Mossberg's Investor Digest

Best Idea Profile **GameStop (NYSE: GME)**

DESCRIPTION:

Headquartered in Grapevine, TX, GameStop is the world's largest video game retailer. GME has approximately 6,200 stores located in the U.S. (4,300 stores), Canada (325 stores), Europe (1,200 stores), and Australia/New Zealand (350 stores). In its stores and on its e-commerce sites, GameStop.com and ebgames.com, GME sells and trades new and used video game software, hardware and other related accessories and merchandise. GME also publishes *Game Informer* magazine the largest video game magazine in N. America…five times larger than its closest competitor. *Game Informer* is the 12th largest consumer publication in the U.S. with 3.5 million paid subscriptions.

KEY INVESTMENT CONSIDERATIONS:

Used video games are the key to GameStop's competitive moat – As the largest retailer of used video games, GameStop has a substantial competitive advantage over other video game retailers, one that would be very difficult to duplicate.

- ***Large selection of games for older platforms –*** GME is the only large retailer that carries a large selection of used games. GME offers approx. 3,000 SKUs of used video game titles for use on current and previous generation gaming platforms. The base of used platforms is large and growing. Based NPD Group reports, only 43% of the 185 million units of handheld and console video game systems in the US are current generation platforms. According to GME's estimates, the installed base of video game software units in the US currently exceeds 1.5 billion units.
- ***Proprietary inventory system –*** Building a system to manage 3,000 SKU's isn't easy. GME's proprietary system is 13 years in the making.
- ***Refurb center –*** GME refurbished 14 million discs and 1 million hardware units in 2008 at its in-house refurb center. No other retailer has this in-house capability.
- ***Trading in used video games becomes currency for new sales –*** Customers can trade in used video games in exchange for credit for new purchases. This is a service that is generally unavailable at most mass merchants, toy stores and electronics retailers.
- ***Used business is heavily regulated with significant compliance burdens –*** GME has invested in training, systems and personnel to be compliant with regulations of trading used games. In addition to regulations designed to prevent sale of stolen merchandise and limits on purchases from minors, there are many specialized local requirements. Approx. 50% of GME's stores require some type of license to buy and sell used goods, about 25% have fingerprinting requirements.

Used video games are recession resistant and produce higher margin – With an average price of $18, compared to the average price of $41 for new video games, it's easy to see the value proposition of used games for consumers with tighter budgets. This was evident in 1Q results….during the first quarter used video game sales increased 32% versus a 3% decline for new games. Used video games also generate significantly higher gross margin, 48% to 50%, versus the company's overall margin of 26% (fiscal 2008). During fiscal 2008, used video games accounted for 23% of revenue and 43% of gross profit. While new game and console sales may be under pressure due to the difficult economic environment, the mix shift that includes higher margin used games should allow the company to meet its annual guidance.

VALUATION:

The current share price is relatively unchanged from where it started the year. In addition to the lackluster top line performance during the first quarter and difficult comparisons in 2Q09, shares are likely feeling pressure from concerns over new entrants into the used video game market and electronic delivery of games. Trading at 4.6x EV/ EBITDA it appears these concerns are already accounted for in the valuation. Based on the CFO's $1 million purchase between $22 and $25 per share, it appears he believes the concerns are overblown.

(NYSE: GME)
Investment Data (as of 6/26/09)

Recent Price	**$22.17**
52-Week Range	16.91 - 47.69
Fiscal Year End	January
Dividend	N/A
Yield	N/A
Shares Outstanding	165 MM
Average Trading Volume (3 mos)	5 MM
Market Capitalization	3.7 B
Cash	230 MM
Long Term Debt	495 MM
Enterprise Value (EV)	3.9 B
LT Debt/ Equity	0.20
BV/ Share	14.71
TTM Revenue	9.0 B
P/ Revenue	0.4x
TTM EPS (non-GAAP)	2.42
P/ EPS	9.2x
TTM EBITDA	848 MM
EV/ TTM EBITDA	4.6x