items stood out (for reference, please refer to the accompanying Spreadsheet uploaded to the Institute website). First, the expansion of the high margin Tech Brand stores helped dramatically improve the *Mobile and Consumer Electronics* segment, resulting in a gross margin expansion of 28% in the past two years alone. We use 2016's COGS margin of 49.7% for this segment. For all other segments, we used historical averages. Part of this margin expansion has been offset by higher selling, general, and administrative (SGA) due to licensing and operational costs of running more stores. We used 25% for SGA instead of the 20.5% average to reflect these changes. The increase of interest expense to the historical high of 0.4% reflects management decision to tap into more debt in order to finance the opening of stores and Tech Brands M&A activity. The 30% of EBITDA tax rate used is higher than the 27.7% historical average. Historically, Capital Expenditures and Depreciation have been equal, and we don't expect this trend to change. Both have been set at 1.83% of revenue.

Model Results

These results are contained in the 'DCF' tab of the accompanying spreadsheet.

With our assumptions detailed in the previous two sections, the HG-DCF model yielded a probable free cash flow of $40.64. This output is surprising given the conservative approach to segmented revenue growths, which follow executive guidance, historical averages, and industry trends. Interestingly enough, long-term asset turnover (LAT) recovers to just 11.5x at the end of the ten-year projection. This is still under the historical high of 12.4x seen in 2014. This reinforces our belief that GME is trading below intrinsic value. The reason behind this value is that the segments which are growing the most also present a better profit margin than the overall company. In fact we can observe an improvement in the COGS margin from the current 68.8% down to 65.9% in 2026.

