

Endgame?

GameStop has made itself into the dominant bricks-and-mortar retailer of videogames in the U.S. Will that work out better for the company than the comparable position for music and movie retailers before it?

Despite ups and downs due to the timing of hit games and product-console releases, the videogame business has been a shining star in the ever-evolving entertainment marketplace. New games selling for \$40 to \$50 each still provide significant bang for a consumer's entertainment buck, while ever more powerful and creative game consoles like Nintendo's Wii broaden both the types of games played and the audience that plays them.

That's been great news for GameStop, the dominant videogame retailer with more than 4,000 U.S. stores under the GameStop and EB Games names. With nearly \$9 billion in annual sales, the company has used its physical presence and large customer base to augment new-game sales with a vibrant trade-in business, in which customers trade used games and hardware for discounts on new purchases. Customers love it and so does GameStop – gross margins on used-game sales are 50%, versus 20% on new games. While consumer-spending woes have fueled a 50% fall in GME's share price since last September, the stock at a recent \$23.50 has more than tripled over the past five years.

Impressive as its past has been, Thomas Eidelman of Eidelman Capital believes GameStop's future is anything but bright. As with music and movie retailers before it, he expects advancing technology – in the form of online delivery of videogames – to lay siege to the company's business. On top of that, in the physical world both Best Buy and Wal-Mart are targeting GameStop's lucrative trade-in model. “The company behaves as if these new threats may be an issue someday,” says Eidelman. “I'm saying they're big, bad and are going to happen fast.”

The key issue is the file size of the typical game, which historically has been too big for the average consumer to efficiently download and store. But as Internet bandwidth speeds increase and computers and consoles become more powerful, Eidelman

expects the calculus to tip quickly in favor of online delivery. Download speeds are already reasonable, he says, as the typical game can be retrieved over a high-speed connection in two to three hours.

Game and console makers are gearing up for increased online-delivery demand. Electronic Arts last month released a download-only game called *Battlefield 1943* which sold 600,000 copies in the first month, while Activision has sold four million online updates to its *Call of Duty, World at War*. The new Sony PSP hand-

held device will only support downloaded games. Microsoft's Xbox Live recently rolled out a game-on-demand system.

“Something like GameStop can be scary to short,” says Eidelman, “because it trades at a low multiple and earnings are still OK. It doesn't go away tomorrow, but we'd expect the share price to be much closer to zero than the current price in 18 to 24 months.”

Funds co-managed by co-Editor Whitney Tilson are short GME. VII

INVESTMENT SNAPSHOT

GameStop (NYSE: GME)

Business: Retailer of new and used videogame hardware and software, sold through GameStop and EB Games mall stores.

Share Information (@8/28/09):

Price	23.47
52-Week Range	16.91 – 46.36
Dividend Yield	0.0%
Market Cap	\$3.86 billion

Financials (TTM):

Revenue	\$8.91 billion
Operating Profit Margin	7.5%
Net Profit Margin	4.4%

Valuation Metrics

(@8/28/09):

	GME	S&P 500
Trailing P/E	10.1	70.8
Forward P/E Est.	8.2	17.2

Largest Institutional Owners

(@6/30/09):

Company	% Owned
Vanguard Group	4.4%
Barclays Global Inv	4.1%
State Street Corp	3.5%

Short Interest (As of 8/11/09):

Shares Short/Float	10.7%
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GME PRICE HISTORY



THE BOTTOM LINE

Tom Eidelman believes increasing online delivery of videogames and new competition from Best Buy and Wal-Mart are about to lay siege to the company's business. Within two years he expects the share price to be “much closer to zero than the current price.”

Sources: Company reports, other publicly available information