GameStop Corp.
Form 10-Q
September 11, 2008

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **FOR THE QUARTERLY PERIOD ENDED AUGUST 2, 2008**
	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. 1-32637

GameStop Corp.
(Exact name of registrant as specified in its Charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**20-2733559** *(I.R.S. Employer Identification No.)*
625 Westport Parkway, Grapevine, Texas *(Address of principal executive offices)*	**76051** *(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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Number of shares of $.001 par value Class A Common Stock outstanding as of August 28, 2008: 163,714,623

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

ITEM 1. *Financial Statements*

GAMESTOP CORP.

CONDENSED CONSOLIDATED BALANCE SHEETS

	August 2, 2008 (Unaudited)	August 4, 2007 (Unaudited)	February 2, 2008
	(In thousands, except per share data)		
ASSETS:			
Current assets:			
Cash and cash equivalents	$ 539,898	$ 349,277	$ 857,414
Receivables, net	60,966	29,798	56,019
Merchandise inventories, net	970,057	713,836	801,025
Prepaid expenses and other current assets	68,470	51,951	52,778
Prepaid taxes	58,689	74,952	
Deferred taxes	26,893	35,979	27,481
Total current assets	1,724,973	1,255,793	1,794,717
Property and equipment:			
Land	12,033	11,298	11,870
Buildings and leasehold improvements	414,896	334,904	378,611
Fixtures and equipment	583,734	477,492	538,738
Total property and equipment	1,010,663	823,694	929,219
Less accumulated depreciation and amortization	485,665	349,927	417,550
Net property and equipment	524,998	473,767	511,669
Goodwill, net	1,447,572	1,402,845	1,402,440
Deferred financing fees	7,656	11,406	8,963
Deferred taxes	31,863	7,677	26,332
Other noncurrent assets	35,335	30,017	31,770
Total other assets	1,522,426	1,451,945	1,469,505
Total assets	$ 3,772,397	$ 3,181,505	$ 3,775,891
LIABILITIES AND STOCKHOLDERS EQUITY:			
Current liabilities:			

Accounts payable	$ 692,098	$ 517,233	$ 844,376
Accrued liabilities	389,009	339,940	409,878
Note payable, current portion		12,173	
Taxes payable			6,303
Total current liabilities	1,081,107	869,346	1,260,557
Senior notes payable, long-term portion, net	545,220	573,993	574,473
Senior floating rate notes payable, long-term portion		120,000	
Deferred rent and other long-term liabilities	82,299	72,492	78,415
Total long-term liabilities	627,519	766,485	652,888
Total liabilities	1,708,626	1,635,831	1,913,445
Commitments and contingencies (Note 10)			
Stockholders equity:			
Preferred stock authorized 5,000 shares; no shares issued or outstanding			
Class A common stock $.001 par value; authorized 300,000 shares; 163,653, 158,993 and 161,007 shares issued and outstanding, respectively	164	159	161
Additional paid-in-capital	1,288,727	1,145,706	1,208,474
Accumulated other comprehensive income	33,384	19,359	31,603
Retained earnings	741,496	380,450	622,208
Total stockholders equity	2,063,771	1,545,674	1,862,446
Total liabilities and stockholders equity	$ 3,772,397	$ 3,181,505	$ 3,775,891

See accompanying notes to condensed consolidated financial statements.

