# GameStop Corp. (GME) CEO George Sherman on Q2 2019 Results - Earnings Call Transcript

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FQ2: 09-10-19 Earnings Summary

*Press Release* SEC *10-Q*

EPS of $-0.32 misses by $-0.10 | Revenue of $1.29B (-21.92% Y/Y) misses by $-52.57M

## Earning Call Audio

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00:00 -49:14

GameStop Corp. (NYSE:GME) Q2 2019 Earnings Conference Call September 10, 2019 5:00 PM ET

**Company Participants**

Eric Cerny - Investor Relations

George Sherman - Chief Executive Officer

Jim Bell - Chief Financial Officer

**Conference Call Participants**

Steph Wissink - Jefferies

Joe Feldman - Telsey Advisory Group

Ben Schachter - Macquarie

Ray Stochel - Consumer Edge Research

Operator: Welcome to GameStop's Second Quarter 2019 Earnings Call. This call is being recorded and will be made available.

I would now like to turn the call over to Eric Cerny, Investor Relations. Please go ahead.

**Eric Cerny**

Thank you. And welcome to GameStop's second quarter fiscal 2019 earnings and conference call.

This conference call will include forward-looking statements, which are subject to various risks and uncertainties that could cause actual results to differ materially from expectations. Any such statements should be considered in conjunction with the cautionary statements and Safe Harbor statement in the earnings release and risk factors discussed in reports filed with the SEC. GameStop assumes no obligation to update any of these forward-looking statements or information. A reconciliation and other information regarding non-GAAP financial measures discussed on the call can be found in the earnings release issued earlier today as well as in the Investor Section of our website.

With me today are GameStop's, Chief Executive Officer, George Sherman; and Chief Financial Officer, Jim Bell. On today's call George will not only discuss some highlights from our second fiscal quarter, but also share specific details of GameStop strategic framework for the future. Jim will then provide more detail on our financial results and some key expectations for the remainder of the year and into 2020.

Now, I would like to turn the call over to the company's Chief Executive Officer, George Sherman.

**George Sherman**

Thank you. Good afternoon, everyone, and thank you for joining us today on our second quarter earnings call. As I mentioned in our last call, I along with my new management team, have been moving quickly to assess the business and develop our strategy to reposition the organization for the future. Following numerous meetings with stakeholders, from across every aspect of our business, we have acquired valuable feedback and data to further reform our direction and, believe, we are formulating the strategic framework and specific initiatives to achieve our long-term growth and profit objectives.

We are committed to taking quick and deliberate actions to improve the performance of the company and set on the correct strategic path, fully leveraging our unique position and brand in the video game industry. I believe that during the call today, you will hear that we are fully committed to that mission and are acting with a sense of urgency to address the areas of the business that are critical to achieving long-term success and value creation.

We recognize that there was a need to rebuild credibility with the investment community and some of our stakeholders. We plan to accomplish this by quickly establishing a track record of delivering on our promises and executing plans for the business that will support improved financial performance and fuel future growth over the long-term. You're going to hear a similar message from Jim Bell regarding clarity of financial metrics and appropriate level of transparency for how we hold ourselves accountable in meeting our objectives.

To that end, today we will outline a strategy that includes both near-term and long-term measurable objectives, which we plan to track our progress against each quarter. Let's get into the details of that plan.

Our strategic plan is anchored on four key tenets: One, optimizing core business by improving efficiency and effectiveness in everything we do. Two, create a social and cultural hub of gaming within each GameStop store and online. Three, build compelling digital capabilities to reach our customers where ever they want to do business and give them the full spectrum of content and access to the products they are looking for and, four, transform our vendor and partner relationships, unlocking additional high-margin revenue streams and optimizing the lifetime value of every customer.

Let's take each of these one by one. First, we'll optimize the core business by driving efficiency and effectiveness across everything we do. There are several initiatives within this pillar, but broadly speaking, they include overhead cost restructuring, inventory management optimization, including streamlining SKU accounts and pricing and promotion optimization and a full review of rationalization of the store footprint across the globe.

As I mentioned, we are moving with a sense of urgency and have already demonstrated our commitment to doing so with our recent efforts to right-size the organization across our corporate infrastructure and our U.S. store leadership organization. Over the last couple of months, we implemented changes that require us to make tough, but necessary decisions for the benefit of our organization moving forward. These changes will drive efficiencies and serve as a catalyst to rightsizing our cost structure.