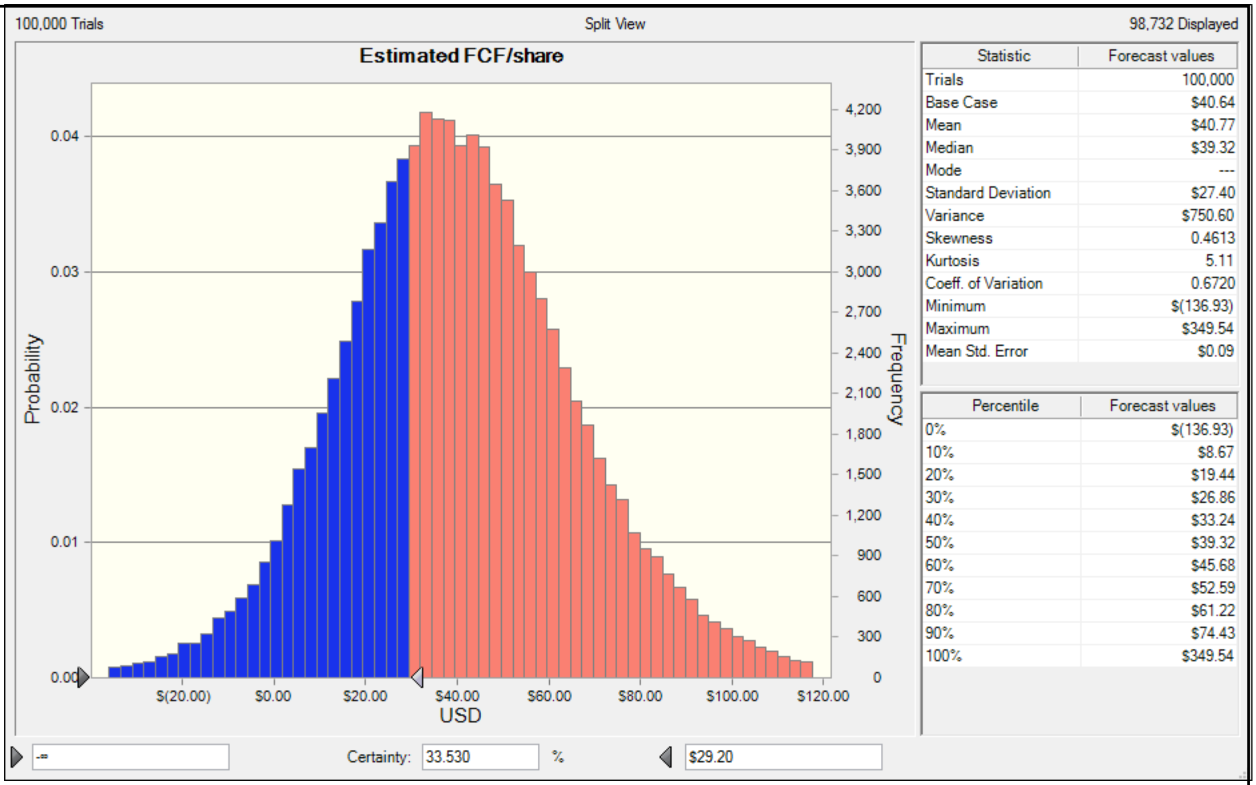


Figure 2: Monte Carlo Simulation Results from GameStop HG-DCF mode

These are the results from 100,000 Monte-Carlo simulations of GameStop's discounted Free-Cash Flow model. The plot is the probability versus the possible discounted free cash flows per share. The pink proportion of the figure indicates possible free cash flow levels that are above today's stock price. The blue region denotes values that are below today's stock price.

Proxy Findings

Management Compensation

These results are based on an in-depth analysis of the proxy statement: SEC Filing DEF-14A accepted for filing May 6th 2016.

We conducted a compensation analysis to determine if management is obligated, or incentivized, to generate shareholder returns aligned with our investment thesis. GameStop's CEO and director J. Paul Raines, age 52, has been in his current role since June 2010. He joined GameStop in September 2008 as Chief Operating Officer. Prior to joining GameStop, Mr. Raines spent eight years with The Home Depot, Inc. in various management positions in retail operations, including as Executive Vice President of U.S. Stores.

According to GameStop's 2015 proxy statement, executive compensation is divided in 3 key segments:

1. Base Salary
2. Short-term incentive awards
3. Long-term incentive awards

Base Salary

The base salary for named executives is based on the responsibility and experiences of each named executive officer (NEO), the results of the benchmarking against the peer group (See Table 2), and the recommendations received from ClearBridge, a compensation adviser, following its research. In addition, the committee also considers the Company's growth and continued expansion of non-core segments such as mobile, collectibles and digital. Base salary for all NEO's increased by 3% in 2015, except for Mr. DeMatteo who is the Executive Chairman. Mr. Raines' Base Salary was of $1,250,000 in 2015. The other four NEOs received an average of $678,000 in Base Salary.

Table 2: List of GameStop's Peer Group (2015)

Abercrombrie & Fitch	Dick's Sporting Goods	Office Depot
Advanced Auto Parts	Foot Locker	O'Reilly Automotive
AutoZone	Gap	PetSmart
Barnes & Noble	L Brands	Ross Stores
Bed Bath and Beyond	Nordstrom	Tiffany & Co

Source: GameStop 2015 Proxy

Short-term incentive (STI)

Each NEO is eligible for a performance-based annual short-term cash incentive. Ultimately, STI payouts were determined based on the achievement of Operating Earnings and the growth of the Technology Brands and other retail stores, weighted 75% and 25% respectively (Table 3). The payout ranged between 85% and 125% of Target. Mr. Raines was eligible for STI awards up to 200% of base salary (Table 4).

Table 3: GameStops Executive Short-term Incentive performance metrics

	Operating Earnings (FY2015)	Technology Brands and other concepts store Growth (FY2015)
Target	$676 million	300 stores
Actual	$678 million	591 stores
STI Earned	100%	125%

Source: GameStop 2015 Proxy

Table 4: Realized Cash Incentive for Named GME Executives

Named Executives	Aggregate Performance Against Target	2015 Award
J. Paul Raines	106%	$2,650,000
Robert A. Lloyd	106%	$729,280
Daniel A. DeMatteo	106%	$874,500
Tony D. Bartel	106%	$1,192,500
Michael K. Mauler	106%	$608,440

Source: GameStop 2015 Proxy

Long-term Incentive Awards (LTI)

Time-vested restricted stock and performance based restricted stock units (RSUs) were granted to align the interests of the NEO's with the interests of the Company's stockholders, offer NEOs incentive for achievement of superior performance and foster the retention of key management personnel. LTI parameters for 2015 were as follows:

1. Time-vested restricted stock awards are subject to a three-year ratable vesting schedule and achieving net income of $200 million for fiscal 2015 to achieve tax deductibility. This condition was met in fiscal 2015.
2. The LTI award was comprised of 50% time-vested restricted stock and 50% performance-based restricted stock.
    a. In determining the amount of equity grants to each NEO, the Compensation Committee considers the Company's overall performance, projections for upcoming fiscal year, each NEO's individual contributions to Company's performance, and total compensation of similar positions within Peer Group.
    b. Performance-based restricted stock are subject to performance against a pre-determined two-year net income goal, measured at end of fiscal 2016. Net income was selected as a measure to focus on the long-term profitability of the Company. The target net-income goals have not been disclosed as of the writing of this paper.
3. The value of performance-based RSU's is relative to a NEO-specific Target Award and determined by the mentioned Net-income Target. NEO's do not receive any award if the performance is less than 85% of Target.
4. The pay for performance scale and respective goals for the 2013 performance-based RSU's were tied to the 3-year Return on Invested Capital (ROIC). The Target was 17.5% and actual performance was 16.6%, which resulted in a 94.7% performance achieved as percentage of Target. NEO's were awarded 85% of Target Award for this performance.

Table 5: Total Compensation for GameStop Corp. CEO, J. Paul Raines

Name and Position	Year	Salary ($)	Stock Awards ($)	Non-Equity Incentive Plans Compensation	Option Awards	All Other Compensation ($)	Total ($)
J. Paul Raines (CEO)	2015	1,246,923	5,002,330	2,650,000	-	240,644	9,139,897
	2014	1,201,346	3,751,078	2,057,000	1,250,236	344,916	8,604,576
	2013	1,059,423	3,002,227	2,120,000	998,757	193,692	8,349,099[1]

1 Includes a Special Cash Bonus of $950,000

Source: GameStop 2015 Proxy

Based on our analysis, it is our opinion that GME's compensation structure is not a detriment to shareholders or our investment thesis. We believe that performance-based pay should have a larger share of total pay. Currently, 50% of the total compensation for NEO's is Base Salary and Time-Vested RSU's. We should notice however, the change from ROIC to Net Income as targets for performance-based RSU's. This shows a larger focus on overall company profitability and bottom line growth than before, which demonstrates commitment to their core industry. At the same time, STI's rewarding earnings and tech stores growth pushes management in the direction of higher-margin businesses. This is what will make GameStop overcome "the next blockbuster" fears and will be a catalyst to unlocking its value.