Table of Contents

GAMESTOP CORP.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	13 Weeks Ended		26 Weeks Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
	(In thousands, except per share data) (Unaudited)			
Sales	$ 1,804,420	$ 1,338,193	$ 3,618,037	$ 2,617,176
Cost of sales	1,320,297	976,894	2,660,508	1,907,108
Gross profit	484,123	361,299	957,529	710,068
Selling, general and administrative expenses	347,745	278,434	676,412	535,550
Depreciation and amortization	36,309	32,118	71,145	63,153
Operating earnings	100,069	50,747	209,972	111,365
Interest income	(1,628)	(2,736)	(6,570)	(6,564)
Interest expense	10,839	16,082	24,269	34,026
Debt extinguishment expense		2,027	2,331	8,751
Earnings before income tax expense	90,858	35,374	189,942	75,152
Income tax expense	33,695	13,564	70,654	28,619
Net earnings	$ 57,163	$ 21,810	$ 119,288	$ 46,533
Net earnings per common share-basic	$ 0.35	$ 0.14	$ 0.73	$ 0.30
Weighted average shares of common stock-basic	163,390	158,438	162,607	155,938
Net earnings per common share-diluted	$ 0.34	$ 0.13	$ 0.71	$ 0.29
Weighted average shares of common stock-diluted	168,067	164,769	167,722	163,013

See accompanying notes to condensed consolidated financial statements.

Table of Contents

GAMESTOP CORP.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

	Class A Common Stock Shares	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
			(In thousands) (Unaudited)			
Balance at February 2, 2008	161,007	$ 161	$ 1,208,474	$ 31,603	$ 622,208	$ 1,862,446
Comprehensive income:						
Net earnings for the 26 weeks ended August 2, 2008					119,288	
Foreign currency translation				1,781		
Total comprehensive income						121,069
Stock-based compensation			20,068			20,068
Exercise of stock options and issuance of shares upon vesting of restricted stock grants (including tax benefit of $36,075)	2,646	3	60,185			60,188
Balance at August 2, 2008	163,653	$ 164	$ 1,288,727	$ 33,384	$ 741,496	$ 2,063,771

See accompanying notes to condensed consolidated financial statements.

Table of Contents

GAMESTOP CORP.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	26 Weeks Ended	
	August 2, 2008	August 4, 2007
	(In thousands) (Unaudited)	
Cash flows from operating activities:		
Net earnings	$ 119,288	$ 46,533
Adjustments to reconcile net earnings to net cash flows used in operating activities:		
Depreciation and amortization (including amounts in cost of sales)	71,802	63,625
Amortization and retirement of deferred financing fees	1,304	3,228
Amortization and retirement of original issue discount on senior notes	747	682
Stock-based compensation expense	20,068	13,645
Deferred taxes	(3,235)	(1,282)
Excess tax benefits realized from exercise of stock-based awards	(33,010)	(62,555)
Loss on disposal of property and equipment	2,634	1,527
Increase in deferred rent and other long-term liabilities	3,794	6,312
Increase in liability to landlords for tenant allowances, net	2,358	1,689
Change in the value of foreign exchange contracts	(1,035)	320
Changes in operating assets and liabilities, net		
Receivables, net	(3,829)	5,647
Merchandise inventories	(152,817)	(19,720)
Prepaid expenses and other current assets	(13,235)	(9,024)
Prepaid taxes	(31,693)	6,129
Accounts payable and accrued liabilities	(193,340)	(253,394)
Net cash flows used in operating activities	(210,199)	(196,638)
Cash flows from investing activities:		
Purchase of property and equipment	(81,540)	(71,388)
Acquisitions, net of cash acquired	(50,299)	1,062
Net cash flows used in investing activities	(131,839)	(70,326)
Cash flows from financing activities:		
Repurchase of notes payable	(30,000)	(150,000)
Issuance of shares relating to stock options	26,738	46,782
Excess tax benefits realized from exercise of stock-based awards	33,010	62,555
Net increase (decrease) in other noncurrent assets and deferred financing fees	(5,219)	3,528
Net cash flows provided by (used in) financing activities	24,529	(37,135)
Exchange rate effect on cash and cash equivalents	(7)	973

Net decrease in cash and cash equivalents	(317,516)	(303,126)
Cash and cash equivalents at beginning of period	857,414	652,403
Cash and cash equivalents at end of period	$ 539,898	$ 349,277

See accompanying notes to condensed consolidated financial statements.

GAMESTOP CORP.

