GAMESTOP CORP
Form 10-Q
December 11, 2003

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended November 1, 2003**

**or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission file no. 1-31228**

# GameStop Corp.

*(Exact name of registrant as specified in its Charter)*

| | |
|---|---|
| **Delaware**<br>*(State or other jurisdiction of incorporation or organization)* | **75-2951347**<br>*(I.R.S. Employer Identification No.)* |
| **2250 William D. Tate Avenue**<br>**Grapevine, Texas**<br>*(Address of principal executive offices)* | **76051**<br>*(Zip Code)* |

**Registrant s telephone number, including area code:**

**(817) 424-2000**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined on Rule 12b-2 of the Exchange Act). Yes þ No o

Number of shares of $.001 par value Class A Common Stock outstanding as of November 28, 2003: 19,371,938

Number of shares of $.001 par value Class B Common Stock outstanding as of November 28, 2003: 36,009,000

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## PART I FINANCIAL INFORMATION

**Item 1.** *Financial Statements*

### GAMESTOP CORP.

### CONSOLIDATED BALANCE SHEETS

| | November 1, 2003 | November 2, 2002 | February 1, 2003 |
|---|---|---|---|
| | (Unaudited) | (Unaudited) | |
| | (In thousands, except per share data) | | |
| **ASSETS** | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 91,577 | $125,121 | $232,030 |
| Receivables, net | 8,013 | 7,461 | 6,893 |
| Merchandise inventories | 309,691 | 268,393 | 161,369 |
| Prepaid expenses and other current assets | 10,964 | 8,976 | 10,127 |
| Prepaid taxes | 16,798 | | |
| Deferred taxes | 6,034 | 3,418 | 6,034 |
| Total current assets | 443,077 | 413,369 | 416,453 |
| Property and equipment: | | | |
| Leasehold improvements | 52,287 | 36,413 | 39,927 |
| Fixtures and equipment | 124,498 | 77,590 | 84,726 |
| | 176,785 | 114,003 | 124,653 |
| Less accumulated depreciation and amortization | 76,067 | 49,854 | 56,259 |
| Net property and equipment | 100,718 | 64,149 | 68,394 |
| Goodwill, net | 320,826 | 317,957 | 317,957 |
| Other noncurrent assets | 1,401 | 1,148 | 1,105 |
| Total other assets | 322,227 | 319,105 | 319,062 |
| Total assets | $866,022 | $796,623 | $803,909 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | |
| Current liabilities: | | | |
| Accounts payable | $239,184 | $209,491 | $160,378 |
| Accrued liabilities | 75,334 | 64,500 | 65,779 |
| Accrued income taxes payable | | 1,888 | 20,614 |
| Total current liabilities | 314,518 | 275,879 | 246,771 |
| Deferred taxes | 5,574 | 3,065 | 5,591 |
| Other long-term liabilities | 3,314 | 2,777 | 2,872 |
| | 8,888 | 5,842 | 8,463 |

| | | | |
|---|---|---|---|
| Total liabilities | 323,406 | 281,721 | 255,234 |
| Stockholders equity: | | | |
| Preferred stock authorized 5,000 shares; no shares issued or outstanding | | | |
| Class A common stock $.001 par value; authorized 300,000 shares; 21,674, 20,971 and 21,050 shares issued, respectively | 22 | 21 | 21 |
| Class B common stock $.001 par value; authorized 100,000 shares; 36,009 shares issued and outstanding | 36 | 36 | 36 |
| Additional paid-in-capital | 499,059 | 491,812 | 493,998 |
| Accumulated other comprehensive loss | (25) | | |
| Retained earnings | 78,530 | 23,033 | 54,620 |
| Treasury Stock, at cost, 2,304, 0 and 0 shares, respectively | (35,006) | | |
| Total stockholders equity | 542,616 | 514,902 | 548,675 |
| Total liabilities and stockholders equity | $866,022 | $796,623 | $803,909 |

See accompanying notes to consolidated financial statements.

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**GAMESTOP CORP.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---|---|---|---|
| | November 1, 2003 | November 2, 2002 | November 1, 2003 | November 2, 2002 |
| | (In thousands, except per share data) (Unaudited) | | | |
| Sales | $326,042 | $286,728 | $953,457 | $832,395 |
| Cost of sales | 227,568 | 212,883 | 680,559 | 616,014 |
| Gross profit | 98,474 | 73,845 | 272,898 | 216,381 |
| Selling, general and administrative expenses | 72,865 | 52,001 | 212,662 | 165,217 |
| Depreciation and amortization | 7,718 | 5,862 | 20,807 | 16,605 |
| Operating earnings | 17,891 | 15,982 | 39,429 | 34,559 |
| Interest income | (290) | (519) | (1,190) | (1,484) |
| Interest expense | 228 | 139 | 542 | 1,229 |
| Earnings before income tax expense | 17,953 | 16,362 | 40,077 | 34,814 |
| Income tax expense | 7,260 | 6,577 | 16,167 | 13,997 |
| Net earnings | $ 10,693 | $ 9,785 | $ 23,910 | $ 20,817 |
| Net earnings per common share-basic | $ 0.19 | $ 0.17 | $ 0.42 | $ 0.37 |
| Weighted average shares of common stock-basic | 55,767 | 56,931 | 56,538 | 56,039 |
| Net earnings per common share-diluted | $ 0.18 | $ 0.16 | $ 0.40 | $ 0.34 |
| Weighted average shares of common stock-diluted | 59,431 | 61,111 | 59,953 | 60,372 |

See accompanying notes to consolidated financial statements.

