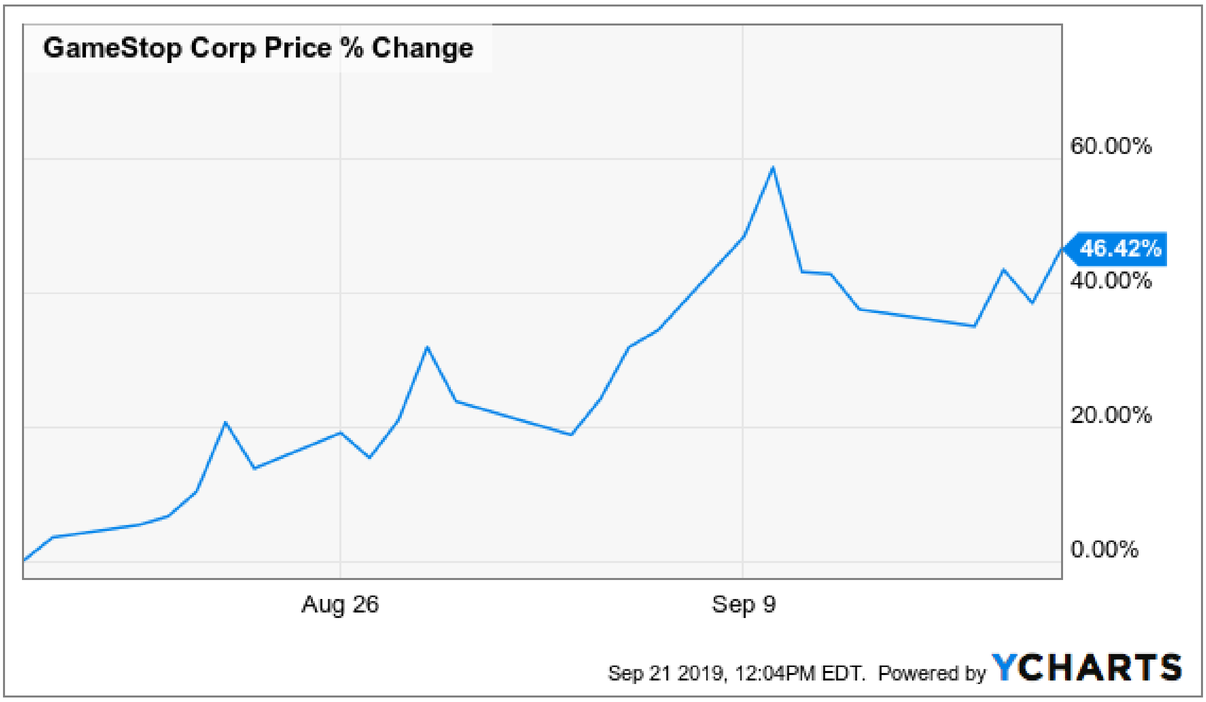
GameStop

GameStop has been a falling knife for years now. It has lost more than 92% of its market value from the time the stock reached all time high in December 2007

However, recently the stock has shown a little recovery gaining about 20% in a couple of days just after investor Michael Burry, who is famous for having shorted the housing market in 2006, said that he was investing in the company.



Just because Michael Burry was right about the housing market doesn't mean that he is right about GameStop. Let's first understand the business, then we will look at the reasons why Michael Burry is investing. Then, we will make our own analysis and find the right valuations for this company.

What is GameStop?

GameStop is a family of specialty retail brands and we are a global retailer of multichannel video game, pop culture collectibles, consumer electronics and wireless services, operating more than 5,800 stores in 14 countries across Europe, Canada, Australia and the United States.

The company's global family of brands include GameStop; EB Games, Micromania, and Game Informer® magazine, ThinkGeek.
Our History

(Source: http://news.gamestop.com/about-gamestop)

GameStop is a retailer and we know that retailers are dying because of ecommerce. Right now only 2.3% of the sales of GameStop come from their website(more on that later). This doesn't seems so good. One good point in their favor is that they have a monopoly. They are a retailer but they sell to only a specific niche and a growing niche as more and more people are playing video games now. You may then wonder why these people would still shop at GameStop if they could buy the game from Amazon. Fair argument. Let's then, dig deeper into the company and have a look at their last annual report (*http://news.gamestop.com/static-files/7bb13c3c-593c-425f-b4ec-3345bd1f91a4*)

As mentioned earlier, they have 5830 stores in 14 countries:

Alabama	61	Kentucky	71	North Dakota	8
Alaska	6	Louisiana	61	Ohio	169
Arizona	73	Maine	11	Oklahoma	48
Arkansas	31	Maryland	83	Oregon	41
California	374	Massachusetts	78	Pennsylvania	179
Colorado	58	Michigan	101	Rhode Island	12
Connecticut	47	Minnesota	44	South Carolina	68
Delaware	15	Mississippi	44	South Dakota	11
Florida	242	Missouri	66	Tennessee	94
Georgia	137	Montana	12	Texas	374
Guam	2	Nebraska	21	Utah	32
Hawaii	17	Nevada	38	Vermont	4
Idaho	17	New Hampshire	26	Virginia	121
Illinois	143	New Jersey	114	Washington	76
Indiana	94	New Mexico	25	West Virginia	29
Iowa	31	New York	211	Wisconsin	56
Kansas	31	North Carolina	131	Wyoming	8
Total Domestic Stores					3,846

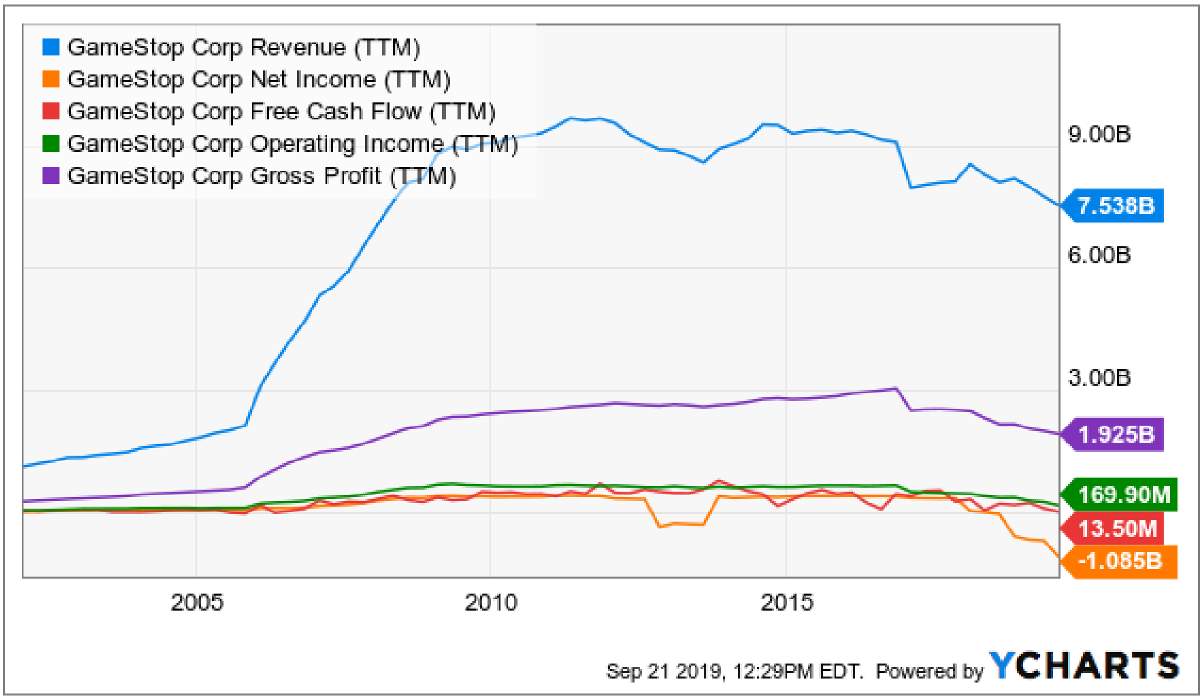
	Number of Stores
Canada	311
Total Stores - Canada Video Game Brands	311
Australia	419
New Zealand	43
Total Stores - Australia Video Game Brands	462
Austria	25
Denmark	34
Finland	16
France	420
Germany	208
Ireland	50
Italy	361
Norway	28
Sweden	52
Switzerland	17
Total Stores - Europe Video Game Brands	1,211
Total International Stores	1,984
Total Stores	5,830

All of this is interesting but what really matters is how much money they are making and I always tell you that the first number you should look at are revenues.