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

1. Basis of Presentation

GameStop Corp. (together with its predecessor companies, GameStop, we, our, or the Company), a Delaware corporation, is the world s largest retailer of video games and entertainment software. The unaudited consolidated financial statements include the accounts of 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 of U.S. dollars 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 unaudited condensed consolidated interim financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and do not include all disclosures required under GAAP for complete financial statements. 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 2, 2008 (fiscal 2007). The preparation of financial statements in conformity with GAAP 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 26 weeks ended August 2, 2008 are not indicative of the results to be expected for the 52 weeks ending January 31, 2009 (fiscal 2008).

Certain reclassifications have been made to conform the prior period data to the current interim period presentation.

2. Change in Accounting Principles

Effective February 3, 2008, the Company implemented Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for its measurement and expands disclosures about fair value measurements. The Company elected to implement this Statement with the one-year deferral permitted by FASB Staff Position (FSP) 157-2 for nonfinancial assets and nonfinancial liabilities measured at fair value, except those that are recognized or disclosed on a recurring basis (at least annually). We do not expect any significant impact to our consolidated financial statements when we implement SFAS 157 for these assets and liabilities.

Due to our election under FSP 157-2, for fiscal 2008, SFAS 157 applies to our foreign exchange contracts, foreign currency options and cross-currency swaps (together, the Foreign Currency Contracts), Company-owned life insurance policies with a cash surrender value and certain nonqualified deferred compensation liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition. The implementation of

SFAS 157 did not result in a significant change in the method of calculating fair value of assets or liabilities. The primary impact from adoption was additional disclosures.

SFAS 157 requires disclosures that categorize assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are observable inputs other than quoted prices included within Level 1 for the asset or liability, either directly or indirectly through market-

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

corroborated inputs. Level 3 inputs are unobservable inputs for the asset or liability reflecting our assumptions about pricing by market participants.

We value our Foreign Currency Contracts, Company-owned life insurance policies with cash surrender values and certain nonqualified deferred compensation liabilities based on Level 2 inputs using quotations provided by major market news services, such as Bloomberg and The Wall Street Journal, and industry-standard models that consider various assumptions, including quoted forward prices, time value, volatility factors, and contractual prices for the underlying instruments, as well as other relevant economic measures. When appropriate, valuations are adjusted to reflect credit considerations, generally based on available market evidence.

The following table provides the fair value of our financial assets and liabilities measured on a recurring basis and recorded on our condensed consolidated balance sheet as of August 2, 2008:

	August 2, 2008 Level 2 (In thousands)
Assets	
Foreign Currency Contracts	$ 2,951
Company-owned life insurance	3,220
Total assets	$ 6,171
Liabilities	
Foreign Currency Contracts	$ 11,165
Non-qualified deferred compensation	1,424
Total liabilities	$ 12,589

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). This Statement permits entities the option to measure many financial instruments and certain other items at fair value at specific election dates. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 was effective for our Company on February 3, 2008. The adoption of SFAS 159 did not have a material impact on our consolidated financial statements.

3. Business Combinations and Goodwill

On April 5, 2008, the Company purchased all the outstanding stock of Free Record Shop Norway AS, a Norwegian private limited liability company (FRS), for $21,006, net of cash acquired. FRS operates 49 record stores in Norway and also operates office and warehouse facilities in Oslo, Norway. The Company is converting these stores into video game stores with an inventory assortment similar to its other stores in Norway. The acquisition was accounted for using the purchase method of accounting, with the excess of the purchase price over the net assets acquired, in the amount of $17,369, recorded as goodwill.

In 2003, the Company purchased a 51% controlling interest in GameStop Group Limited which operates stores in Ireland and the United Kingdom. Under the terms of the purchase agreement, the minority interest owners of the remaining 49% have the ability to require the Company to purchase their remaining shares in incremental percentages at a price to be determined based partially on the Company s price to earnings ratio and GameStop Group Limited s earnings. On May 21, 2008, the minority interest owners exercised their right to sell one-third of their shares, or approximately 16% of GameStop Group Limited, to the Company under the terms of the original purchase agreement for $27,383. The transaction was completed in June 2008 and recorded in accordance with the provisions of the Statement of Financial Accounting Standards No. 141, *Business Acquisitions*.