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**GAMESTOP CORP.**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

| | Common Stock | | | | Additional Paid in Capital | Accumulated Other Comprehensive Loss | Retained Earnings | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Class A | Shares | Class B | | | | | |
| | (In thousands) (Unaudited) | | | | | | | | |
| Balance at February 1, 2003 | 21,050 | $ 21 | 36,009 | $ 36 | $ 493,998 | $ | $ 54,620 | $ | $ 548,675 |
| Comprehensive income: | | | | | | | | | |
| Net earnings for the 39 weeks ended November 1, 2003 | | | | | | | 23,910 | | |
| Foreign currency translation | | | | | | (25) | | | |
| Total comprehensive income | | | | | | | | | 23,885 |
| Exercise of employee stock options (including tax benefit of $2,815) | 624 | 1 | | | 5,061 | | | | 5,062 |
| Treasury stock acquired, 2,304 shares | | | | | | | | (35,006) | (35,006) |
| Balance at November 1, 2003 | 21,674 | $ 22 | 36,009 | $ 36 | $ 499,059 | $ (25) | $ 78,530 | $ (35,006) | $ 542,616 |

See accompanying notes to consolidated financial statements.

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**GAMESTOP CORP.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | 39 Weeks Ended November 1, 2003 | 39 Weeks Ended November 2, 2002 |
|---|---|---|
| | (In thousands) (Unaudited) | |
| Cash flows from operating activities: | | |
| Net earnings | $ 23,910 | $ 20,817 |
| Adjustments to reconcile net earnings to net cash flows used in operating activities: | | |
| Depreciation and amortization | 20,807 | 16,605 |
| Amortization of loan cost | 233 | 181 |
| Tax benefit realized from exercise of stock options by employees | 2,815 | |
| Deferred taxes | (17) | |
| Loss on disposal of property and equipment | 188 | 156 |
| Increase in other long-term liabilities for scheduled rent increases in long-term leases | 243 | 234 |
| Minority interest | (200) | |
| Changes in operating assets and liabilities, net | | |
| Receivables, net | (494) | (1,531) |
| Merchandise inventories | (146,130) | (130,042) |
| Prepaid expenses and other current assets | (746) | (721) |
| Prepaid taxes | (16,798) | |
| Accounts payable, accrued liabilities and accrued income taxes payable | 66,002 | 70,282 |
| Net cash flows used in operating activities | (50,187) | (24,019) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (51,725) | (29,287) |
| Acquisition of controlling interest in Gamesworld Group Limited, net of cash acquired | (3,027) | |
| Net increase in other noncurrent assets | (509) | (770) |
| Net cash flows used in investing activities | (55,261) | (30,057) |
| Cash flows from financing activities: | | |
| Issuance of 20,764 shares relating to the public offering, net of the related expenses | | 347,339 |
| Issuance of shares relating to employee stock options | 2,247 | 731 |
| Repayment of debt of Gamesworld Group Limited | (2,296) | |
| Repayment of debt due to Barnes & Noble, Inc. | | (250,000) |
| Net increase in other payable to Barnes & Noble, Inc. | | 377 |
| Purchase of treasury shares through repurchase program | (35,006) | |
| Net cash flows (used in) provided by financing activities | (35,055) | 98,447 |
| Exchange rate effect on cash and cash equivalents | 50 | |
| Net increase (decrease) in cash and cash equivalents | (140,453) | 44,371 |
| Cash and cash equivalents at beginning of period | 232,030 | 80,750 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $ 91,577 | $ 125,121 |

See accompanying notes to consolidated financial statements.

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**GAMESTOP CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(In thousands, except per share data)**
**(Unaudited)**

**1. Basis of Presentation**

The unaudited consolidated financial statements include the accounts of GameStop Corp. (the Company ) and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. All dollar and share amounts in the consolidated financial statements and notes to the consolidated financial statements are stated in thousands unless otherwise indicated.

The unaudited consolidated financial statements included herein reflect all adjustments (consisting only of normal, recurring adjustments) which are, in the opinion of the Company s management, necessary for a fair presentation of the information for the periods presented. These consolidated financial statements are condensed and, therefore, do not include all of the information and footnotes required by generally accepted accounting principles. These consolidated financial statements should be read in conjunction with the Company s annual report on Form 10-K for the 52 weeks ended February 1, 2003. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. Changes in the estimates and assumptions used by management could have significant impact on the Company s financial results. Actual results could differ from those estimates.

Due to the seasonal nature of the business, the results of operations for the 39 weeks ended November 1, 2003 are not indicative of the results to be expected for the 52 weeks ending January 31, 2004.

**2. Effect of Accounting Change**

In November 2002, the FASB Emerging Issues Task Force ( Task Force ) issued EITF Issue 02-16, Accounting by a Customer (including a Reseller) for Cash Consideration Received from a Vendor, ( EITF 02-16 ). EITF 02-16 addresses the following two issues: (i) the classification in a reseller s financial statements of cash consideration received from a vendor ( Issue 1 ); and (ii) the timing of recognition by a reseller of a rebate or refund from a vendor that is contingent upon achieving a specific cumulative level of purchases or remaining a customer for a specified time period ( Issue 2 ). Issue 1 stipulates that cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor s products and should, therefore, be recognized as a reduction of cost of merchandise sold when recognized in the reseller s financial statements. However, that presumption is overcome when the consideration is either (a) a payment for assets or services delivered to the vendor, in which case the cash consideration should be recognized as revenue (or other income, as appropriate) when recognized in the reseller s income statement, or (b) a reimbursement of a specific, incremental, identifiable cost incurred by the reseller in selling the vendor s products, in which case the cash consideration should be characterized as a reduction of that cost when recognized in the reseller s income statement. Issue 2 states that vendor rebates should be recognized on a systematic and rational allocation of the cash consideration offered to each of the underlying transactions that results in progress by the reseller toward earning the rebate, provided the amounts are probable and reasonably estimable. Issue 1 is effective prospectively for all new arrangements, including modifications of existing arrangements, entered into after December 31, 2002. Issue 2 is effective prospectively for all new arrangements initiated after November 21, 2002.

