GAMESTOP CORP
Form 10-Q
September 07, 2004

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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 July 31, 2004

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 *(State or other jurisdiction of incorporation or organization)*	**75-2951347** *(I.R.S. Employer Identification No.)*
2250 William D. Tate Avenue, 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 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 August 27, 2004: 20,314,091

Number of shares of $.001 par value Class B Common Stock outstanding as of August 27, 2004: 36,009,000

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

GAMESTOP CORP.

CONSOLIDATED BALANCE SHEETS

	July 31, 2004	August 2, 2003	January 31, 2004
	(Unaudited)	(Unaudited)	
	(In thousands, except per share data)		
ASSETS			
Current assets:			
Cash and cash equivalents	$159,748	$144,147	$204,905
Receivables, net	6,547	6,213	9,545
Merchandise inventories	184,059	156,374	223,526
Prepaid expenses and other current assets	14,628	11,054	14,340
Prepaid taxes	11,968	13,818	12,775
Deferred taxes	7,661	6,034	7,661
Total current assets	384,611	337,640	472,752
Property and equipment:			
Land	2,000		
Buildings and leasehold improvements	77,042	48,072	57,259
Fixtures and equipment	154,557	112,395	131,556
	233,599	160,467	188,815
Less accumulated depreciation and amortization	100,088	68,802	84,784
Net property and equipment	133,511	91,665	104,031
Goodwill, net	320,888	320,691	320,826
Other noncurrent assets	1,698	1,470	1,315
Total other assets	322,586	322,161	322,141
Total assets	$840,708	$751,466	$898,924
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$130,361	$120,736	$204,011
Accrued liabilities	89,965	68,452	79,839
Total current liabilities	220,326	189,188	283,850
Deferred taxes	17,629	5,591	17,731
Other long-term liabilities	3,319	3,410	3,310

	20,948	9,001	21,041
Total liabilities	241,274	198,189	304,891
Stockholders equity:			
Preferred stock authorized 5,000 shares; no shares issued or outstanding			
Class A common stock $.001 par value; authorized 300,000 shares; 23,483, 21,439 and 22,993 shares issued, respectively	23	21	23
Class B common stock $.001 par value; authorized 100,000 shares; 36,009 shares issued and outstanding	36	36	36
Additional paid-in-capital	516,813	496,970	510,597
Accumulated other comprehensive income	125	(75)	296
Retained earnings	132,437	67,837	118,087
Treasury stock, at cost, 3,263, 910 and 2,304 shares, respectively	(50,000)	(11,512)	(35,006)
Total stockholders equity	599,434	553,277	594,033
Total liabilities and stockholders equity	$840,708	$751,466	$898,924

See accompanying notes to consolidated financial statements.

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GAMESTOP CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

	13 Weeks Ended		26 Weeks Ended	
	July 31, 2004	August 2, 2003	July 31, 2004	August 2, 2003
	(In thousands, except per share data) (Unaudited)			
Sales	$345,593	$305,674	$717,329	$627,415
Cost of sales	238,386	216,691	504,582	452,991
Gross profit	107,207	88,983	212,747	174,424
Selling, general and administrative expenses	85,965	71,262	172,591	139,797
Depreciation and amortization	8,697	6,872	16,841	13,089
Operating earnings	12,545	10,849	23,315	21,538
Interest income	(392)	(375)	(719)	(900)
Interest expense	198	168	372	314
Earnings before income tax expense	12,739	11,056	23,662	22,124
Income tax expense	5,067	4,450	9,312	8,907
Net earnings	$ 7,672	$ 6,606	$ 14,350	$ 13,217
Net earnings per common share basic	$ 0.14	$ 0.12	$ 0.25	$ 0.23
Weighted average shares of common stock basic	56,620	56,764	56,805	56,924
Net earnings per common share diluted	$ 0.13	$ 0.11	$ 0.24	$ 0.22
Weighted average shares of common stock diluted	59,533	60,193	59,832	60,215