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During July 2008, the Company purchased certain assets and website operations from The Gamesman Limited, a video game and entertainment software retailer, including eight stores in New Zealand for $1,910. The acquisition was accounted for using the purchase method of accounting, with the excess of the purchase price over the net assets acquired, in the amount of $605, recorded as goodwill.

The pro forma effect assuming the above acquisitions were made at the beginning of fiscal 2007 is not material to the Company s consolidated financial statements.

4. Accounting for Stock-Based Compensation

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. This valuation model requires the use of subjective assumptions, including expected option life, expected volatility and the expected employee forfeiture rate. The Company uses historical data to estimate the option life and the employee forfeiture rate, and uses historical volatility when estimating the stock price volatility. There were no options to purchase common stock granted during the 13 weeks ended August 2, 2008 and August 4, 2007. The options to purchase common stock granted during the 26 weeks ended August 2, 2008 and August 4, 2007 were 1,362 and 939, respectively, with a weighted-average fair value estimated at $15.45 and $10.16 per share, respectively, using the following assumptions:

	26 Weeks Ended	
	August 2, 2008	August 4, 2007
Volatility	38.2%	40.5%
Risk-free interest rate	2.4%	4.8%
Expected life (years)	3.5	4.0
Expected dividend yield	0%	0%

In the 13 weeks ended August 2, 2008 and August 4, 2007, the Company included compensation expense relating to stock option grants of $3,998 and $3,895, respectively, in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. In the 26 weeks ended August 2, 2008 and August 4, 2007, the Company included compensation expense relating to stock option grants of $8,818 and $8,071, respectively, in selling, general and administrative expenses. As of August 2, 2008, the unrecognized compensation expense related to the unvested portion of our stock options was $22,332 which is expected to be recognized over a weighted average period of 2.1 years. The total intrinsic value of options exercised during the 13 weeks ended August 2, 2008 and August 4, 2007 were $10,584 and $42,933, respectively. The total intrinsic value of options exercised during the 26 weeks ended August 2, 2008 and August 4, 2007 were $83,745 and $177,902, respectively.

There were no restricted stock shares granted during the 13 weeks ended August 2, 2008 and 7 shares of restricted stock were granted during the 13 weeks ended August 4, 2007 with a fair market value of $39.83 per share. During the 26 weeks ended August 2, 2008 and August 4, 2007, the Company granted 534 shares and 964 shares, respectively, of restricted stock. The shares had a fair market value of $49.95 and $26.78 per share, respectively, and vest in equal installments over three years. During the 13 weeks ended August 2, 2008 and August 4, 2007, the Company included compensation expense relating to the restricted share grants in the amount of $4,304 and $2,789, respectively, in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. During the 26 weeks ended August 2, 2008 and August 4, 2007, the Company included compensation expense relating to the restricted share grants in the amount of $11,251 and $5,574, respectively, in selling, general and administrative expenses. As of August 2, 2008, there was $29,640 of unrecognized compensation expense related to nonvested restricted stock awards that is expected to be recognized over a weighted average period of 2.1 years.

Table of Contents

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Computation of Net Earnings per Common Share

On February 7, 2007, all outstanding shares of Class B common stock were converted into shares of Class A common stock on a one-for-one basis (the Conversion). In addition, as of February 9, 2007, the Board of Directors of the Company authorized a two-for-one stock split, effected by a one-for-one stock dividend to stockholders of record at the close of business on February 20, 2007, paid on March 16, 2007 (the Stock Split). The effect of the Conversion and the Stock Split has been retroactively applied to all periods presented in the condensed consolidated financial statements and notes thereto. The Company now has only Class A common stock outstanding and computes earnings per share in accordance with Statement of Financial Accounting Standards No. 128, *Earnings per Share*. A reconciliation of shares used in calculating basic and diluted net earnings per common share follows:

	13 Weeks Ended		26 Weeks Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
	(In thousands, except per share data)			
Net earnings	$ 57,163	$ 21,810	$ 119,288	$ 46,533
Weighted average common shares outstanding	163,390	158,438	162,607	155,938
Dilutive effect of options and restricted shares on common stock	4,677	6,331	5,115	7,075
Common shares and dilutive potential common shares	168,067	164,769	167,722	163,013
Net earnings per common share:				
Basic	$ 0.35	$ 0.14	$ 0.73	$ 0.30
Diluted	$ 0.34	$ 0.13	$ 0.71	$ 0.29

The following table contains information on restricted shares and options to purchase shares of Class A common stock which were excluded from the computation of diluted earnings per share because they were anti-dilutive:

	Anti-Dilutive Shares	Range of Exercise Prices	Expiration Dates
	(In thousands, except per share data)		
13 Weeks Ended August 2, 2008	1,362	$ 49.95	2018
13 Weeks Ended August 4, 2007	3		2010

6. Debt

In October 2005, in connection with the Company s merger with Electronics Boutique Holdings Corp. (EB) (the merger), the Company entered into a five-year, $400,000 Credit Agreement (the Revolver), including a $50,000 letter of credit sub-limit, secured by the assets of the Company and its U.S. subsidiaries. The Revolver places certain restrictions on the Company and its subsidiaries, including limitations on asset sales, additional liens and the incurrence of additional indebtedness. In April 2007, the Company amended the Revolver to extend the maturity date from October 11, 2010 to April 25, 2012, reduce the LIBO interest rate margin, reduce and fix the rate of the unused commitment fee and modify or delete certain other covenants.

The availability under the Revolver is limited to a borrowing base which allows the Company to borrow up to the lesser of (x) approximately 70% of eligible inventory and (y) 90% of the appraisal value of the inventory, in each case plus 85% of eligible credit card receivables, net of certain reserves. Letters of credit reduce the amount available to borrow by their face value. The Company s ability to pay cash dividends, redeem options and repurchase shares is generally prohibited, except that if availability under the Revolver is or will be after any such

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

payment equal to or greater than 25% of the borrowing base, the Company may repurchase its capital stock and pay cash dividends. In addition, in the event that credit extensions under the Revolver at any time exceed 80% of the lesser of the total commitment or the borrowing base, the Company will be subject to a fixed charge coverage ratio covenant of 1.5:1.0.

The interest rate on the Revolver is variable and, at the Company s option, is calculated by applying a margin of (1) 0.0% to 0.25% above the higher of the prime rate of the administrative agent or the federal funds effective rate plus 0.50% or (2) 1.00% to 1.50% above the LIBO rate. The applicable margin is determined quarterly as a function of the Company s consolidated leverage ratio. As of August 2, 2008, the applicable margin was 0.0% for prime rate loans and 1.00% for LIBO rate loans. In addition, the Company is required to pay a commitment fee of 0.25% for any unused portion of the total commitment under the Revolver. As of August 2, 2008, there were no borrowings outstanding under the Revolver and letters of credit outstanding totaled $7,271.

In September 2007, the Company s Luxembourg subsidiary entered into a discretionary, $20,000 Uncommitted Line of Credit (the Line of Credit) with Bank of America. There is no term associated with the Line of Credit and Bank of America may withdraw the facility at any time without notice. The Line of Credit will be made available to the Company s foreign subsidiaries for use primarily as a bank overdraft facility for short term liquidity needs and for the issuance of bank guarantees and letters of credit to support operations. As of August 2, 2008, there was $3,730 of cash overdrafts outstanding under the Line of Credit and bank guarantees outstanding totaled $4,874.