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**GAMESTOP CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company and its vendors participate in cooperative advertising programs and other vendor marketing programs in which the vendors provide the Company with cash consideration in exchange for marketing and advertising the vendors products. The change of our accounting for cooperative advertising arrangements and other vendor marketing programs resulted in consideration received from our vendors being used to lower product costs in inventory rather than as an offset to our marketing and advertising costs. The impact of the new accounting method decreased our cost of goods sold for the third fiscal quarter of 2003 by $11.4 million and increased net advertising expenses by $12.4 million. The impact of the new accounting method decreased our cost of goods sold for the first three fiscal quarters of 2003 by $13.8 million and increased net advertising expenses by $16.0 million. The impact to cost of goods sold reflects the reclassification of the cooperative advertising credit, as well as $2.2 million deferred as a reduction in inventory. Prior periods have not been restated. However, the following table presents the 13 weeks and 39 weeks ended November 1, 2003 and November 2, 2002 on a pro forma basis as if EITF 02-16 had been implemented prior to the beginning of fiscal 2002:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---|---|---|---|
| | November 1, 2003 | November 2, 2002 | November 1, 2003 | November 2, 2002 |
| | (In thousands, except per share data) (Unaudited) | | | |
| Sales | $326,042 | $286,728 | $953,457 | $832,395 |
| Cost of sales | 226,401 | 201,856 | 677,858 | 597,339 |
| Gross profit | 99,641 | 84,872 | 275,599 | 235,056 |
| Selling, general and administrative expenses | 72,865 | 63,158 | 212,662 | 184,151 |
| Depreciation and amortization | 7,718 | 5,862 | 20,807 | 16,605 |
| Operating earnings | 19,058 | 15,852 | 42,130 | 34,300 |
| Interest income | (290) | (519) | (1,190) | (1,484) |
| Interest expense | 228 | 139 | 542 | 1,229 |
| Earnings before income tax expense | 19,120 | 16,232 | 42,778 | 34,555 |
| Income tax expense | 7,687 | 6,525 | 17,197 | 13,891 |
| Net earnings | $ 11,433 | $ 9,707 | $ 25,581 | $ 20,664 |
| Net earnings per common share basic | $ 0.21 | $ 0.17 | $ 0.45 | $ 0.37 |
| Weighted average shares of common stock basic | 55,767 | 56,931 | 56,538 | 56,039 |
| Net earnings per common share diluted | $ 0.19 | $ 0.16 | $ 0.43 | $ 0.34 |
| Weighted average shares of common stock diluted | 59,431 | 61,111 | 59,953 | 60,372 |

**3. Accounting for Stock-Based Compensation**

Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation, ( SFAS 123 ) encourages but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. As permitted under Statement of Financial Accounting Standards No. 148, Accounting for Stock Based Compensation Transition and Disclosure, ( SFAS 148 ) which amended SFAS 123, the Company has elected to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost for stock options is

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**GAMESTOP CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

measured as the excess, if any, of the quoted market price of the Company s stock at the date of the grant over the amount an employee must pay to acquire the stock.

The following table illustrates the effect on net earnings and net earnings per common share as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation for the options granted under its plans:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---|---|---|---|
| | November 1, 2003 | November 2, 2002 | November 1, 2003 | November 2, 2002 |
| | (In thousands, except per share data) | | | |
| Net earnings, as reported | $10,693 | $9,785 | $23,910 | $20,817 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects* | 2,276 | 2,138 | 6,455 | 6,147 |
| Pro forma net earnings | $ 8,417 | $7,647 | $17,455 | $14,670 |
| Net earnings per common share basic, as reported | $ 0.19 | $ 0.17 | $ 0.42 | $ 0.37 |
| Net earnings per common share basic, pro forma | $ 0.15 | $ 0.13 | $ 0.31 | $ 0.26 |
| Net earnings per common share diluted, as reported | $ 0.18 | $ 0.16 | $ 0.40 | $ 0.34 |
| Net earnings per common share diluted, pro forma | $ 0.14 | $ 0.13 | $ 0.29 | $ 0.24 |

* Amounts include compensation expense associated with options to acquire approximately 350 shares of Barnes & Noble, Inc. ( Barnes & Noble ) which were issued to GameStop employees in January 2000 pursuant to the Barnes & Noble 1996 Incentive Plan.