Dividend and Per Share History

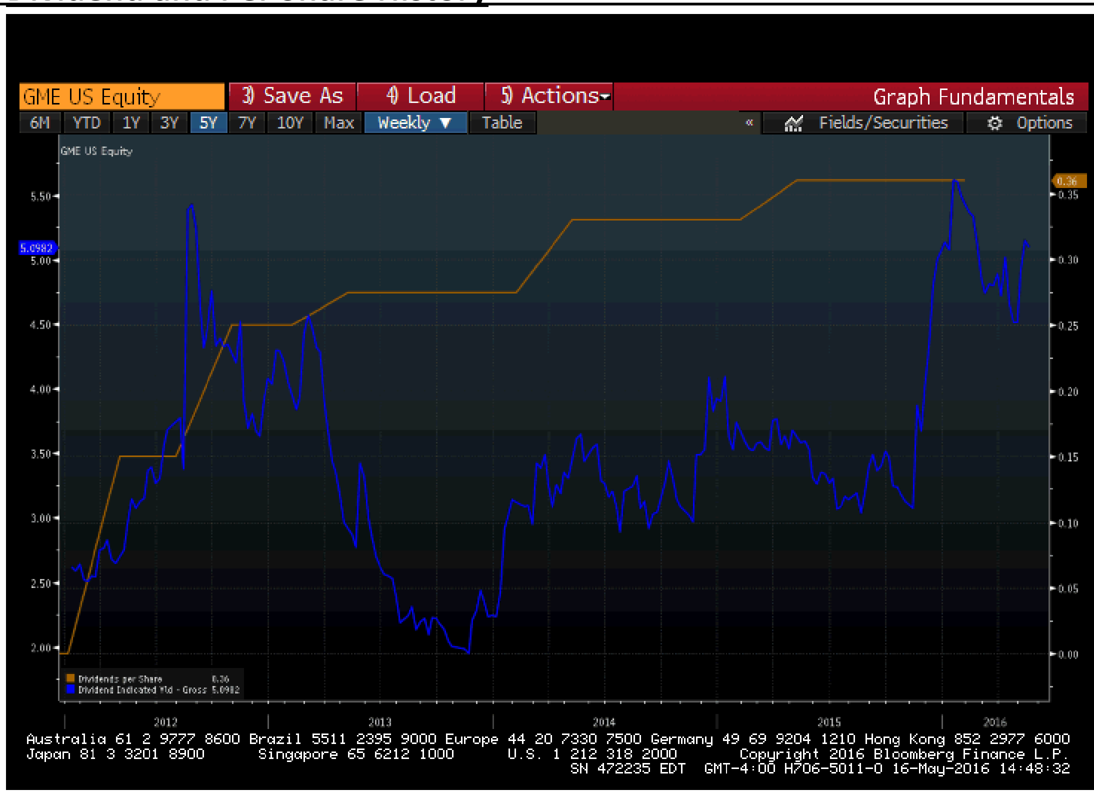


Figure 3 : GameStop's Dividend per Share (Brown) and Dividend Yield (Blue) from 2012 to 2015.
Source: Bloomberg Terminal. Command: GF. Accessed 5/16/2016

GME has declared dividends since early 2012, and has steadily increased them since from $1.10 to $1.48/share (Figure3). The current dividend level relative to the current stock price yields a high 5.10%. Keeping a track record of strong dividends allows management to affirm the company's ability to generate enough cash flows overtime.

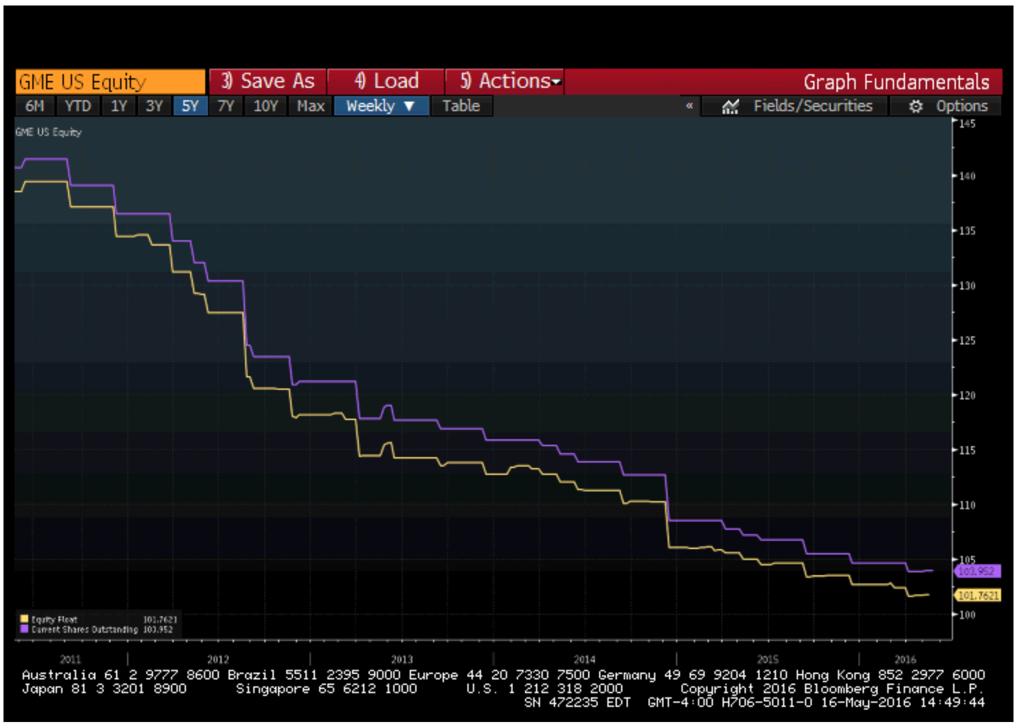


Figure 4 : GameStop's Equity Float (Yellow) and Shares Outstanding (purple) from 2011 to 2015.
Source: Bloomberg Terminal. Command: GF. Accessed 5/16/2016

Both equity float and shares outstanding have steadily declined from 140 Million to 104 Million, a result of substantial repurchase programs (Figure 4). Since 2014, GME has repurchased $793.7MM of shares, and an additional $245.3 remains.

Management Guidance

During the 4th quarter 2015-16 Annual earnings call, Mr. Lloyd (CFO) provided some details on future expectations for GameStop. Full-year revenue is forecasted to range between flat and positive 3%, with same-store sales ranging from negative 3% to flat. The expected decline in hardware is what drives down the same-store sales number. Tech Brand Sales, not included in the comps, are expected to grow between 50 %and 60%. Bottom line earnings per share (EPS) is projected between $3.90 and $4.05, or flat to an increase of 5%. Management expects an increase in operating earnings of 3% to 7% by continuing expansion of gross margins to new record levels. Mr. Lloyd also reaffirms GameStop's commitment to pursuing growth on their non-physical gaming segments and expects it to reach 30% of operating earnings for 2016.