In September 2005, the Company, along with GameStop, Inc. as co-issuer (together with the Company, the Issuers), completed the offering of U.S. $300,000 aggregate principal amount of Senior Floating Rate Notes due 2011 (the Senior Floating Rate Notes) and U.S. $650,000 aggregate principal amount of Senior Notes due 2012 (the Senior Notes and, together with the Senior Floating Rate Notes, the Notes). The Notes were issued under an Indenture dated September 28, 2005 (the Indenture), by and among the Issuers, the subsidiary guarantors party thereto, and Citibank, N.A., as trustee (the Trustee). The net proceeds of the offering were used to pay the cash portion of the merger consideration paid to the stockholders of EB in connection with the merger.

The Senior Notes bear interest at 8.0% per annum, mature on October 1, 2012 and were priced at 98.688%, resulting in a discount at the time of issue of $8,528. The discount is being amortized using the effective interest method. As of August 2, 2008, the unamortized original issue discount was $4,780. The rate of interest on the Senior Floating Rate Notes prior to their redemption on October 1, 2007 was 9.2350% per annum. The Issuers pay interest on the Senior Notes semi-annually, in arrears, every April 1 and October 1, to holders of record on the immediately preceding March 15 and September 15, and at maturity.

The Indenture contains affirmative and negative covenants customary for such financings, including, among other things, limitations on (1) the incurrence of additional debt, (2) restricted payments, (3) liens, (4) sale and leaseback transactions and (5) asset sales. Events of default provided for in the Indenture include, among other things, failure to pay interest or principal on the Notes, other breaches of covenants in the Indenture, and certain events of bankruptcy and insolvency. As of August 2, 2008, the Company was in compliance with all covenants associated with the Revolver and the Indenture.

Under certain conditions, the Issuers may on any one or more occasions prior to maturity redeem up to 100% of the aggregate principal amount of Senior Notes issued under the Indenture at redemption prices at or in excess of 100% of the principal amount thereof plus accrued and unpaid interest, if any, to the redemption date. The circumstances which would limit the percentage of the Notes which may be redeemed or which would require the Company to pay a premium in excess of 100% of the principal amount are defined in the Indenture. Upon a Change of Control (as defined in the Indenture), the Issuers are required to offer to purchase all of the Notes then outstanding at 101% of the principal amount thereof plus accrued and unpaid interest, if any, to the date of purchase. The Issuers may acquire Senior Notes by means other than redemption, whether by tender offer, open market purchases, negotiated transactions or otherwise, in accordance with applicable securities laws, so long as such acquisitions do not otherwise violate the terms of the Indenture.

Table of Contents

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In May 2006, the Company announced that its Board of Directors authorized the buyback of up to an aggregate of $100,000 of its Senior Floating Rate Notes and Senior Notes. As of February 3, 2007, the Company had repurchased the maximum authorized amount, having acquired $50,000 of its Senior Notes and $50,000 of its Senior Floating Rate Notes, and delivered the Notes to the Trustee for cancellation.

On February 9, 2007, the Company announced that its Board of Directors authorized the buyback of up to an aggregate of an additional $150,000 of its Senior Notes and Senior Floating Rate Notes. As of August 4, 2007, the Company had repurchased the maximum authorized amount, having acquired $20,000 of its Senior Notes and $130,000 of its Senior Floating Rate Notes, and delivered the Notes to the Trustee for cancellation. The associated loss on retirement of this debt was $2,027 and $8,751 for the 13 and 26 week periods ended August 4, 2007, respectively, which consists of the premium paid to retire the Notes and the recognition of the deferred financing fees and the original issue discount on the Notes.

On June 28, 2007, the Company announced that its Board of Directors authorized the redemption of the remaining $120,000 of Senior Floating Rate Notes outstanding. The Company redeemed the Senior Floating Rate Notes on October 1, 2007 at the redemption price specified by the Senior Floating Rate Notes of 102.0%, plus all accrued and unpaid interest through the redemption date. The Company incurred a one-time pre-tax charge of $3,840 associated with the redemption, which represents a $2,400 redemption premium and $1,440 to recognize unamortized deferred financing costs.