That work is continuing and we are further executing other ways to optimize operational cost, including restructuring or exiting unprofitable businesses or markets, and each and every aspect of our indirect procurement activities. As we told you in June, we are exiting the Simply Mac business and continue to work towards that divestiture in the near term. We also embedded ThinkGeek.com into the GameStop.com environment to leverage that existing platform, further streamlining the organization.

As you may know, in June we hired Chris Homeister as our Chief Merchandising Officer. Chris has an extensive hardlines and specifically consumable electronics retail background and has already developed and implemented several initiatives to improve the overall productivity of our stores and products. First, we are employing more effective merchandising practices, including among other things, few rationalization, which will declutter our stores and provide a better experience to our customers. The first store set with this evolving strategy begins next week.

Second, we believe that through a more comprehensive pricing architecture and end-to-end product and pricing life cycle management, we can drive higher overall product margins. And third, we are committed to adding and growing high-margin product categories, which not only work to offset market-driven declines and pre-owned software sales, but also add to our credibility with customers as the only retail outlet for the aggregation of all things video gaming and pop culture.

For example, we see further opportunity in expanding our double-digit growth collectibles category, creating more exclusive packages with our vendors, expanding our PC gaming offerings, and evolving our private label business by leveraging our significant scale and retail expertise. Optimizing our store base for an increasingly digital world is essential for the future and increasing profit productivity. We have an expansive and profitable store base with 95% of our stores posting overall EBITDA positive results. However, we know we have the opportunity to do even better and expand profitability by de-densifying our store footprint in some markets.

We are committed to both closing loss-making locations as well as maximizing profit productivity from capturing sales and profit transfer in stores with overlapping trade areas. We believe that store de-densification will be materially accretive to the overall business model, and remembering that our average lease life is only two years, we can approach these strategic decisions with limited, if any, cost implications.

In total, we believe these operating profit improvement initiatives will substantially exceed the previous management team's initial $100 million target that was communicated earlier in the year. We believe the total annualized run rate of our profit improvement initiatives will be in excess of $200 million for 2020 and beyond.

Moving to the second pillar of our strategy, we are committed to creating a social and cultural hub of gaming within each GameStop store, online and within the digital environment. This is especially important as the video game industry experiences a significant change, from the evolving methods in which customers are consuming video games to the more near-term disruption from the current console cycle coming to an end.

We are and have been the leading expert in the industry for decades and have the ability to leverage that position to create an experience that ignites passion before, during and after each transaction. Not only are we the largest videos sales generator for our hardware and software partners, we are also the video game authority in countless neighborhoods around the globe. This is what makes GameStop unique. There is no other brand better position to be the aggregator of video game products and content including eSports and Digital Media, with the deep expertise of our associates to gamers of all demographics worldwide.

As part of this strategy, we have begun testing a series of experiential offerings within the Tulsa, Oklahoma market. Think of this approach as a live laboratory, which will help us define and execute the optimum mix of high margin immersive experiential gaming content with our existing array of the video games and collectibles products.

For example, we are trying – try before you buy experience was up to 12 gaming days, eSports focused comparative gaming content delivery. Our Collectibles focus is experience, all supporting physical and digital video gaming accessories transactions. Of note, this is a very controlled and disciplined test that fits well with our capital expense budget for fiscal 2019, and any rollout from this test will not be implemented in every store in the chain. It's still early, and we will share some of these findings with you as we progress in the coming quarters.

While we believe these tests along with our other initiatives are necessary to define and add new high-growth and high-margin revenue streams for our business. We remain committed to two things. One, we are the leading omni-channel video game retailer and will continue to be. And two, we do not intend to completely remodel our chain of stores, but rather we expect the results of these tests will yield a highly profitable store model that will complement various key markets, further enhancing our already strong customer engagement as well as evolving our product offering and position within the gaming industry.

Finally, an integral part of being the social and cultural hub of gaming is our customer engagement within our loyalty program. We are exploring ways to expand the PowerUp Rewards program by enhancing the program's value to our most active shoppers, while simultaneously driving profitability.

Most importantly, we are redesigning our PowerUp Rewards program where among other things we are testing various recurring revenues subscription opportunities. Secondly, we are in the final stages of rolling out a new and improved value proposition for the paid PowerUp Pro tier which in early test is yielding favorable results in enrollment and customer frequency.

Finally, we've upgraded our customer database management toolset based on the Salesforce marketing cloud platform. This integration along with some new agency partnerships will enable a more sophisticated propensity-driven marketing model at the one-to-one level thereby focused on growing customer lifetime value and ROI.