Multiples Analysis

To inspect where GME is currently trading on a multiples level relative to where it has historically traded we inspected the historical data on a Bloomberg Terminal. This may provide insight into market expectations that may or may not be discounted into the current stock price.

Figure 5: GameStop's Price to Book Ratio from 2011 to 2015
The trend for GME's P:B ratio seems to be following their stock price

GameStops average Price-to-Book ratio in the past five years was 1.72x and its current Book Value per share is 20.15 (figure 5). This would imply a share price of $34.66. From a historic Book Value standpoint, GME shares are undervalued.

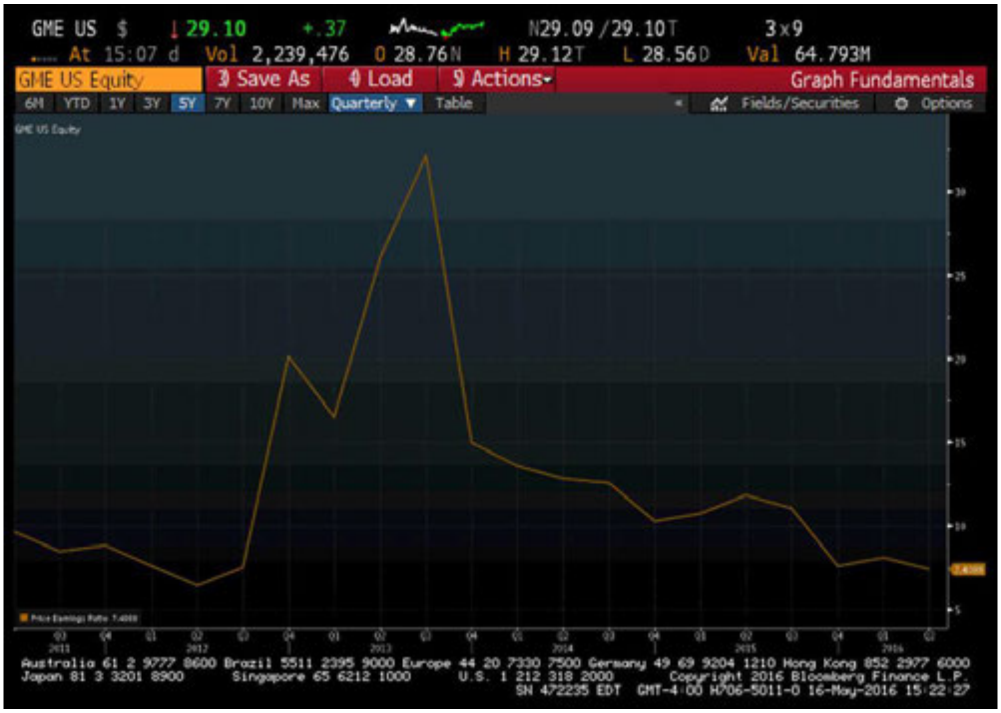
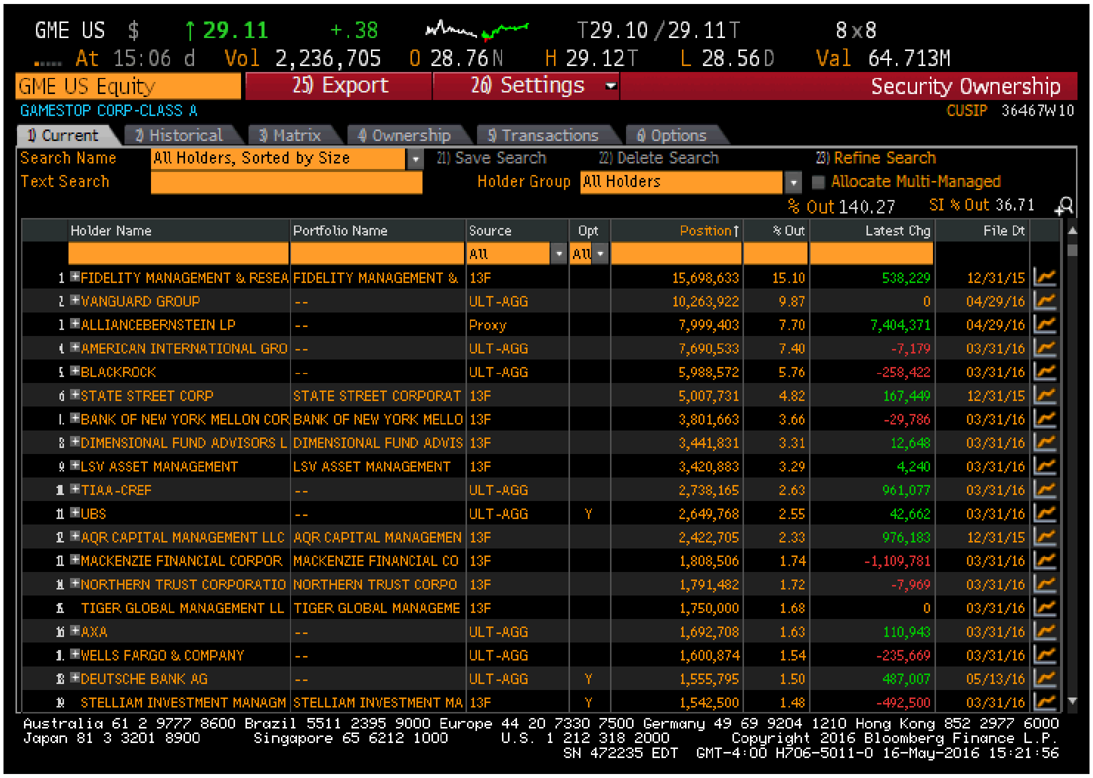