On February 7, 2008, the Company announced that its Board of Directors authorized the buyback of up to an aggregate of an additional $130,000 of its Senior Notes. The timing and amount of the repurchases will be determined by the Company s management based on their evaluation of market conditions and other factors. In addition, the repurchases may be suspended or discontinued at any time. As of August 2, 2008, the Company had repurchased $30,000 of its Senior Notes pursuant to this new authorization and delivered the Senior Notes to the Trustee for cancellation. The associated loss on retirement of debt is $2,331, which consists of the premium paid to retire the Senior Notes and the write-off of the deferred financing fees and the original issue discount on the Senior Notes.

During October 2007, the Company paid the final principal payment of $12,173 to Barnes & Noble, Inc. (Barnes & Noble) on the promissory note that was issued in connection with the repurchase of GameStop s common stock held by Barnes & Noble, satisfying the promissory note in full. The note was unsecured and bore interest at 5.5% per annum.

7. 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		26 Weeks Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
	(In thousands)			

Net earnings	$ 57,163	$ 21,810	$ 119,288	$ 46,533
Other comprehensive income:				
Foreign currency translation adjustments	(1,453)	5,844	1,781	16,132
Total comprehensive income	$ 55,710	$ 27,654	$ 121,069	$ 62,665

8. Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examination by tax authorities

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

for years before and including the fiscal year ended January 31, 2004. The Internal Revenue Service (IRS) commenced an examination of the Company s U.S. income tax returns for the fiscal years ended January 29, 2005 and January 28, 2006 in the first quarter of fiscal 2007 that is anticipated to be completed in 2008. The Company does not anticipate any adjustments that would result in a material impact on its condensed consolidated financial statements.

For the 13 weeks ended August 2, 2008 and August 4, 2007, the Company recognized an increase of $3 and a decrease of $1,649 in the liability for unrecognized tax benefits, respectively, and an increase of $433 and $377 for interest and penalties, respectively. For the 26 weeks ended August 2, 2008 and August 4, 2007, the Company recognized a decrease of $657 and $1,388 in the liability for unrecognized tax benefits, respectively, and an increase of $757 and $819 for interest and penalties, respectively. As of August 2, 2008, the gross amount of unrecognized tax benefits, interest and penalties was $24,325. The total amount of unrecognized tax benefit that, if recognized, would affect the effective tax rate was $19,895 as of August 2, 2008. The Company had $4,430 in interest and penalties related to unrecognized tax benefits accrued as of August 2, 2008.

It is reasonably possible that the amount of the unrecognized benefit with respect to certain of our unrecognized tax positions could significantly increase or decrease within the next 12 months as a result of settling ongoing audits. At this time, an estimate of the range of the reasonably possible outcomes cannot be made.

The tax provisions for the 13 weeks and 26 weeks ended August 2, 2008 and August 4, 2007 are based upon management s estimate of the Company s annualized effective tax rate.

9. Certain Relationships and Related Transactions

The Company operates departments within nine bookstores operated by Barnes & Noble, a stockholder of the Company until November 2004 and an affiliate through a common stockholder who is the chairman of the Board of Directors of Barnes & Noble and a member of the Company s Board of Directors. 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. During the 13 weeks ended August 2, 2008 and August 4, 2007, these charges amounted to $290 and $255, respectively. During the 26 weeks ended August 2, 2008 and August 4, 2007, these charges amounted to $584 and $487, respectively.

Until June 2005, GameStop participated in Barnes & Noble s workers compensation, property and general liability insurance programs. The costs incurred by Barnes & Noble under these programs were allocated to GameStop based upon total payroll expense, property and equipment, and insurance claim history of GameStop. Management deemed the allocation methodology to be reasonable. Although the Company secured its own insurance coverage, costs will likely continue to be incurred by Barnes & Noble on insurance claims which were incurred under its programs prior to June 2005 and any such costs applicable to insurance claims against the Company will be allocated to the Company. During the 13 weeks ended August 2, 2008 and August 4, 2007, these allocated charges amounted to $31 and $69, respectively. During the 26 weeks ended August 2, 2008 and August 4, 2007, these allocated charges amounted to $104 and $135, respectively.