Our third strategic pillar is building a complete and compelling set of digital capabilities. Digital is not only a growing aspect of our industry it's also a large part of who we are. Today, we attach significantly more digital content in-store and online purchases than any other retailer and we're focused on evolving further as we build-out best-in-class omni-channel capabilities. Simply, we have to adapt to meet our customers where ever they want to do business. We must and will be channel agnostic.

The first component of delivering a best-in-class omni-channel experience is the new GameStop.com platform that launched in August. This new online experience delivers highly engaged and fast online merchandising, new buy or hold and pick up in store functionality and rich community content. With enhanced functionality like Apple Pay and integrated PowerUp Rewards enrollments and improved shopability, this re-launch marks an important step towards our long-term goal of creating $1 billion e-commerce business. It also provides our customers with the omni-channel capabilities that they've come to expect.

Our efforts won't end here. Instead, we are currently working on various capabilities that we believe will add significant value for customers. Simply by leveraging existing assets, we have the opportunity to enrich and monetize data available to us and create digital exclusives. We recognize and embracing digital as an opportunity for GameStop and we are committed to supporting our vendor initiatives, both digitally and physically, including initiatives such as developing capabilities that allow for or enable, a more streamlined embedded digital purchase process.

Finally, the fourth pillar in our strategy. We're in the early stages of transforming our vendor and partner relationships to better position us for the future of video gaming. When I first spoke to you in June, I told you that, I believe it was important for GameStop to transform and evolve to remain a viable player in our industry, which is undergoing meaningful technological change. We are committed to doing that, but recognize that this part of the strategy will take longer to develop. The good news is twofold.

First, we are advancing very constructive discussions with our partners and they have recognized the value that we bring to them. And second, both Microsoft and Sony recognize the market and technology advancement will still require physical disks in the next gaming console cycle.

Our 50,000-plus knowledgeable associates worldwide remain the only full-time dedicated sales force in the video game industry. And the results they drive are meaningful. We attach significantly more games, content, digital media and related pop-culture content than any retail outlet for both our hardware and software partners and in most cases are their number one volume sales outlets.

Our associates bring an enormous amount of value to console makers, given they are integral part of our customer acquisition model. Our partners are actively engaging with us to evolve the model from a historical transactional model to one that rewards us across the customer acquisition and lifetime value spectrum, not simply transactions.

As an organization, we are intensely focused on advancing each of our four strategic tenets and we will continue to update you on our progress against our goals in the months ahead.

Some of these opportunities will serve to benefit us sooner, rather than later and some of these initiatives will take time to nurture and cultivate over the long term. We will be disciplined with our approach to innovation by focusing on initiatives that will benefit the core video game business and leverage our current portfolio of assets, but not require significantly more capital growth.

In fact, we intend to maintain our historical annual capital expenditure levels and redirect some of those funds toward these initiatives. We are out of the diversification business. We will test and learn before we deploy and our decision-making will be driven by a disciplined approach to capital allocation. We will not under any circumstances debt to farm.

As you can tell from my comments, I'm excited about the opportunity in front of us. It's a tremendous challenge and will require significant effort on our part, but we are well on our way. Make no mistake, this transition will take time and our sales expectations over the next several quarters will reflect the end of console cycle and the next generation of console launches by both Sony and Microsoft later for 2020.

However, as you can see, our strategic framework is focused not only on sales, but expanding our gross margin, reducing costs and optimizing inventory management, all of which will lead to continued growth of free cash flow of the business, both in the near term and over the long term.

Before I turn the call over to Jim for our financial review of the quarter and outlook for the remainder of the year, I want to take a minute to address some of the misconceptions that I've heard over my first few months. It's clear to me that market sentiment regarding our core business is not fully reflective of our intrinsic value. There are likely several things driving that many of which we are currently addressing.

But what I do know is that, we have tremendous assets that have driven and can continue to drive meaningful shareholder value and cash return. We believe those assets are being discounted by a market that is focused solely on a short-term view and mistake supplier management such as sale diversification investment decisions.

In our view, our current sales performance reflects the natural end of console cycle that will rebound with console launches later in 2020. However, while we believe strongly in the value creation opportunity of our initiatives, this management team is committed to being a goods stored as capital and being disciplined and highly strategic in terms of any potential investments, as well as returning excess capital to shareholders. We have a strong and improving balance sheet and cash flows, a highly profitable store base, a very resilient brand that operates resilient strength in the industry.

In closing, we have a tremendous chance to shape the future of GameStop in this evolving and dynamic industry as the leading provider of rich video gaming products, content and expertise across all purchasing channels.