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 Income	Retained Earnings	Treasury Stock	Total
	Shares	Class A	Shares	Class B					
					(In thousands) (Unaudited)				
Balance at January 31, 2004	22,993	$ 23	36,009	$ 36	$510,597	$ 296	$118,087	$(35,006)	$594,033
Comprehensive income:									
Net earnings for the 26 weeks ended July 31, 2004							14,350		
Foreign currency translation						(171)			
Total comprehensive income									14,179
Exercise of employee stock options (including tax benefit of $1,652)	490				6,216				6,216
Treasury stock acquired, 959 shares								(14,994)	(14,994)
Balance at July 31, 2004	23,483	$ 23	36,009	$ 36	$516,813	$ 125	$132,437	$(50,000)	$599,434

See accompanying notes to consolidated financial statements.

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GAMESTOP CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	26 Weeks Ended July 31, 2004	26 Weeks Ended August 2, 2003
	(In thousands) (Unaudited)	
Cash flows from operating activities:		
Net earnings	$ 14,350	$ 13,217
Adjustments to reconcile net earnings to net cash flows provided by (used in) operating activities:		
Depreciation and amortization	16,841	13,089
Amortization of loan cost	177	147
Tax benefit realized from exercise of stock options by employees	1,652	1,601
Deferred taxes	(102)	
Loss on disposal of property and equipment	106	121
Increase in other long-term liabilities for scheduled rent increases in long-term leases	104	162
Minority interest	(96)	(23)
Changes in operating assets and liabilities, net		
Receivables, net	2,975	1,291
Merchandise inventories	39,353	7,095
Prepaid expenses and other current assets	(275)	(840)
Prepaid taxes	799	(13,818)
Accounts payable, accrued liabilities and accrued income taxes payable	(63,391)	(59,174)
Net cash flows provided by (used in) operating activities	12,493	(37,132)
Cash flows from investing activities:		
Purchase of property and equipment	(46,533)	(34,923)
Acquisition of controlling interest in Gamesworld Group Limited, net of cash acquired		(2,892)
Net increase in other noncurrent assets	(622)	(491)
Net cash flows used in investing activities	(47,155)	(38,306)
Cash flows from financing activities:		
Issuance of shares relating to employee stock options	4,564	1,371
Repayment of debt of Gamesworld Group Limited		(2,296)
Purchase of treasury shares through repurchase program	(14,994)	(11,512)
Net cash flows used in financing activities	(10,430)	(12,437)
Exchange rate effect on cash and cash equivalents	(65)	(8)
Net decrease in cash and cash equivalents	(45,157)	(87,883)
Cash and cash equivalents at beginning of period	204,905	232,030
Cash and cash equivalents at end of period	$ 159,748	$ 144,147

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 January 31, 2004. 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 26 weeks ended July 31, 2004 are not indicative of the results to be expected for the 52 weeks ending January 29, 2005.

2. 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 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.

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GAMESTOP CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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		26 Weeks Ended	
	July 31, 2004	August 2, 2003	July 31, 2004	August 2, 2003
	(In thousands, except per share data)			
Net earnings, as reported	$7,672	$6,606	$14,350	$13,217
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	2,458	2,079	4,541	4,179
Pro forma net earnings	$5,214	$4,527	$ 9,809	$ 9,038
Net earnings per common share basic, as reported	$ 0.14	$ 0.12	$ 0.25	$ 0.23
Net earnings per common share basic, pro forma	$ 0.09	$ 0.08	$ 0.17	$ 0.16
Net earnings per common share diluted, as reported	$ 0.13	$ 0.11	$ 0.24	$ 0.22
Net earnings per common share diluted, pro forma	$ 0.09	$ 0.08	$ 0.16	$ 0.15

The weighted-average fair value of the options granted during the 13 weeks ended July 31, 2004 and August 2, 2003 were estimated at $6.38 and $5.38, respectively, and the 26 weeks ended July 31, 2004 and August 2, 2003 were estimated at $7.86 and $5.17, respectively, using the Black-Scholes option pricing model with the following assumptions:

	13 Weeks Ended		26 Weeks Ended	
	July 31, 2004	August 2, 2003	July 31, 2004	August 2, 2003
Volatility	58.1%	60.9%	60.1%	61.8%
Risk-free interest rate	4.1%	2.4%	3.3%	3.1%
Expected life (years)	6.0	6.0	6.0	6.0
Expected dividend yield	0%	0%	0%	0%

3. 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		26 Weeks Ended	
July 31,	August 2,	July 31,	August 2,

	2004	2003	2004	2003
	(In thousands, except per share data)			
Net earnings	$ 7,672	$ 6,606	$ 14,350	$ 13,217
Weighted average common shares outstanding	56,620	56,764	56,805	56,924
Common share equivalents related to options and warrants	2,913	3,429	3,027	3,291
Common shares and common share equivalents	59,533	60,193	59,832	60,215
Net earnings per common share:				
Basic	$ 0.14	$ 0.12	$ 0.25	$ 0.23
Diluted	$ 0.13	$ 0.11	$ 0.24	$ 0.22

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GAMESTOP CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Options to purchase approximately 5,142 shares of common stock at exercise prices ranging from $16.48 to $21.25 per share were outstanding during the 13 weeks ended July 31, 2004, but were not included in the computation of diluted earnings per share because they were anti-dilutive. These options expire at various times through 2014.

4. Debt

In June 2004, the Company amended and restated its $75,000 senior secured revolving credit facility, which now expires in June 2009. The revolving credit facility is governed by an eligible inventory borrowing base agreement, defined as 55% of non-defective inventory, net of certain reserves. Loans incurred under the credit facility will be maintained from time to time, at the Company s option, as: (1) Prime Rate loans which bear interest at the prime rate (defined in the credit facility as the higher of (a) the administrative agent s announced prime 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) LIBO Rate loans bearing interest at the LIBO 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, currently 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. Under certain circumstances, the revolving credit facility may restrict our ability to pay dividends. There have been no borrowings under the revolving credit facility.

5. 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	
	July 31, 2004	**August 2, 2003**	**July 31, 2004**	**August 2, 2003**
	(In thousands)			
Net earnings	$7,672	$6,606	$14,350	$13,217
Other comprehensive income (loss):				
Foreign currency translation adjustments	6	(75)	(171)	(75)
Total comprehensive income	$7,678	$6,531	$14,179	$13,142

6. Income Taxes

The tax provisions for the 13 weeks and 26 weeks ended July 31, 2004 and August 2, 2003 are based upon management s estimate of the Company s annualized effective tax rate.

7. 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 $181 and $200 for the 13 weeks ended July 31, 2004 and August 2, 2003, respectively, and $381 and $436 for the 26 weeks ended July 31, 2004 and August 2, 2003, 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 $650

GAMESTOP CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and $635 for the 13 weeks ended July 31, 2004 and August 2, 2003, respectively, and $1,320 and $1,165 for the 26 weeks ended July 31, 2004 and August 2, 2003, 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.

8. 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 any time 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. During court-ordered mediation in March 2004, the parties reached a settlement in principle which, if approved by the court, would define the class of current and former salaried retail managers and would result in a cost to the Company of approximately $2,750. A provision for this proposed settlement was recorded in the 13 weeks ended May 1, 2004. Management expects that the settlement and resolution of this case will take place in fiscal 2004.

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.

9. Supplemental Cash Flow Information

	26 Weeks Ended July 31, 2004	26 Weeks Ended August 2, 2003
Cash paid during the period for:		
Interest	$ 111	$ 152
Income taxes	8,035	41,890

10. Acquisitions

On June 23, 2003, the Company acquired a controlling interest in Gamesworld Group Limited (Gamesworld), an Ireland-based electronic games retailer, for approximately $3,340. 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 $2,930, has been recorded as goodwill. The pro forma effect assuming the acquisition of Gamesworld at the beginning of fiscal 2003 is not material.