In October 2004, the Company s Board of Directors authorized a repurchase of the common stock held by Barnes & Noble. The Company repurchased 12,214 shares of its common stock at a price equal to $9.13 per share for aggregate consideration before expenses of $111,520. The Company paid $37,500 in cash and issued a promissory note in the principal amount of $74,020, which was payable in installments and bore interest at 5.5% per annum, payable when principal installments were due. The Company s final scheduled principal payment of $12,173 was paid in October 2007. Interest expense on the promissory note for the 13 weeks and 26 weeks ended August 4, 2007 totaled $169 and $338, respectively.

In May 2005, the Company entered into an arrangement with Barnes & Noble under which www.gamestop.com became the exclusive specialty video game retailer listed on www.bn.com, Barnes & Noble s e-commerce site. Under the terms of this agreement, the Company pays a fee to Barnes & Noble for sales of video

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

game or PC entertainment products sold through www.bn.com. The fee to Barnes & Noble was $72 and $45 for the 13 weeks ended August 2, 2008 and August 4, 2007, respectively, and $143 and $99 for the 26 weeks ended August 2, 2008 and August 4, 2007, respectively.

10. Commitments and Contingencies

On February 14, 2005, and as amended, Steve Strickland, as personal representative of the Estate of Arnold Strickland, deceased, Henry Mealer, as personal representative of the Estate of Ace Mealer, deceased, and Willie Crump, as personal representative of the Estate of James Crump, deceased, filed a wrongful death lawsuit against GameStop, Sony, Take-Two Interactive, Rock Star Games and Wal-Mart (collectively, the Defendants) and Devin Moore, alleging that Defendants actions in designing, manufacturing, marketing and supplying Defendant Moore with violent video games were negligent and contributed to Defendant Moore killing Arnold Strickland, Ace Mealer and James Crump. Moore was found guilty of capital murder in a criminal trial and was sentenced to death in August 2005.

Plaintiffs new Alabama counsel has named a new expert, a psychiatrist who testified at the criminal trial on behalf of the criminal defendant, who will opine (if allowed) that violent video games were a substantial factor in causing the murders. This same testimony from this same expert was excluded in the criminal trial from the same judge hearing this case. The motion to bar this testimony in this case is set for October 30, 2008. The ruling on this motion will have an effect on whether the case is able to proceed. There is no current trial date. The Company 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 the Company s 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 financial condition or results of operations.

11. Significant Product Information

The Company is principally engaged in the sale of new and used video game systems and software, personal computer entertainment software and related accessories. The following table sets forth sales (in millions) by significant product category for the periods indicated:

	13 Weeks Ended				26 Weeks Ended			
	August 2, 2008		August 4, 2007		August 2, 2008		August 4, 2007	
	Sales	Percent of Total	Sales	Percent of Total	Sales	Percent of Total	Sales	Percent of Total
	(Unaudited)							
Sales:								
New video game	$ 379.7	21.0%	$ 293.8	22.0%	$ 718.7	19.9%	$ 575.2	22.0%

hardware								
New video game software	705.0	39.1%	494.2	36.9%	1,497.8	41.4%	954.8	36.5%
Used video game products	471.5	26.1%	357.3	26.7%	887.2	24.5%	683.7	26.1%
Other	248.2	13.8%	192.9	14.4%	514.3	14.2%	403.5	15.4%
Total	$ 1,804.4	100.0%	$ 1,338.2	100.0%	$ 3,618.0	100.0%	$ 2,617.2	100.0%

Other products include PC entertainment and other software and accessories, magazines and character-related merchandise.

GAMESTOP CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth gross profit (in millions) and gross profit percentages by significant product category for the periods indicated:

	13 Weeks Ended		26 Weeks Ended	
	August 2, 2008	August 4, 2007	August 2, 2008	August 4, 2007
	Gross	Gross	Gross	Gross