Our team is committed to tackling the challenges in front of us and we are confident that we are positioning the business to deliver strong results, particularly with the next console cycle on the horizon.

As we evolve our business model over that same timeframe, we'll be better equipped to drive increased profitability when the industry cycle turns and consoles launch in 2020. I'd now like to turn the call over to Jim for a recap of the quarter and our outlook on key business metrics. Thank you.

**Jim Bell**

Thank you, George, and good afternoon, everyone. It's great to be with you here today. I like George, was drawn to GameStop by the enormous potential of this business. GameStop's strong brand positioning and engagement with the large passionate customer base has the leading authority in all things video games, along with the opportunity to be part of a leadership team, driving innovation and transformation make this an exciting and pivotal time to be at GameStop.

My initial observations are very much aligned with George's and the other members of our senior leadership team. We have quickly joined forces to take definitive actions on things that needed to be done, such as exiting unprofitable businesses, rightsizing our cost structure, applying deep retail expertise to elevate the overall efficacy of our operations and setting the stage for developing new revenue streams for the future of the business, particularly as the videogame industry continues to evolve.

However as George shared, we are not done and have a lot of work in front of us. But we are acting with a sense of urgency, making tough but necessary decisions and moving forward with the disciplined approach to deploying these strategies which we believe will position GameStop to maximize shareholder value.

We are committed to providing you with as much transparency as possible and updating you as we progress through the transformation of the business which is specifically intended to restore credibility amongst the investment community.

Now I would like to shift to the recap of the second quarter results. From the topline perspective, total sales declined $315.4 million or 14.3% as compared to the second quarter of 2018. The sales decline was comprised of an 11.6% comparable store sales decline, a 130 basis points related to 195 store closures since the second quarter last year and 140 basis points of negative foreign exchange impact.

While not up to our expectations, these results are generally in-line with declines across the videogame industry and indicative of sales volumes at this point in the console cycle.

As such, the primary driver of the sales decline was new hardware sales, which was down 41% year-over-year. However as you know, we are focused on growing other product lines that are important to our gamer community.

Our collectibles business is a great example. It continues to positively expand, posting a 21% year-over-year increase in the second quarter exceeding our expectations and marking the 15th consecutive quarter of growth with 14 out of the 15 in double digits.

Software sales declined 5.3% with declines across most categories, slightly offset by growth in the Nintendo Switch software and the release of the current year title in the Madden NFL franchise toward the end of the quarter.

In line with the current stage of the console cycle, our pre-owned video game business was down 17.5% with consistent declines across both hardware and software. It is worth noting that within pre-owned hardware, we continue to see strong demand for the Nintendo Switch, but a solid sales increase on this platform was more than offset by declines in the other consoles as we await next generation launches later in 2020.

Overall, gross margins declined by 30 basis points to 31.0%, primarily driven by a markdown activity related to the wind down of our thinkgeek.com business. Excluding the effects of this transition, overall margins for the quarter would have been 31.4%, reflecting a 10 basis point expansion.

As reported, SG&A for the second quarter was $459 million, compared to $442 million a year ago. The increase was driven by $37 million in one-time transformation, severance, and other charges associated with our GameStop Reboot profit improvement initiatives.

After adjusting for these one-time charges, SG&A expenses declined by $19.2 million or 4.3%, reflecting just the beginning of the impact of our organizational changes as we implemented them late in or subsequent in the quarter.

During the quarter, we incurred a non-cash non-operating goodwill impairment charge of $364 million related to the decline in company share price. We reported an operating loss from continuing operations of $447 million, which included the goodwill impairment and the other $37 million in one-time charges previously noted. Excluding these items, we reported an adjusted operating loss of $46 million compared to operating earnings of $1.5 million last year.

Our effective tax rate for the quarter was 8.8% due to the partial deductibility of the impairment charge. Excluding the effect of the impairment and other charges, our effective tax rate was 39.4%, which was impacted by certain discrete items recorded in the quarter and the mix of earnings across the jurisdictions in which we operate.

Second quarter adjusted loss per diluted share excluding the impact of asset impairment charges and other items was $0.32 compared to $0.10 in the prior year period. We ended the quarter with $707 million of total cash and liquidity comprised of $424 million in cash and $283 million in net availability under our revolving line of credit, which is an increase of $20 million from the prior year.

We ended the quarter with long-term debt of $419.1 million versus $819.2 million at the end of the second quarter of 2018. And as we continue to execute against our objective to significantly improve inventory management, we ended the quarter with inventory of $949 million, a 16% decline from the second quarter last year, significantly improving inventory management and in particular, increasing our inventory turns as a major initiative and we believe provides an opportunity to materially improve the already strong cash flow of our business.