11. 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 26 weeks ended

July 31, 2004, the Company repurchased 959 shares at an average share price of $15.64.

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GAMESTOP CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the 26 weeks ended August 2, 2003, the Company repurchased 910 shares at an average share price of $12.65. From the inception of this repurchase program through July 31, 2004, the Company repurchased 3,263 shares at an average share price of $15.32, totaling $50,000, and, as of July 31, 2004, had no amount remaining available for purchases under this repurchase program.

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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 January 31, 2004 filed with the Securities and Exchange Commission on April 14, 2004 (the Form 10-K).

General

We are the largest specialty retailer of video game products and PC entertainment software in the United States, based on the number of U.S. retail stores we operate and our total U.S. revenues. 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 July 31, 2004, we operated 1,676 stores, in 49 states, the District of Columbia, Ireland, Puerto Rico and Guam, primarily under the name GameStop. We also operate an electronic commerce web site under the name gamestop.com and publish *Game Informer,* the 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. Nintendo introduced the Game Boy Advance SP in March 2003. 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. We expect that the installed base of these hardware platforms and sales of related software and accessories will increase in the future.

Results of Operations

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

	13 Weeks Ended		26 Weeks Ended	
	July 31, 2004	**August 2, 2003**	**July 31, 2004**	**August 2, 2003**
Statement of Operations Data:				
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	69.0	70.9	70.3	72.2
Gross profit	31.0	29.1	29.7	27.8
Selling, general and administrative expenses	24.9	23.3	24.1	22.3
Depreciation and amortization	2.5	2.2	2.3	2.1
Operating earnings	3.6	3.6	3.3	3.4
Interest income, net	(0.1)	0.0	0.0	(0.1)
Earnings before income tax expense	3.7	3.6	3.3	3.5
Income tax expense	1.5	1.4	1.3	1.4
Net earnings	2.2%	2.2%	2.0%	2.1%

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13 Weeks Ended July 31, 2004 Compared with the 13 Weeks Ended August 2, 2003

Sales increased by $39.9 million, or 13.0%, from $305.7 million in the 13 weeks ended August 2, 2003 to $345.6 million in the 13 weeks ended July 31, 2004. The increase in sales was primarily attributable to the additional sales resulting from 283 net new stores opened since August 2, 2003, which was partially offset by a 2.4% 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 second quarter of 2004 was partially due to hardware supply shortages in late June and July, as well as hardware price declines.

Cost of sales increased by $21.7 million, or 10.0%, from $216.7 million in the 13 weeks ended August 2, 2003 to $238.4 million in the 13 weeks ended July 31, 2004. Cost of sales as a percentage of sales decreased from 70.9% in the 13 weeks ended August 2, 2003 to 69.0% in the 13 weeks ended July 31, 2004. This decrease was primarily the result of the shift in sales mix to higher margin used video game products and efficiencies in freight expense from investments in our distribution network.

Selling, general and administrative expenses increased by $14.7 million, or 20.6%, from $71.3 million in the 13 weeks ended August 2, 2003 to $86.0 million in the 13 weeks ended July 31, 2004. 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. Selling, general and administrative expenses as a percentage of sales increased from 23.3% in the 13 weeks ended August 2, 2003 to 24.9% in the 13 weeks ended July 31, 2004. The increase in selling, general and administrative expenses as a percentage of sales was primarily due to the costs associated with the continued rollout of new stores and the effect these stores have on leveraging of selling, general and administrative expenses, as well as investments in our international infrastructure.

Depreciation and amortization expense increased from $6.9 million for the 13 weeks ended August 2, 2003 to $8.7 million in the 13 weeks ended July 31, 2004. This increase of $1.8 million was due to the capital expenditures for new stores and management information systems.

Interest income resulting from the investment of excess cash balances remained constant at $0.4 million in the 13 weeks ended August 2, 2003 and $0.4 million in the 13 weeks ended July 31, 2004. In addition, interest expense remained constant at $0.2 million in the 13 weeks ended August 2, 2003 and $0.2 million in the 13 weeks ended July 31, 2004.