Figure 6: GameStop's P/E Ratio from 2011 to 2015
The last 5 years of P/E ratios have fluctuated. Very dissimilar to revenue and EPS trends

GameStops price to earnings (P/E) ratio has been trading below 15x for the past three years. The average P/E Ratio in the past five years is 12.85x. The current multiple being below 10x suggests that the market is discounting potential fears of the physical gaming business into its current valuation. We believe this is the cornerstone of our thesis and provides significant upside should GME recover.

Holders and Insider Trading



GME US $ ↑29.11 +.38 T29.10/29.11T 8x8
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GME US Equity 25) Export 26) Settings Security Ownership
GAMESTOP CORP-CLASS A CUSIP 36467W10
1) Current 2) Historical 3) Matrix 4) Ownership 5) Transactions 6) Options
Search Name All Holders, Sorted by Size 21) Save Search 22) Delete Search 23) Refine Search
Text Search Holder Group All Holders Allocate Multi-Managed
% Out 140.27 SI % Out 36.71

	Holder Name	Portfolio Name	Source	Opt	Position	% Out	Latest Chg	File Dt
			All	All				
1	FIDELITY MANAGEMENT & RESEA	FIDELITY MANAGEMENT &	13F		15,698,633	15.10	538,229	12/31/15
2	VANGUARD GROUP	--	ULT-AGG		10,263,922	9.87	0	04/29/16
3	ALLIANCEBERNSTEIN LP	--	Proxy		7,999,403	7.70	7,404,371	04/29/16
4	AMERICAN INTERNATIONAL GRO	--	ULT-AGG		7,690,533	7.40	-7,179	03/31/16
5	BLACKROCK	--	ULT-AGG		5,988,572	5.76	-258,422	03/31/16
6	STATE STREET CORP	STATE STREET CORPORAT	13F		5,007,731	4.82	167,449	12/31/15
7	BANK OF NEW YORK MELLON COR	BANK OF NEW YORK MELLO	13F		3,801,663	3.66	-29,786	03/31/16
8	DIMENSIONAL FUND ADVISORS L	DIMENSIONAL FUND ADVIS	13F		3,441,831	3.31	12,648	03/31/16
9	LSV ASSET MANAGEMENT	LSV ASSET MANAGEMENT	13F		3,420,883	3.29	4,240	03/31/16
10	TIAA-CREF	--	ULT-AGG		2,738,165	2.63	961,077	03/31/16
11	UBS	--	ULT-AGG	Y	2,649,768	2.55	42,662	03/31/16
12	AQR CAPITAL MANAGEMENT LLC	AQR CAPITAL MANAGEMEN	13F		2,422,705	2.33	976,183	12/31/15
13	MACKENZIE FINANCIAL CORPOR	MACKENZIE FINANCIAL CO	13F		1,808,506	1.74	-1,109,781	03/31/16
14	NORTHERN TRUST CORPORATIO	NORTHERN TRUST CORPO	13F		1,791,482	1.72	-7,969	03/31/16
15	TIGER GLOBAL MANAGEMENT LL	TIGER GLOBAL MANAGEME	13F		1,750,000	1.68	0	03/31/16
16	AXA	--	ULT-AGG		1,692,708	1.63	110,943	03/31/16
17	WELLS FARGO & COMPANY	--	ULT-AGG		1,600,874	1.54	-235,669	03/31/16
18	DEUTSCHE BANK AG	--	ULT-AGG	Y	1,555,795	1.50	487,007	05/13/16
19	STELLIAM INVESTMENT MANAGM	STELLIAM INVESTMENT MA	13F	Y	1,542,500	1.48	-492,500	03/31/16