From a capital allocation perspective, during the quarter, we had $23 million of capital expenditures bringing the year-to-date total to $41 million. We are projecting our full year capital expenditures to be between $90 million and $95 million, reflecting a reduction to our historical CapEx levels.

Additionally, we repurchased $62.4 million or 12 million shares for our modified Dutch auction. We also reduced outstanding debt by $51 million bringing the year-to-date total reduction in debt to $404 million.

We remain committed to returning excess capital to shareholders when appropriate and have approximately $237 million remaining under the existing share repurchase authorization. We will be balanced in our approach as we consider additional share repurchases, debt reductions, and responsibly investing in the business.

With the second quarter behind us and results that admittedly were below what we would do want, particularly on the topline, I want to share with you how we are approaching the remainder of fiscal 2019.

As you know the video game business cyclical and generally driven by the launch of consoles as well as some seasonality given the historically strong title launches that for the most part occur in the second half of the year in the holiday season.

We are approaching the end of the current console cycle with nice generation consoles slated to be available in late 2020, and as such we expect our year-over-year sales to be down over the next three or four quarters, reflecting the end of that cycle.

Compounding this negative impact on sales is the fact that console makers have confirmed to launch earlier than they have in the past. We anticipate that this will lead to much lighter title slate through the rest of 2019 and early 2020 given the end of the cycle timing for the current consoles.

As a result, at this time, we expect a percentage decline from comparable same-store sales for 2019 to be in the low-teens which includes a difficult comparable sales challenge from last year as we are up against blockbuster titles like Red Dead Redemption 2, 2018's number one volume title without a comparable launch in 2019.

While we expect the current topline trend to continue through the first half of 2020, we remain focused on the strategic initiatives George outlined which we believe will position us for long-term profit and cash flow expansion.

As a result, our results over the coming few quarters will not be sales-driven, but we believe will reflect the strengthening of our core business with expanding margins, disciplined expense management, and capital expenditures, and finally, strong and growing free cash flow.

In that light, we expect the overall annualized run rate of our profit improvement initiatives to be over $200 million in 2021 as we execute on them throughout the rest of 2019 and through 2020.

An important evolution for any retailer is the optimization of its portfolio. We are no different. After years of growth, both organic and inorganic, we maintain a very profitable store base with over 95% of our more than 5,700 worldwide stores posting four-wall positive EBITDA. While that is an impressive statistic, we have a clear opportunity to improve our overall profitability by de-densifying our chain. That work is well underway.

We are on track to close between 180 and 200 underperforming stores globally by the end of this fiscal year. And while these closers were more opportunistic, we are applying a more definitive analytic approach, including profit levels and sales transferability that we expect will yield a much larger tranche of closures over the coming 12 months to 24 months. We believe these actions will significantly add to our profit improvement run rate with little to no cash expense as our average lease life is approximately two years.

In addition to optimizing our store portfolio, we are continuing to evaluate strategic and operational alternatives for certain unprofitable operating subsidiaries or business units, primarily within our International segments. We will provide more information on network in the future.

Historically, there is a fair amount of seasonality in our business and our working capital throughout any fiscal year. In that light, after adjusting for the timing of certain invoice payments related to holiday 2018 inventory that were paid after the end of the fiscal year last year, we expect our adjusted free cash flow for fiscal 2019 to be in the $225 million to $250 million range. Finally, given my earlier comments related to our sales outlook for both the industry and our business, we expect adjusted diluted earnings per share for fiscal 2019 to be in the $1.15 to $1.30 range.

In closing, I will reiterate that we fully expect sales across the industry and in our business to be relatively soft for the coming few quarters. However, we are not willing to relinquish our market share leadership in the space, which is driven by our unique positioning. We are not a transactional retailer, but in fact, the only aggregator of the best and exclusive new and pre-owned video game products, compelling digital content, including access to esports media and the leading industry publication in Game Informer and the largest group of foremost gaming experts our store associates. All of which serve one of the largest and most engaged customer databases in retail today. We look forward to keeping you updated as we progress against our strategic initiatives over the coming few quarters.

And with that, I will turn it over to the operator to open the line to any questions that you may have.

**Question-and-Answer Session**

**Operator**

Thank you. [Operator Instructions] We will now take our first question from Steph Wissink of Jefferies. Please go ahead.

