GameStop
POWER TO THE PLAYERS

FRAMEWORK Investing

Valuation Waterfall

Revenue Growth

GME's main source of revenues (>75%) has been the video game distribution business, including new gaming hardware (consoles, etc.), new game software (physical and digital), pre-owned game software (physical and digital) and gaming accessories. In 2016, the company diversified into collectibles (thinkgeek) and electronics (Spring Mobile, Cricket Wireless (ATT) and SimplyMac (Apple)). These businesses are growing over 15% annually with the company's target for it to overtake the legacy videogame business by 2021. The question is can it grow fast enough to stem the contraction in gaming?

Profitability

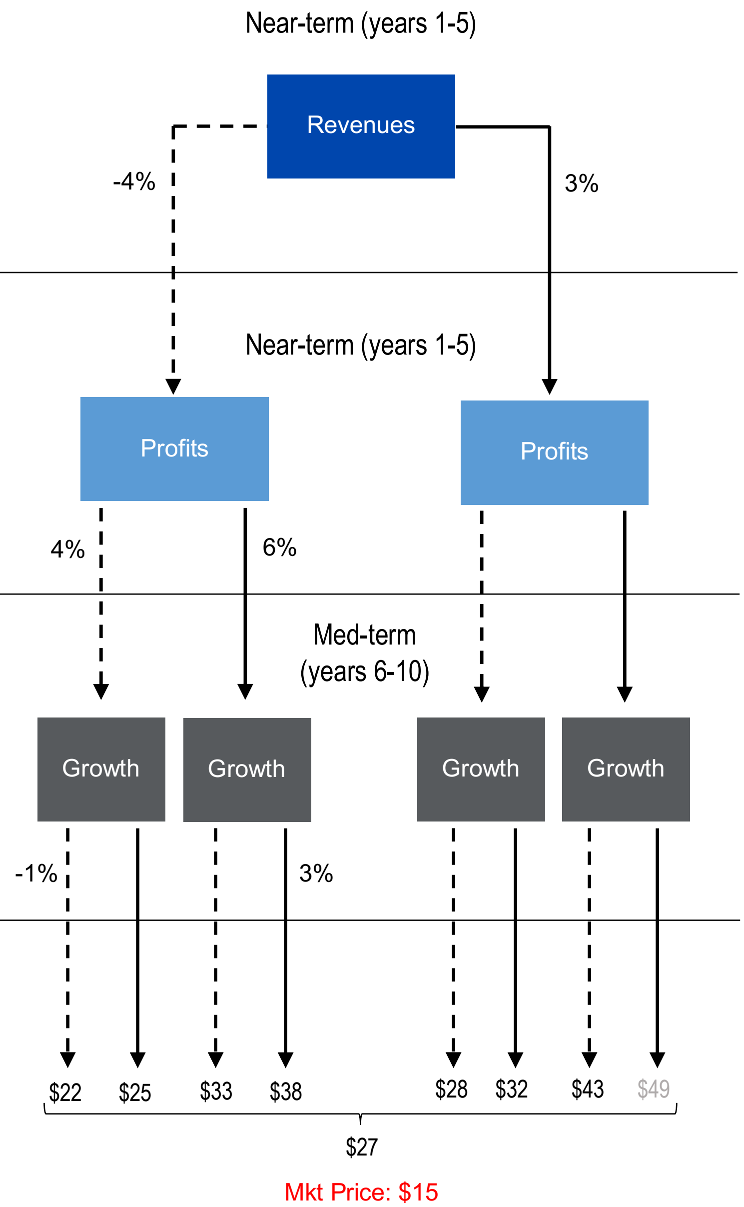
Profit Margins at the Company have been steady even as the sources of revenues have evolved. At the low end, GME delivers OCP margins ~4% and at the high end around 6%. GME management works very hard to manage store counts and locations. This has resulted in strengthening same store sales in FY2018. Strong merchandising and pricing management delivered a better than expected holiday season. GME counts HR management and real estate knowledge as part of their core competencies. All this is designed to help them manage costs on a low margin business.

Medium-Term Cash Flow Growth

We expect investment stage cash flow growth to remain muted running at or below GDP in the US. This is driven by GME's transition phase between being a pure play video game distributor to becoming a family of retail brands selling popular culture and consumer electronics products. This transition is in its early days and we will be watching carefully for signs that the company can successfully navigate it's new business lines.

Fair Value Range

Our fair value range extends from $22 to $43 / share and four out of eight of the values lie between $25 and $33 per share. The average of all our FV scenarios is $32 per share, 100% higher than the present price. The worst-worst-worst scenario valuation is $22 per share; 46% HIGHER than the current price. GME appears priced for a rapid decline in financial performance followed by "GAME OVER". Based on the company's operations, that does not appear likely.



16 March 2018

Methodology

Framework Investing analyses focus on three main valuation drivers: revenue growth, profitability, and medium-term cash flow growth. We estimate a best- and worst-case scenario for each of these drivers resulting in a total of 2^3 = 8 fair value scenarios based on discounted cash flow methodology. Profitability is measured by [Owners' Cash Profit (OCP)]() margin and our measure of free cash flow is termed [Free Cash Flow to Owners (FCFO)](). We use a discount rate of 10% for large capitalization stocks. A wide spread of lowest and highest fair values indicates a firm whose value is uncertain. Risk depends on the stock price's relationship to the valuation range. Best-case scenarios are represented with a solid line; worst-case scenarios, with a dotted one.