Tax expense for the 13 weeks ended August 2, 2003 and the 13 weeks ended July 31, 2004 was based upon management s estimate of the Company s annualized effective tax rate, which is expected to decrease from fiscal 2003 (the 52 weeks ended January 31, 2004) to fiscal 2004 (the 52 weeks ending January 29, 2005) due to corporate restructuring. Income tax expense increased from $4.5 million for the 13 weeks ended August 2, 2003 to $5.1 million in the 13 weeks ended July 31, 2004.

The factors described above led to an increase in operating earnings of $1.7 million, or 15.7%, from $10.8 million in the 13 weeks ended August 2, 2003 to $12.5 million in the 13 weeks ended July 31, 2004, and an increase in net earnings of $1.1 million, or 16.7%, from $6.6 million in the 13 weeks ended August 2, 2003 to $7.7 million in the 13 weeks ended July 31, 2004.

26 Weeks Ended July 31, 2004 Compared with the 26 Weeks Ended August 2, 2003

Sales increased by $89.9 million, or 14.3%, from $627.4 million in the 26 weeks ended August 2, 2003 to $717.3 million in the 26 weeks ended July 31, 2004. The increase in sales was primarily attributable to the additional sales resulting from 283 net new stores opened since August 2, 2003, which was partially offset by a 2.1% decrease in comparable store sales.

Cost of sales increased by $51.6 million, or 11.4%, from $453.0 million in the 26 weeks ended August 2, 2003 to $504.6 million in the 26 weeks ended July 31, 2004. Cost of sales as a percentage of sales decreased from 72.2% in the 13 weeks ended August 2, 2003 to 70.3% in the 13 weeks ended

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July 31, 2004. This decrease was primarily the result of the shift in sales mix to higher margin used video game products and efficiencies in freight expense from investments in our distribution network.

Selling, general and administrative expenses increased by $32.8 million, or 23.5%, from $139.8 million in the 26 weeks ended August 2, 2003 to $172.6 million in the 26 weeks ended July 31, 2004. 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 $2.8 million provision for the proposed California labor litigation settlement. Selling, general and administrative expenses as a percentage of sales increased from 22.3% in the 26 weeks ended August 2, 2003 to 24.1% in the 26 weeks ended July 31, 2004. The increase in selling, general and administrative expenses as a percentage of sales was primarily due to the costs associated with the continued rollout of new stores and the effect these stores have on leveraging of selling, general and administrative expenses, and due to the provision for the proposed California labor litigation settlement, as well as investments in our international infrastructure.

Depreciation and amortization expense increased from $13.1 million for the 26 weeks ended August 2, 2003 to $16.8 million in the 26 weeks ended July 31, 2004. This increase of $3.7 million was due to the capital expenditures for new stores and management information systems.

Interest income resulting from the investment of excess cash balances decreased from $0.9 million in the 26 weeks ended August 2, 2003 to $0.7 million in the 26 weeks ended July 31, 2004 due to a decrease in the level of investments and the average yield on the investments. Interest expense increased from $0.3 million in the 26 weeks ended August 2, 2003 to $0.4 million in the 26 weeks ended July 31, 2004.

Tax expense for the 26 weeks ended August 2, 2003 and the 26 weeks ended July 31, 2004 was based upon management s estimate of the Company s annualized effective tax rate, which is expected to decrease from fiscal 2003 (the 52 weeks ended January 31, 2004) to fiscal 2004 (the 52 weeks ending January 29, 2005) due to corporate restructuring. Income tax expense increased from $8.9 million for the 26 weeks ended August 2, 2003 to $9.3 million in the 26 weeks ended July 31, 2004.

The factors described above led to an increase in operating earnings of $1.8 million, or 8.4%, from $21.5 million in the 26 weeks ended August 2, 2003 to $23.3 million in the 26 weeks ended July 31, 2004, and an increase in net earnings of $1.1 million, or 8.3%, from $13.2 million in the 26 weeks ended August 2, 2003 to $14.3 million in the 26 weeks ended July 31, 2004.