**Steph Wissink**

Hi, everyone. I mean, I want to focus on three areas if we can. George my first question is for you is on initiative number for a transforming your vendor partnerships. I'm wondering if you can talk a little bit about some of the incremental or additional high margin revenue streams that you see in that specific agenda item? Again, just give us a sneak peek at some of those things that you might be looking at.

And then my second question is you spotlighted collectible as one of the areas of outperformance. I think you mentioned 14 or 15 quarters of double-digit comp growth. Can you talk a little bit more about how that range of products has evolved? How do you think this business has evolved? How you're thinking about collectibles as a core driver under some of the new initiatives that you described at the beginning of the call? Thank you.

**George Sherman**

Yeah. Thanks, Steph. I think starting off with your question on the transforming vendor partner relationships as that covers a very broad spectrum. I think first and foremost, we never really had truly negotiated as a global company, and that's certainly part of our focus going forward.

We're looking at the full spectrum of opportunities with our partners. I think that includes new revenue streams, and I think that includes things like digital exclusive, physical exclusive just as we've done in the past. When we talk about high margin categories, we are referring to other categories as well like private label.

We find on a global basis that the U.S. private label penetration is lower than our other operating businesses. And that, there's an opportunity there to go ahead and drive more of that, and we certainly look at categories that we think that we've been missing for a while like PC gaming. Kind of transitioning into collectibles, clearly, that's a high margin category for us as well. It's been successful. I think there's been a level of trial and error along the way with collectibles, because it was new to us. I'd say that our view as to where success lies in collectibles has become much more focused and we're able to kind of hone in on those areas.

So it's one that we intend to grow. It's one that we see continued double-digit growth ahead. It's one that we see as a means of attracting new customers in the gaming, which is very, very important for our vendor partners is bringing new folks into gaming for the first time as very often collectibles customers are not necessarily core gamers, so.

**Steph Wissink**

Thank you.

**George Sherman**

Thank you. Good luck tomorrow with your trading day for the Bahamas by the way. Thanks.

**Steph Wissink**

Thank you.

**Operator**

Our next question comes from Joe Feldman of Telsey Advisory Group. Please go ahead.

**Joe Feldman**

Yeah. Hi, guys. I wanted to understand that you made a comment about digital subscription model for games. Can you give a little more color on that, and like kind of what you’re thinking on that front?

**George Sherman**

Joe, I don't recall the comment on digital subscription. It's clearly something that some of our partners are getting into. And as we collaborate with them, it's important to them, it's important to us. And we certainly see the sale of digital subscriptions as part of our future on their behalf, but no more specifics in that right now.

**Joe Feldman**

Got it. All right. Sorry, I may misheard it. I thought, I heard subscription and associated it with digital. So I apologize on that. With regard to the collectibles growth that you guys have had over the past few years, it's just been great. But how much of it is an increasing penetration of collectibles whether in the store, or just adding more SKUs versus driving incremental demand in that category?

**Jim Bell**

Yeah. It's actually more about incremental demand. I mean, in fact, we’re thinking about -- as we go forward, George talked about SKU rationalization. This is an area that we have an opportunity to be more efficient and effective with the inventory within collectibles. So if we think about SKU base across side, it's more about rationalizing the numbers of SKUs and letting those that are highly productive continue to be highly productive and penetrate from a demand perspective.

**Joe Feldman**

Got it, got it. Thanks. And then if I could just sneak maybe one more in. You talked about being more formulaic about the approach to store closures in the future. Can you share a little more thought on, like, do you guys have a number in mind? Or do you have a rough estimate of what you think you might need to close? Or is it still little early for that?

**George Sherman**

I think, we're rapidly developing the point of view on that and we haven't disclosed that. We will share more with you in the future. But suffice it to say, we're taking a very specific approach that looks at, if you think about this business over multiple years.

The inorganic or acquisition growth of this business created opportunities in certain markets where we have quite a dance footprint and where we have -- stores within -- in overlapping trade areas or that overlapping within a trade area. That de-densification gives us the opportunity for transferability, regardless of whether or not we are loss making, one of those two stores for example might be loss making.

And so, that's really how we're approaching it. That's the analytic that we're applying. That's why we think about it not as a binary function of loss making versus non-loss making stores. But more importantly, in total, as we rationalize the chain, how can it fully be accretive to -- for bottom line performance.

**Joe Feldman**

Yeah. That makes a lot of sense. Thanks for sharing that. I'll see you too. Thank you.

**George Sherman**

Thanks a lot Joe.

**Operator**

[Operator Instructions] Our next question comes to us from Ben Schachter of Macquarie. Please go ahead.