There were no options granted during either of the 13 week-periods ended November 1, 2003 or November 2, 2002. The weighted-average fair value of the options granted during the 39 week-periods ended November 1, 2003 and November 2, 2002 were estimated at $5.17 and $8.08, using the Black-Scholes option pricing model with the following assumptions:

| | 39 Weeks Ended | |
|---|---|---|
| | November 1, 2003 | November 2, 2002 |
| Volatility | 61.8% | 61.9% |
| Risk-free interest rate | 3.1% | 4.6% |
| Expected life (years) | 6.0 | 6.0 |
| Expected dividend yield | 0% | 0% |

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**GAMESTOP CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

### 4. Computation of Net Earnings Per Common Share

A reconciliation of shares used in calculating basic and diluted net earnings per common share follows:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---|---|---|---|
| | November 1, 2003 | November 2, 2002 | November 1, 2003 | November 2, 2002 |
| | (In thousands, except per share data) | | | |
| Net earnings | $10,693 | $ 9,785 | $23,910 | $20,817 |
| Weighted Common Shares Outstanding | 55,767 | 56,931 | 56,538 | 56,039 |
| Common Share Equivalents Related to Options and Warrants | 3,664 | 4,180 | 3,415 | 4,333 |
| Common Shares and Common Share Equivalents | 59,431 | 61,111 | 59,953 | 60,372 |
| Net Earnings per Common Share: | | | | |
| Basic | $ 0.19 | $ 0.17 | $ 0.42 | $ 0.37 |
| Diluted | $ 0.18 | $ 0.16 | $ 0.40 | $ 0.34 |

Options to purchase approximately 4,071 shares of common stock at exercise prices ranging from $18.00 to $21.25 per share were outstanding during the 39 weeks ended November 1, 2003, but were not included in the computation of diluted earnings per share because they were anti-dilutive. These options expire at various times through 2012.

### 5. Debt

In February 2002, the Company entered into a $75,000 senior secured revolving credit facility which expires in February 2005. The revolving credit facility is governed by an eligible inventory borrowing base agreement, defined as 50% of non-defective inventory. Loans incurred under the credit facility will be maintained from time to time, at the Company s option, as: (1) base rate loans which bear interest at the base rate (defined in the credit facility as the higher of (a) the administrative agent s announced base rate, or (b) 1/2 of 1% in excess of the federal funds effective rate, each as in effect from time to time); or (2) LIBOR loans bearing interest at the LIBOR rate for the applicable interest period, in each case plus an applicable interest margin. In addition, the Company is required to pay a commitment fee of 0.375% for any unused amounts of the revolving credit facility. Any borrowings under the revolving credit facility are secured by the assets of the Company. The revolving credit facility generally restricts our ability to pay dividends and requires the Company to maintain certain financial ratios. There have been no borrowings under the revolving credit facility.

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**GAMESTOP CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. Comprehensive income**

Comprehensive income is net earnings, plus certain other items that are recorded directly to stockholders equity and consists of the following:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---|---|---|---|
| | November 1, 2003 | November 2, 2002 | November 1, 2003 | November 2, 2002 |
| | (In thousands) | | | |
| Net earnings | $10,693 | $9,785 | $23,910 | $20,817 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 50 | | (25) | |
| Total comprehensive income | $10,743 | $9,785 | $23,885 | $20,817 |

**7. Income Taxes**

The tax provisions for the 13 weeks and 39 weeks ended November 1, 2003 and November 2, 2002 are based upon management s estimate of the Company s annualized effective tax rate.

**8. Certain Relationships and Related Transactions**

The Company operates departments within bookstores operated by Barnes & Noble, an affiliate of the Company. The Company pays a license fee to Barnes & Noble on the gross sales of such departments. Management deems the license fee to be reasonable and based upon terms equivalent to those that would prevail in an arm s length transaction. These charges amounted to $207 and $243 for the 13 weeks ended November 1, 2003 and November 2, 2002, respectively, and $643 and $743 for the 39 weeks ended November 1, 2003 and November 2, 2002, respectively.

The Company participates in Barnes & Noble s worker s compensation, property and general liability insurance programs. The costs incurred by Barnes & Noble under these programs are allocated to the Company based upon the Company s total payroll expense, property and equipment, and insurance claim history. Management deems the allocation methodology to be reasonable. These charges amounted to $628 and $453 for the 13 weeks ended November 1, 2003 and November 2, 2002, respectively, and $1,793 and $1,281 for the 39 weeks ended November 1, 2003 and November 2, 2002, respectively.

In July 2003, the Company purchased an airplane from a company controlled by a member of the Board of Directors. The purchase price was $9,500 and was negotiated through an independent third party following an independent appraisal.

**9. Legal Proceedings**

On May 29, 2003, former Store Manager Carlos Moreira ( Plaintiff ) filed a class action lawsuit against the Company and its wholly owned subsidiary Gamestop, Inc. (collectively GameStop ) in Los Angeles County Superior Court alleging that GameStop s salaried retail managers were misclassified as exempt and should have been paid overtime. Plaintiff is seeking to represent a class of current and former salaried retail managers who were employed by GameStop in California at anytime between May 29, 1999 and the present. Plaintiff has alleged claims for violation of California Labor Code sections 203, 226 and 1194 and California Business and Professions Code section 17200. Plaintiff is seeking recovery of unpaid overtime, interest, penalties, attorneys fees and costs. The matter is in the precertification stage, and the parties are in the middle of class discovery. The court has ordered the parties to mediation, which will take place on January 15, 2004. The class certification hearing is set for April 28, 2004. GameStop intends to vigorously defend this action.

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**GAMESTOP CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Management does not believe there is sufficient information to estimate the amount of the possible loss, if any, resulting from the lawsuit.

In the ordinary course of our business, the Company is, from time to time, subject to various other legal proceedings. Management does not believe that any such other legal proceedings, individually or in the aggregate, will have a material adverse effect on the Company s operations or financial condition.