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 26 weeks ended July 31, 2004 cash provided by operations was $12.4 million compared to cash used in operations of $37.1 million during the 26 weeks ended August 2, 2003. In the 26 weeks ended July 31, 2004, cash provided by operations was primarily due to a decrease in merchandise inventories of $39.4 million, net income of $14.3 million, depreciation and amortization of $16.8 million and a decrease in receivables of $3.0 million, which were offset by a decrease in accounts payable and accrued liabilities of $63.4 million. In the 26 weeks ended August 2, 2003, cash used in operations was primarily due to a decrease in accounts payable and accrued liabilities of $59.2 million, which includes payment of income taxes payable of $20.6 million, and an increase in prepaid taxes of $13.8 million, which were offset partially by net income of $13.2 million, depreciation and amortization of $13.1 million and a decrease in merchandise inventories of $7.1 million. The decreases in accounts payable and accrued liabilities in both the 26 week-periods ended July 31, 2004 and August 2, 2003 are typical as payments are made for purchases of merchandise inventories which took place in the fourth quarter of the previous fiscal year.

Cash used in investing activities was $47.2 million and $38.3 million during the 26 weeks ended July 31, 2004 and August 2, 2003, respectively. During the 26 weeks ended July 31, 2004, our capital expenditures included approximately $14.5 million to acquire a new corporate headquarters and distribution

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center facility in Grapevine, Texas. The remaining $32.0 million in capital expenditures was used to open new stores, remodel existing stores and invest in information systems. During the 26 weeks ended August 2, 2003, we had capital expenditures of $34.9 million to open new stores, remodel existing stores and invest in information systems.

Our 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 174 stores in the 26 weeks ended August 2, 2003 compared to 180 stores in the 26 weeks ended July 31, 2004 and expect to open between 300 and 330 stores in fiscal 2004. Projected capital expenditures for fiscal 2004 are approximately $90.0 million, to be used primarily to fund new store openings, purchase, improve and equip our new headquarters and distribution center and invest in distribution and information systems.

The projected capital expenditures for fiscal 2004 include approximately $29.0 million to purchase, improve and equip the 420,000 square foot headquarters and distribution center facility in Grapevine, Texas which the Company acquired in March 2004. We expect that the total cost to purchase, improve and equip this facility will be approximately $32.0 million. The distribution systems in this facility are expected to be ready for testing in late 2004 and the facility is expected to be fully operational in 2005 and all headquarters and distribution functions will be relocated at that time.

In June 2004, the Company amended and restated its $75.0 million senior secured revolving credit facility, which now expires in June 2009. The revolving credit facility is governed by an eligible inventory borrowing base agreement, defined as 55% of non-defective inventory, net of certain reserves. Loans incurred under the credit facility will be maintained from time to time, at the Company s option, as: (1) Prime Rate loans which bear interest at the prime rate (defined in the credit facility as the higher of (a) the administrative agent s announced prime 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) LIBO Rate loans bearing interest at the LIBO 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, currently 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. Under certain circumstances, the revolving credit facility may restrict our ability to pay dividends. 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 26 weeks ended July 31, 2004, the Company repurchased 959,000 shares at an average share price of $15.64. During the 26 weeks ended August 2, 2003, the Company repurchased 910,000 shares at an average share price of $12.65. From the inception of this repurchase program through July 31, 2004, the Company repurchased 3,263,000 shares at an average share price of $15.32, totaling $50.0 million, and, as of July 31, 2004, had no amount remaining available for purchases under this repurchase program.

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.

Critical Accounting Policies

Our 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 2003 Annual Report on Form 10-K, filed on April 14, 2004, in Note 1 of Notes to the Consolidated Financial Statements.

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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 successfully and efficiently transfer our headquarters and distribution center to our new facility;

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, pro forma, should, seeks, will or similar expressions. These statements are or 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.

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.