**Ben Schachter**

Yeah. Can we talk about high-level -- the shift to digital, and then how it impacted the business? So a few questions on that. One, when you think about the next cycle, what percentage of total game, do you think are going to be sold physically versus digital? And what your share might look like in that?

Two, how do you expect to participate in digital? How will that evolve for you guys versus what it is today? And then three, around the used business, what does that look like as we move more to digital?

And then somewhat separately, you talked about the social cultural hub, I think it's an interesting thought there and can you talk about how eSports might play into that and how you might use the store footprint to participate there? Thanks.

**George Sherman**

Yeah, thanks Ben. Let me start off with the question around the next cycle and it's a mix between physical and digital games. Our assumption is that, they'll launch in both formats with the new cycle just as they do now. And our assumption is that, we'll have a piece of both businesses. Obviously, we have a very, very significant share when it comes to physical games. Physical games are still a significant portion of the overall gaming industry today. And as we have noted in our -- in the script, we attached at a significantly higher level on digital gaming than most of the competitive set.

We want to make it easier. We want to make it more so. I think it's fair to say that, historically, we probably had a preference for physical games versus digital games and we've been clear to say both internally and externally that we're going to be agnostic and it has to be the customer's choice, as to which may we sell.

So we will focus on making the digital sales process easier, more streamlined, more embedded, and we'll push to make sure that we have that approach. If you think of a trial before you buy type scenario as one of the test that we talked about in Tulsa, it's that customers' choice, as to which minute they want to buy again, physical or digital.

**Jim Bell**

Yeah. As for pre-owned, we think pre-owned is following very similar trends as new physical games are right now. While the category is down, there is no debate about that, it is following the same pattern as we see on the new gaming side of the business; meaning specifically, that our sales around the switch are best performers within pre-owned games and that the other two versions are feeling more the self-pinch right now. We would expect that to continue by the way in the new gaming cycle.

I think when you think of the new consoles, there are a couple of things that are pretty significant. One is, backward compatibility. The other is the fact that, both new devices will have a disk drive on them.

So certainly, I think when that becomes widely understood that we'll see a bit of a -- another bite to the apple in terms of pre-owned gaming as it will be -- certainly alive and well for few years to come.

**Ben Schachter**

Any thoughts on eSports and how that's going to impact the social cultural hub initiative?

**Jim Bell**

Yeah. eSports is something that we've got involved with. We had a partnership with Complexity Gaming. And with that we have the naming rights for their training center here in Dallas. We also have a partnership with Team Envy. So we move closer and closer. We think that it will be a valuable; first of all, content. So, the ability to get content from these facilities, from these teams that we can share with our best customers, that we can share with our in-store gamers.

And I mean certainly, I think we looked down the road and if there is significant gaming activity in stores there’s a stream up capability as well. So we certainly see an opportunity to partner and have the -- our version of the little league's going on in stores or the minor league’s going on in stores that could over time lead to a connection with those professional sports businesses.

**Operator**

Our next question comes from Ray Stochel of Consumer Edge Research. Please go ahead.

**Ray Stochel**

Great. Thanks for taking my question. You guys had mentioned that you looked at a bunch of data with your stakeholders. Do you guys have a broad sense of some KPIs? What I'd be looking for would be lifetime value, but other KPIs would be helpful as well. Your customers versus the lifetime value or other KPIs of customers acquired from Walmart, Target, Amazon or Best Buy especially for Sony and Microsoft?

And then my follow-up question to that would be more on store count, has there been a change in the economics over reverse cannibalization or recapture now with e-commerce? And is your new e-commerce site positioned more effectively to recapture consumers whether that be, the new -- the consumer purchasing new or the consumer purchasing pre-owned? Thanks.

**George Sherman**

Yes, thanks Ray. I think in the first question as it applies to the data that we -- in our understanding of the customer base, we've done more and more assuring of that with our vendor partners than -- and it’s been mutual. So, I think certainly that's one of our competitive advantage is that, it's a pretty well known fact among our partner community that we over indexed with customers.

We have a higher digital attach rate, customers who buy physical games for us buy more games overall; customers who buy from us, buy more accessories overall. So -- and virtually every category that business, whether it be digital, physical games or accessories, you see a higher attachment rate at a GameStop store, no question about it. So, that is certainly something that we are proud of and certainly a view that we share. And again as it applies to the lifetime value, we have more of a cross exchange going out with our vendor partners that we probably have in the past.