**10. Supplemental Cash Flow Information**

| | 39 Weeks Ended November 1, 2003 | 39 Weeks Ended November 2, 2002 |
|---|---|---|
| Cash paid during the period for: | | |
| Interest | $ 238 | $ 47,111 |
| Income taxes | 50,982 | 13,794 |
| Non-cash financing activity: | | |
| Barnes & Noble capital contribution | $ | $ 150,000 |

**11. Acquisitions**

On June 23, 2003, the Company acquired a controlling interest in Gamesworld Group Limited ( Gamesworld ), an Ireland-based electronic games retailer, for approximately $3,279. The acquisition was accounted for using the purchase method of accounting and, accordingly, the results of operations for the period subsequent to the acquisition are included in the consolidated financial statements. The excess of purchase price over the net assets acquired, in the amount of approximately $2,869, has been recorded as goodwill. The pro forma effect assuming the acquisition of Gamesworld at the beginning of fiscal 2002 and fiscal 2003 is not material.

**12. Repurchase of Equity Securities**

In March 2003, the Board of Directors authorized a common stock repurchase program for the purchase of up to $50,000 of the Company s Class A common shares. The Company may repurchase shares from time to time in the open market or through privately negotiated transactions, depending on prevailing market conditions and other factors. The repurchased shares will be held in treasury. During the 39 weeks ended November 1, 2003, the Company repurchased 2,304 shares at an average share price of $15.19.

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**Item 2.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

*The following discussion should be read in conjunction with the information contained in our consolidated financial statements, including the notes thereto. Statements regarding future economic performance, management s plans and objectives, and any statements concerning assumptions related to the foregoing contained in Management s Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements. Certain factors, which may cause actual results to vary materially from these forward-looking statements, accompany such statements or appear in the Company s Annual Report on Form 10-K for the fiscal year ended February 1, 2003 filed with the Securities and Exchange Commission on May 2, 2003 (the Form 10-K ).*

**General**

We are the largest specialty retailer of video game products and PC entertainment software in the United States. We sell new and used video game hardware, video game software and accessories, as well as PC entertainment software and related accessories and other merchandise. As of November 1, 2003, we operated 1,472 stores, in 49 states, Puerto Rico, Guam, and Ireland, primarily under the GameStop brand. We also operate an electronic commerce web site under the name gamestop.com and publish *Game Informer,* the industry s largest circulation multi-platform video game magazine in the United States.

Growth in the video game industry is driven by the introduction of new technology. In October 2000, Sony introduced PlayStation 2 and in June 2001 Nintendo introduced Game Boy Advance. Microsoft introduced Xbox, and Nintendo introduced GameCube in November 2001. As is typical following the introduction of new video game platforms, sales of new video game hardware generally increase as a percentage of sales in the first full year following introduction. As video game platforms mature, the sales mix attributable to complementary video game software and accessories, which generate higher gross margins, generally increases in the second and third years. The net effect is generally a decline in gross margins in the first full year following new platform releases and an increase in gross margins in the second and third years. Unit sales of maturing video game platforms are typically also driven by manufacturer-funded retail price decreases, further driving sales of related software and accessories. The retail prices for the PlayStation 2, the Xbox and the GameCube were reduced significantly in May 2002, which led to an increase in unit sales and sales of the related software and accessories during the 39 weeks ended November 2, 2002. Retail prices on the PlayStation 2 and Xbox were reduced minimally in May 2003 which again led to an increase in unit sales, but not to the extent of the increases caused by the price reductions in the prior year. We expect that sales of the software and accessories related to the PlayStation 2, the Xbox and the GameCube will continue to increase as the installed base of these platforms increases.

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**Results of Operations**

The following table sets forth statement of operations items as a percentage of sales for the periods indicated:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---|---|---|---|
| | November 1, 2003 | November 2, 2002 | November 1, 2003 | November 2, 2002 |
| **Statement of Operations Data:** | | | | |
| Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 69.8 | 74.2 | 71.4 | 74.0 |
| Gross profit | 30.2 | 25.8 | 28.6 | 26.0 |
| Selling, general and administrative expenses | 22.3 | 18.2 | 22.3 | 19.9 |
| Depreciation and amortization | 2.4 | 2.0 | 2.2 | 2.0 |
| Operating earnings | 5.5 | 5.6 | 4.1 | 4.1 |
| Interest expense, net | 0.0 | (0.1) | (0.1) | (0.1) |
| Earnings before income tax expense | 5.5 | 5.7 | 4.2 | 4.2 |
| Income tax expense | 2.2 | 2.3 | 1.7 | 1.7 |
| Net earnings | 3.3% | 3.4% | 2.5% | 2.5% |

***13 weeks ended November 1, 2003 compared with the 13 weeks ended November 2, 2002***

Sales increased by $39.3 million, or 13.7%, from $286.7 million in the 13 weeks ended November 2, 2002 to $326.0 million in the 13 weeks ended November 1, 2003. The increase in sales was primarily attributable to the additional sales resulting from 286 net new stores opened since November 2, 2002, which was partially offset by a 1.9% decrease in comparable store sales. Stores are included in our comparable store sales base beginning in the thirteenth month of operation. The comparable store sales decrease for the third quarter of 2003 was expected after the October 2002 release of the best selling video game of all time (Grand Theft Auto: Vice City) led to a 30.3% increase in the comparable store sales in the third quarter of 2002.