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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. 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 any time 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. During court-ordered mediation in March 2004, the parties reached a settlement in principle which, if approved by the court, would define the class of current and former salaried retail managers and would result in a cost to the Company of approximately $2,750,000. A provision for this proposed settlement was recorded in the 13 weeks ended May 1, 2004. Management expects that the settlement and resolution of this case will take place in fiscal 2004.

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 2. ***Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities***

Issuer Purchases of Equity Securities(1)

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
May 2, 2004 May 29, 2004	125,000	$ 15.58	125,000	$ 13,047,301
May 30, 2004 July 3, 2004	833,787	$ 15.65	833,787	$ 0
July 4, 2004 July 31, 2004				$ 0
Total	958,787	$ 15.64	958,787	$ 0

Item 4. ***Submission of Matters to a Vote of Security Holders***

The Company s Annual Meeting of Shareholders was held on June 29, 2004. At the close of business on the record date for the meeting (which was May 5, 2004), there were 21,189,788 shares of Class A Common Stock and 36,009,000 shares of Class B Common Stock outstanding and entitled to vote at the meeting as one class. Holders of 20,097,593 shares of Class A Common Stock (with one vote per share) and 36,009,000 shares of Class B Common Stock (with ten votes per share) were present at the meeting, either in person or by proxy.

The following individuals were elected to the Company s Board of Directors to hold office for a term of three years and until their respective successors are duly elected and qualified, with the vote specified below:

Nominee	In Favor	Withheld
R. Richard Fontaine	369,332,087	10,855,506
Stephanie M. Shern	379,160,602	1,026,991

The following individuals continue to serve on the Company s Board of Directors until the expiration of their terms: Daniel A. DeMatteo, Leonard Riggio, Michael N. Rosen, Edward A. Volkwein and Gerald R. Szczepanski.

The Company s shareholders also ratified the appointment of BDO Seidman, LLP as the Company s independent certified public accountants for the fiscal year ending January 29, 2005 by the following vote:

In Favor	Against	Abstained
379,936,303	250,233	1,057

(1) In March 2003, the Board of Directors authorized a common stock repurchase program for the purchase of up to $50,000,000 of the Company s Class A Common Shares. From the inception of this repurchase program through July 31, 2004, the Company repurchased 3,263,000 shares at an average price of $15.32, totaling $50,000,000 and, as of July 31, 2004, had no amount remaining available for purchases under this repurchase program.

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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	Amended and Restated Credit Agreement, dated as of June 21, 2004.
10.10	Amended and Restated Security Agreement, dated as of June 21, 2004.
10.11	Amended and Restated Securities Collateral Pledge Agreement, dated as of June 21, 2004, between GameStop Corp. and Fleet Retail Group, Inc., as Administrative Agent.
10.12	Amended and Restated Securities Collateral Pledge Agreement, dated as of June 21, 2004, between GameStop, Inc. and Fleet Retail Group, Inc., as Administrative Agent.
10.13	Securities Collateral Pledge Agreement, dated as of June 21, 2004, between GameStop of Texas (GP), LLC and Fleet Retail Group, Inc., as Administrative Agent.
10.14	Securities Collateral Pledge Agreement, dated as of June 21, 2004, between GameStop (LP), LLC and Fleet Retail Group, Inc., as Administrative Agent.
10.15	Amended and Restated Patent and Trademark Securities Agreement, dated as of June 21, 2004.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 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 Rule 13a-14(b) under the Securities Exchange Act of 1934 and 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).

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(b) Reports on Form 8-K

On May 18, 2004, the Company furnished a Form 8-K pursuant to Items 7 and 12 of such form regarding a press release issued with earnings information for the fiscal quarter ended May 1, 2004.

Subsequent to the end of the second quarter of fiscal 2004, on August 17, 2004 the Company furnished a Form 8-K pursuant to Items 7 and 12 of such form regarding a press release issued with earnings information for the fiscal quarter ended July 31, 2004.

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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: September 7, 2004

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GAMESTOP CORP.

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