On the website, I think, couple of things jump to mind. First and foremost, among the new capabilities is buy online pickup in-store. It is a very common in retail, obviously, and I see it was a bit of a disadvantage for us. You could hold online buy in-store, but not buy online pickup in-store. We think that will be a significant growth category for us going forward.

We also have what we think is pretty uniquely positioned to ship to home capability at every store in our fleet. So, when you talk about supply, it's not just two distribution centers, it’s virtually every store in our company can service one as well and get product quickly to a customer.

Shopability is better, ease of navigation. It was a bit cumbersome to buy for instances soft lines in our prior site. It was clunky when it came to buying by size that's now been fixed in this community aspect of it as well that we think is pretty different.

**Ray Stochel**

Great. Thanks again.

**George Sherman**

Thanks.

**Operator**

[Operator Instructions] Our next question comes from Seth Sigman of Credit Suisse. Please go ahead.

**Unidentified Analyst**

Hi. This is [indiscernible] on for Seth. Thanks for taking our questions. So firstly to start off with the pre-owned business, I think last quarter you spoke of some changes in the business stream that you were looking at investing some models to enhance the value proposition. I mean could you give us some results of the test and frame the magnitude of the margin reset that you may see like in 2H and beyond?

**George Sherman**

Yeah. We had a couple of test that we are not quite ready to speak to results on and it applies to both pre-owned as well as to our loyalty customer base and the new PowerUp offer. So they are early on. We're seeing some initial good success.

I will say that the biggest change that we have made that's now done is it applies to pre-own gaming is to unify the gaming business under our single merchant. So when the past has been fragmented across the pre-owned merchant, a new game merchant and now we own the business across the spectrum including pricing optimization. So that's been the biggest change that's done. There's a couple of things that are, I'd say just too early for us to comment on.

**Unidentified Analyst**

Got it. So, just a follow-up on the cost initiatives. So regarding the profit improvement plan that you guys highlighted, how do we think about that time line? When shall it start showing up, I mean, are we still supposed see some sort of benefit in the back half or like it was the end of 4Q? And then we see the ramping up with the next year?

**George Sherman**

Yeah. Our initiative, our profit initiative is you can think of almost effectively as a 50/50 split between cost reduction and areas like margin improvement. Obviously, the cost reduction is going to happen fast, and as Jim mentioned in his comments most of what we did here recently happen at the late portion or subsequent to the end of Q2.

So it's all very new, but it is now in effect, we think of that call it $100 million of cost reduction opportunity has been roughly 40% complete now. And that's a combination of structural changes that we made as well as some indirect procurement initiatives that have taken hold. So, that gives us a level of confidence again to commit to a $200 million number because we made very, very good progress on -- to get there.

**Unidentified Analyst**

Got it. And just if I can just squeeze one more really quickly here, so regarding some of the initiatives within the store, you guys spoke about rationalizing the collectibles assortment within the store. I mean apart from that, are there any other store resets that you are working on and that you could elaborate on?

**George Sherman**

Yeah. I'd say generally speaking, we mentioned that we are a week away from a reset in the store. And that's not the end product. It's a step in the right direction. It's what the teams are remarkable job on about six weeks to get things done. So, you're going to see some SKU reduction, you're going to see I'd say better pairing by ecosystem, meaning when you look at your assortment within the Sony Nintendo and Microsoft world that are more logical, there's more accessories pulled in together, there's a bit more private label, there's a bit more attach areas that are part of it. And it's a bit cleaner on the collectibles side of the business as well.

And as I mentioned to step on your comments, it would be a much more focused in terms of where we know collectibles works. And there are categories. We have remarkable relationship with Funko and we've been enormously successful with the pops business. It's a big part of our collectibles for us. So, I think you're going to see a step in the right direction, but it's not in any -- in respect to finished product, it's the best effort in a very short period of time.

**Unidentified Analyst**

Got you. Thank you so much.

**Operator**

That's all the time we have for questions. At this time, I will turn the conference back to George Sherman for any additional or closing remarks. Please go ahead.

**George Sherman**

Yes. Thank you. And thanks to everyone for joining us today on our call. We appreciate your interest in GameStop as always. I have to say coming off of our Preholiday Store Leadership Conference in Nashville just a couple of weeks ago, I want to give a shout out to our store teams, in particular our store managers, and really the entire team overall. I mean it's a wildly enthusiastic group. It's obvious that they already executed in the new direction, they are passionate about moving us forward as quickly as possible, and we have a great team that's ready to win. I want to thank them for their hard work ahead of the important holiday season. Thank you all.

**Operator**

This concludes today's call. Thank you for your participation. You may now disconnect.