Cost of sales increased by $14.7 million, or 6.9%, from $212.9 million in the 13 weeks ended November 2, 2002 to $227.6 million in the 13 weeks ended November 1, 2003. Cost of sales as a percentage of sales decreased from 74.2% in the 13 weeks ended November 2, 2002 to 69.8% in the 13 weeks ended November 1, 2003. This decrease was primarily the result of the implementation of EITF 02-16 (see footnote 2 to the Consolidated Financial Statements) and the shift in sales mix from lower margin video game hardware to higher margin PlayStation 2, Game Boy Advance, Xbox and GameCube video game software and used video game products.

Selling, general and administrative expenses increased by $20.9 million, or 40.2%, from $52.0 million in the 13 weeks ended November 2, 2002 to $72.9 million in the 13 weeks ended November 1, 2003. These increases were primarily attributable to the effect of implementing EITF 02-16 and to the increase in the number of stores in operation, and the related increases in store, distribution, and corporate office operating expenses. Selling, general and administrative expenses as a percentage of sales increased from 18.2% in the 13 weeks ended November 2, 2002 to 22.3% in the 13 weeks ended November 1, 2003. The increase in selling, general and administrative expenses as a percentage of sales was primarily due to the effect of implementing EITF 02-16 and the costs associated with opening 83 stores in the 13 weeks ended November 1, 2003 compared to opening 63 stores in the 13 weeks ended November 2, 2002.

Depreciation and amortization expense increased from $5.9 million for the 13 weeks ended November 2, 2002 to $7.7 million in the 13 weeks ended November 1, 2003. This increase of $1.8 million was due to the capital expenditures for new stores, management information systems and distribution center enhancements.

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Interest income resulting from the investment of excess cash balances decreased from $519,000 in the 13 weeks ended November 2, 2002 to $290,000 in the 13 weeks ended November 1, 2003 due to a decrease in the level of investments and the average yield on the investments. Interest expense increased by $89,000 from $139,000 in the 13 weeks ended November 2, 2002 to $228,000 in the 13 weeks ended November 1, 2003.

Income tax expense increased from $6.6 million for the 13 weeks ended November 2, 2002 to $7.3 million in the 13 weeks ended November 1, 2003. Tax expense for the 13 weeks ended November 2, 2002 and the 13 weeks ended November 1, 2003 was based upon management s estimate of the Company s annualized effective tax rate.

The factors described above led to an increase in operating earnings of $1.9 million, or 11.9%, from $16.0 million in the 13 weeks ended November 2, 2002 to $17.9 million in the 13 weeks ended November 1, 2003 and an increase in net earnings of $0.9 million, or 9.2%, from $9.8 million in the 13 weeks ended November 2, 2002 to $10.7 million in the 13 weeks ended November 1, 2003.

***39 weeks ended November 1, 2003 compared with the 39 weeks ended November 2, 2002***

Sales increased by $121.1 million, or 14.5%, from $832.4 million in the 39 weeks ended November 2, 2002 to $953.5 million in the 39 weeks ended November 1, 2003. The increase in sales was primarily attributable to the additional sales resulting from 286 net new stores opened since November 2, 2002.

Cost of sales increased by $64.6 million, or 10.5%, from $616.0 million in the 39 weeks ended November 2, 2002 to $680.6 million in the 39 weeks ended November 1, 2003. Cost of sales as a percentage of net sales decreased from 74.0% in the 39 weeks ended November 2, 2002 to 71.4% in the 39 weeks ended November 1, 2003. This decrease was primarily the result of the implementation of EITF 02-16 (see footnote 2 to the Consolidated Financial Statements) and the shift in sales mix from lower margin video game hardware to higher margin PlayStation 2, Game Boy Advance, Xbox and GameCube video game software and used video game products.

Selling, general and administrative expenses increased by $47.5 million, or 28.8%, from $165.2 million in the 39 weeks ended November 2, 2002 to $212.7 million in the 39 weeks ended November 1, 2003. These increases were primarily attributable to the increase in the number of stores in operation and the related increases in store, distribution, and corporate office operating expenses and the effect of implementing EITF 02-16. Selling, general and administrative expenses as a percentage of sales increased from 19.9% in the 39 weeks ended November 2, 2002 to 22.3% in the 39 weeks ended November 1, 2003. The increase in selling, general and administrative expenses as a percentage of sales was primarily due to the effect of implementing EITF 02-16 and the costs associated with opening 257 stores in the 39 weeks ended November 1, 2003 compared to opening 163 stores in the 39 weeks ended November 2, 2002.

Depreciation and amortization expense increased from $16.6 million for the 39 weeks ended November 2, 2002 to $20.8 million in the 39 weeks ended November 1, 2003. This increase of $4.2 million was due to the capital expenditures for new stores, management information systems and distribution center enhancements.

Interest income resulting from the investment of excess cash balances decreased from $1.5 million in the 39 weeks ended November 2, 2002 to $1.2 million in the 39 weeks ended November 1, 2003 due to a decrease in the level of investments and the average yield on the investments. Interest expense decreased by $0.7 million from $1.2 million in the 39 weeks ended November 2, 2002 to $0.5 million in the 39 weeks ended November 1, 2003. The decrease was attributable to the repayment of $250.0 million in debt in February 2002 using the proceeds of the Company s February 2002 public offering and the contribution of the remaining $150.0 million in debt to paid-in-capital by Barnes & Noble.

Income tax expense increased from $14.0 million for the 39 weeks ended November 2, 2002 to $16.2 million in the 39 weeks ended November 1, 2003. Tax expense for the 39 weeks ended November 2, 2002 and the 39 weeks ended November 1, 2003 was based upon management s estimate of the Company s annualized effective tax rate.