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Figure 7: GameStop's Institutional Shareholders
Source: Bloomberg Terminal. Command: OWN. Accessed 5/16/2016

Figure 7 (above) is a list of GME's top shareholders in descending order. The Company is owned primarily by large institutional investors and financial corporations such as Fidelity, AIG, BlackRock, BNY Mello, UBS, and others. Hedge Funds such as Stelliam Investment Management and AQR Capital Management also hold large positions. Given the high-quality nature of these holders, we believe that there is no cause for concern for our investment thesis.

Firm specific issues

We understand the market concerns that GameStop's core business is unstable. GameStop will keep facing fierce competition from both Brick and Mortar brands such as Wal-Mart, Target, and Best Buy, as well as Online giants such as Microsoft, Sony, and Amazon. As consumer demand shifts from physical to downloadable content, it is possible that any competitive advantage GME presents will fade away. However, we don't expect the shift to digital content to be as fast as the market anticipates. Additionally, one could argue that operating small technology stores will become the next core business for GME.

One other source of concern is the lack of positive investments by Executive Management in the Company. We have discussed in the proxy statement analysis that management receives large amounts of compensation through stock awards, and as such it is natural to observe some liquidation of positions overtime. Therefore, it is common to see insiders increasing their stock holdings after price dips. This is not the case of GME (See Figure 8), which has only observed divestitures from insiders in the past two years, even after significant dips. This does not allow us to identify what insiders think to be the "fair-value" of the stock price.

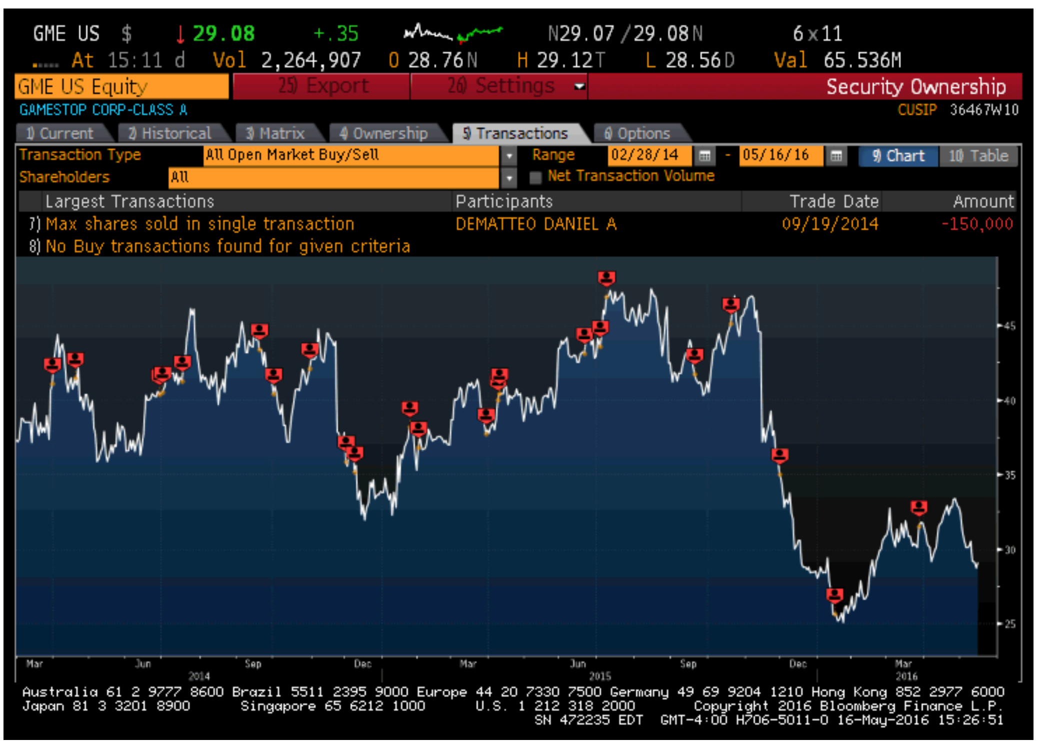

Figure 8: GameStop's Insiders Transactions

Each red pentagonal shape represents a divestiture or sale of GME shares. The plot is of share price versus time in years and month.