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The factors described above led to an increase in operating earnings of $4.8 million, or 13.9%, from $34.6 million in the 39 weeks ended November 2, 2002 to $39.4 million in the 39 weeks ended November 1, 2003 and an increase in net earnings of $3.1 million, or 14.9%, from $20.8 million in the 39 weeks ended November 2, 2002 to $23.9 million in the 39 weeks ended November 1, 2003.

**Seasonality**

The Company s business, like that of many retailers, is seasonal, with the major portion of the sales and operating profit realized during the quarter which includes the holiday selling season.

**Liquidity and Capital Resources**

During the 39 weeks ended November 1, 2003 and November 2, 2002, cash used in operations was $50.2 million and $24.0 million, respectively. In the 39 weeks ended November 1, 2003, cash used in operations was primarily due to an increase in merchandise inventories of $146.1 million and an increase in prepaid taxes of $16.8 million, which were offset partially by net income of $23.9 million, depreciation and amortization of $20.8 million, and an increase in accounts payable and accrued liabilities of $66.0 million. In the 39 weeks ended November 2, 2002, cash used in operations was primarily due to an increase in merchandise inventories of $130.0 million, which was offset partially by net income of $20.8 million and depreciation and amortization of $16.6 million and an increase in accounts payable and accrued liabilities of $70.3 million. The increases in merchandise inventories and related accounts payable in both the 39 weeks ended November 1, 2003 and November 2, 2002 resulted from purchases of merchandise inventories in anticipation of fourth quarter seasonal activity.

Cash used in investing activities was $55.3 million and $30.1 million during the 39 weeks ended November 1, 2003 and November 2, 2002, respectively. During the 39 weeks ended November 1, 2003 and November 2, 2002, we had capital expenditures of $51.7 million and $29.3 million, respectively, to open new stores, remodel existing stores, and invest in information systems. Future capital requirements will depend on the number of new stores we open and the timing of those openings within a given fiscal year. We opened 163 stores in the 39 weeks ended November 2, 2002 compared to 257 stores in the 39 weeks ended November 1, 2003 and expect to open between 40 and 50 stores in the remainder of fiscal 2003. Projected capital expenditures for fiscal 2003 are between $55.0 and $60.0 million, to be used primarily to fund new store openings.

In February 2002, the Company entered into a $75.0 million senior secured revolving credit facility which expires in February 2005. The revolving credit facility is governed by an eligible inventory borrowing base agreement, defined as 50% of non-defective inventory. Loans incurred under the credit facility will be maintained from time to time, at the Company s option, as: (1) base rate loans which bear interest at the base rate (defined in the credit facility as the higher of (a) the administrative agent s announced base rate, or (b) 1/2 of 1% in excess of the federal funds effective rate, each as in effect from time to time); or (2) LIBOR loans bearing interest at the LIBOR rate for the applicable interest period, in each case plus an applicable interest margin. In addition, the Company is required to pay a commitment fee of 0.375% for any unused amounts of the revolving credit facility. Any borrowings under the revolving credit facility are secured by the assets of the Company. The revolving credit facility generally restricts our ability to pay dividends and requires the Company to maintain certain financial ratios. There have been no borrowings under the revolving credit facility.

In March 2003, the Board of Directors authorized a common stock repurchase program for the purchase of up to $50.0 million of the Company s Class A common shares. The Company may repurchase shares from time to time in the open market or through privately negotiated transactions, depending on prevailing market conditions and other factors. The repurchased shares will be held in treasury. During the 39 weeks ended November 1, 2003, the Company repurchased 2,304,100 shares at an average share price of $15.19.

Based on our current operating plans, we believe that cash generated from our operating activities and available cash balances will be sufficient to fund our operations, store expansion and remodeling activities and corporate capital expenditure programs for at least the next 12 months.

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**Critical Accounting Policies**

Our condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these financial statements. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our 2002 Annual Report on Form 10-K, filed on May 2, 2003, in Note 1 of Notes to the Consolidated Financial Statements.

**Disclosure Regarding Forward-looking Statements**

This report on Form 10-Q and other oral and written statements made by the Company to the public contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act ). The forward-looking statements involve a number of risks and uncertainties. A number of factors could cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not limited to:

- our reliance on suppliers and vendors for new product releases;
- economic conditions affecting the electronic game industry;
- the competitive environment in the electronic game industry;
- our ability to open and operate new stores;
- our ability to attract and retain qualified personnel; and
- other factors described in the Form 10-K, including those set forth under the caption Business Risk Factors.

In some cases, forward-looking statements can be identified by the use of terms such as anticipates, believes, continues, could, estimates, expects, intends, may, plans, potential, predicts, will, should, seeks, pro forma or similar expressions. These statements are o involve known and unknown risks, uncertainties and other factors that may cause our or our industry s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. You should not place undue reliance on these forward-looking statements.

Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this Form 10-Q. In light of these risks and uncertainties, the forward-looking events and circumstances contained in this Form 10-Q may not occur, causing actual results to differ materially from those anticipated or implied by our forward-looking statements.

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

**Interest Rate Exposure**

We do not use derivative financial instruments to hedge interest rate exposure. We limit our interest rate risks by investing our excess cash balances in short-term, highly-liquid instruments with an original maturity of three months or less. We do not expect any material losses from our invested cash balances, and we believe that our interest rate exposure is modest.

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**Foreign Exchange Exposure**

We do not believe we have material foreign currency exposure, because only a very immaterial portion of our business is transacted in other than United States currency. The Company historically has not entered into hedging transactions with respect to its foreign currency, but may do so in the future.

**Item 4.** ***Controls and Procedures***

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company s disclosure controls and procedures are effective. Disclosure controls and procedures are the controls and procedures designed to provide reasonable assurances that information required to be disclosed in the Company s reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company s periodic reports.

(b) Changes in Internal Controls

There was no change in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company s most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

## PART II OTHER INFORMATION

**Item 1.** ***Legal Proceedings***

On May 29, 2003, former Store Manager Carlos Moreira ( Plaintiff ) filed a class action lawsuit against the Company and its wholly owned subsidiary Gamestop, Inc. (collectively GameStop ) in Los Angeles County Superior Court alleging that GameStop s salaried retail managers were misclassified as exempt and should have been paid overtime. Plaintiff is seeking to represent a class of current and former salaried retail managers who were employed by GameStop in California at anytime between May 29, 1999 and the present. Plaintiff has alleged claims for violation of California Labor Code sections 203, 226 and 1194 and California Business and Professions Code section 17200. Plaintiff is seeking recovery of unpaid overtime, interest, penalties, attorneys fees and costs. The matter is in the precertification stage, and the parties are in the middle of class discovery. The court has ordered the parties to mediation, which will take place on January 15, 2004. The class certification hearing is set for April 28, 2004. GameStop intends to vigorously defend this action. We do not believe there is sufficient information to estimate the amount of the possible loss, if any, resulting from the lawsuit.

In the ordinary course of our business, we are from time to time subject to various other legal proceedings. We do not believe that any such other legal proceedings, individually or in the aggregate, will have a material adverse effect on our operations or financial condition.

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**Item 6.** ***Exhibits and Reports on Form 8-K***

(a) *Exhibits*

| Exhibit Number | Description |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation.(1) |
| 3.2 | Bylaws.(1) |
| 10.1 | Separation Agreement, dated as of January 1, 2002, between Barnes & Noble and GameStop Corp.(2) |
| 10.2 | Tax Disaffiliation Agreement, dated as of January 1, 2002, between Barnes & Noble and GameStop Corp.(1) |
| 10.3 | Insurance Agreement, dated as of January 1, 2002, between Barnes & Noble and GameStop Corp.(1) |
| 10.4 | Operating Agreement, dated as of January 1, 2002, between Barnes & Noble and GameStop Corp.(1) |
| 10.5 | 2001 Incentive Plan.(2) |
| 10.6 | Lease, dated as of March 6, 1997, between RREEF Mid-Cities Industrial L.P. and Babbage s Etc. LLC.(1) |
| 10.7 | First Amendment to Lease, dated as of December 30, 1999, between RREEF Mid-Cities Industrial L.P. and Babbage s Etc. LLC.(1) |
| 10.8 | Registration Rights Agreement, dated as of January 1, 2002, between Barnes & Noble and GameStop Corp.(1) |
| 10.9 | Revolving Credit Agreement, dated as of February 19, 2002, among GameStop Corp., Fleet National Bank, as Administrative Agent, the Banks party thereto and Fleet Securities, Inc., as Arranger.(3) |
| 10.10 | Security Agreement, dated as of February 19, 2002, by GameStop Corp. in favor of Fleet National Bank, as secured party and as Administrative Agent.(3) |
| 10.11 | Subsidiary Guaranty, dated as of February 19, 2002, by and among GameStop, Inc., Babbage s Etc. LLC, Sunrise Publications, Inc. and GameStop.com, Inc. and Fleet National Bank, as Administrative Agent.(3) |
| 10.12 | Securities Collateral Pledge Agreement, dated as of February 19, 2002, between GameStop Corp. and Fleet National Bank, as Administrative Agent.(3) |
| 10.13 | Patent and Trademark Securities Agreement, dated as of February 19, 2002, between GameStop Corp. and Fleet National Bank, as secured party and as Administrative Agent.(3) |
| 10.14 | Amendment to Revolving Credit Agreement, dated as of March 18, 2003.(5) |
| 10.15 | Amendment to Revolving Credit Agreement, dated as of June 3, 2003.(6) |
| 31.1 | Certification of Chief Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(1) Incorporated by reference to the Registrant s Amendment No. 3 to Form S-1 filed with the Securities and Exchange Commission on January 24, 2002 (No. 333-68294).

(2) Incorporated by reference to the Registrant s Amendment No. 4 to Form S-1 filed with the Securities and Exchange Commission on February 5, 2002 (No. 333-68294).

(3) Incorporated by reference to the Registrant s Form 10-Q for the fiscal quarter ended May 4, 2002 filed with the Securities and Exchange Commission on June 13, 2002.

(4) Incorporated by reference to the Registrant s Amendment No. 1 to Form S-1 filed with the Securities and Exchange Commission on October 15, 2001 (No. 333-68294).

(5) Incorporated by reference to the Registrant s Form 10-Q for the fiscal quarter ended May 3, 2003 filed with the Securities and Exchange Commission on June 13, 2003.

(6) Incorporated by reference to the Registrant s Form 10-Q for the fiscal quarter ended August 2, 2003 filed with the Securities and Exchange Commission on September 12, 2003.

(b) *Reports on Form 8-K*

Form 8-K furnished on August 18, 2003 regarding a press release issued with earnings information for the quarter ended August 2, 2003.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GAMESTOP CORP.

By: /s/ DAVID W. CARLSON

David W. Carlson
*Executive Vice President and*
*Chief Financial Officer*
*(Principal Accounting and Financial Officer)*

Date: December 11, 2003

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