Source: Bloomberg Terminal. Command: GPTR Accessed 5/16/2016

Conclusion

From the analysis presented above, we estimate that GME's shares are currently undervalued. As of the time of this writing, we believe GME is worth approximately $39.57 per share representing a 35.5% upside (currently trading at $28.73). We believe that GME's diversifying revenue stream coupled with margin expansion is not fully appreciated by the market. Management compensation is aligned with our investment thesis and we believe they are capable of instituting the necessary changes to restore growth. Furthermore, the negative sentiment surrounding the decline of GME's core business has led to a market overreaction. This in turn makes the company cheap on an intrinsic valuation basis and represents a money making opportunity to us. Thus, we conclude that GME is a **STRONG BUY**.

Addendum

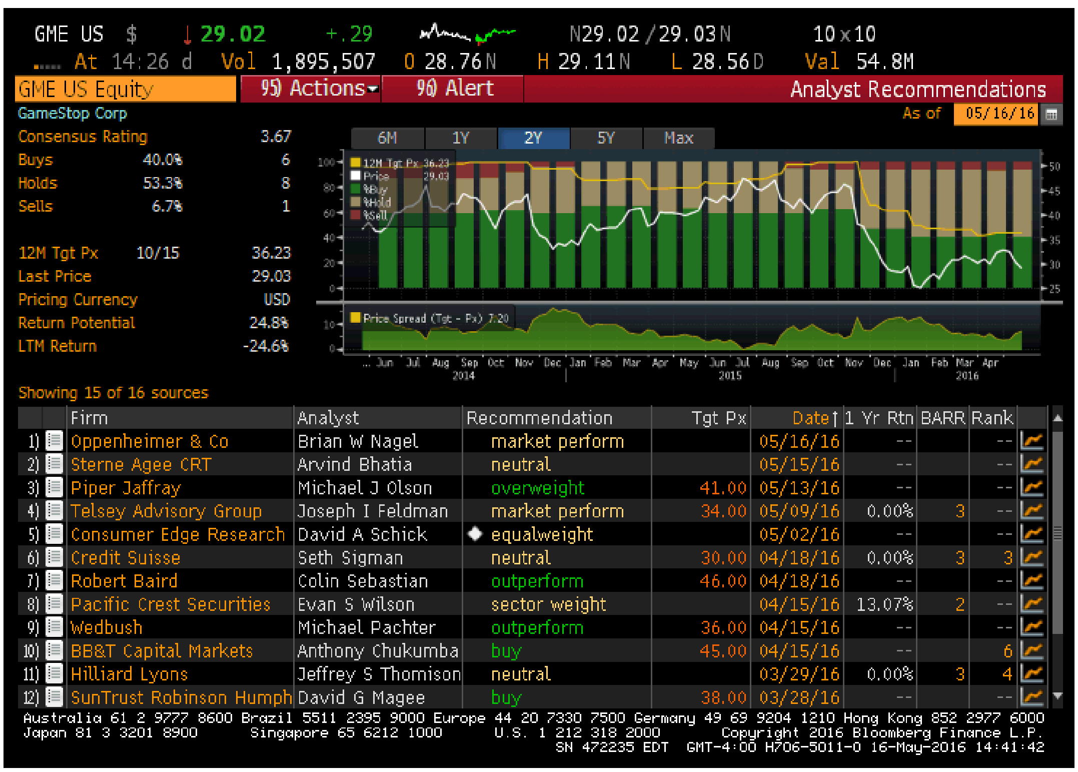

Figure 9: Analyst Recommendations

Source: Bloomberg Terminal. Command: ANR Accessed 5/16/2016

The majority of Analysts covering GME rate the stock a "hold" (53%) while the other significant share of analysts rate the stock a buy (40%). This corroborates our thesis that the market is not seeing the opportunity to go long GameStop as it shifts its business to more profitable segments within the retail space.