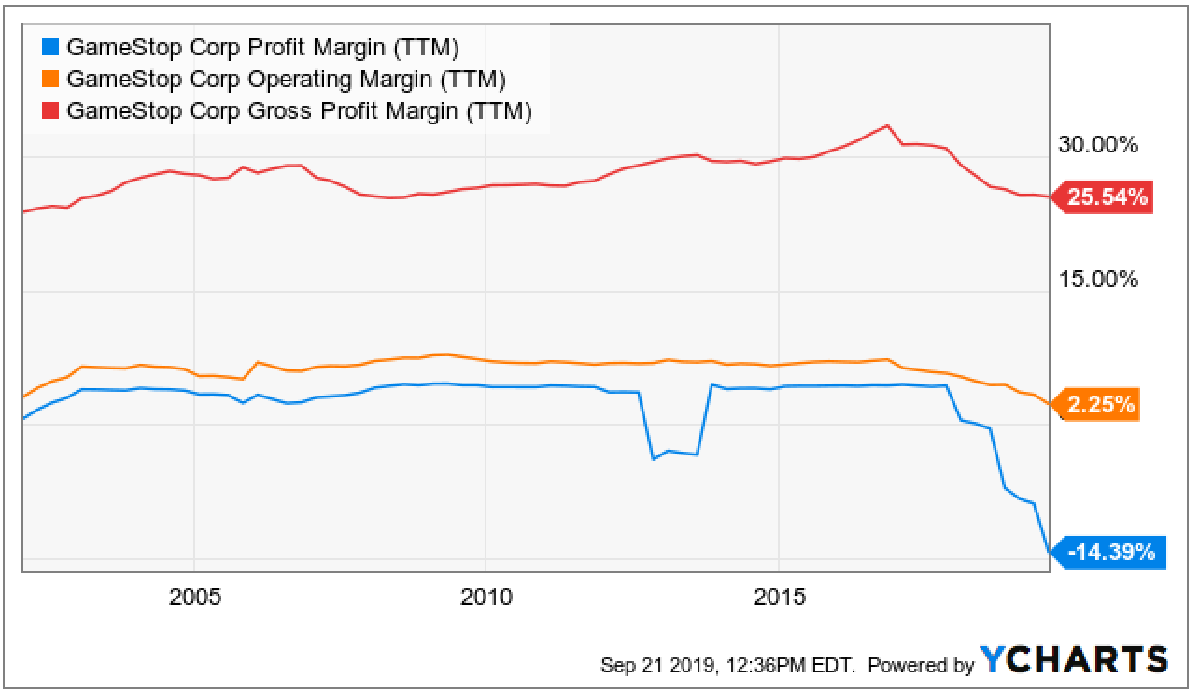
	Fiscal Year				
	2018	2017	2016	2015	2014
	(In millions, except statistical and per share data)				
Statement of Operations Data:[1]					
Net sales	$ 8,285.3	$ 8,547.1	$ 7,965.0	$ 9,018.9	$ 9,084.0
Cost of sales	5,977.2	6,062.2	5,465.1	6,359.1	6,448.0
Gross profit	2,308.1	2,484.9	2,499.9	2,659.8	2,636.0
Selling, general and administrative expenses	1,888.6	1,909.6	1,861.9	1,905.5	1,906.6
Depreciation and amortization	105.6	122.3	136.7	141.0	149.6
Goodwill impairments[2]	970.7	—	—	—	—
Asset impairments[3]	45.2	13.8	19.6	4.6	2.2
Operating (loss) earnings	(702.0)	439.2	481.7	608.7	577.6
Interest expense, net	51.1	55.3	53.0	23.0	10.0
(Loss) earnings from continuing operations before income tax expense	(753.1)	383.9	428.7	585.7	567.6
Income tax expense	41.7	153.5	124.2	206.5	198.5
Net (loss) income from continuing operations	(794.8)	230.4	304.5	379.2	369.1
Income (loss) from discontinued operations, net of tax	121.8	(195.7)	48.7	23.6	24.0
Net (loss) income	$ (673.0)	$ 34.7	$ 353.2	$ 402.8	$ 393.1

At first look, it seems that revenues are fluctuating. Net income was going down and last year, they lost money.

Let’s just put all this data on a chart for us to better understand.



Now, it makes more sense. Revenues peaked in 2012 then it has been declining. What happened in 2013? Why were revenues increasing from 2006 to 2012? One way to find out is to read the 10-K and 10-Q forms for these years. But we will soon find the answer in the current report itself. Nevertheless, if you are really interested in a company, I will suggest you read the past reports. As far as profits are concerned, if you look closely, you will see that they follow revenues. It means they kept their margins over the years. That’s a good thing. Even though sales are going down. They are able to sustain their business. Only last year, they lost money.



Now let's have a look at how they actually makes money.

Business Segments

Merchandise

We categorize our sale of products and services as follows:

- *New Video Game Hardware.* We offer video game platforms from the major manufacturers. The current generation of consoles include the Sony PlayStation 4 (2013), Microsoft Xbox One (2013) and the Nintendo Switch (March 2017). In 2016, Sony and Microsoft released refreshes to the PlayStation 4 and Xbox One, respectively. In November 2017, Microsoft released a further enhanced version of its current generation console, the Xbox One X. We also offer extended service agreements. Video game hardware sales are generally driven by the introduction of new platform technology and the reduction in price points as platforms mature.
- *New Video Game Software.* We offer new video game software for current and certain prior generation consoles from the leading manufacturers, including Sony, Nintendo and Microsoft, as well as all other major third-party game publishers, such as Electronic Arts and Activision Blizzard. We are one of the largest retailers of video game titles sold by these publishers. We carry new video game software across a variety of genres, including sports, action, strategy, adventure/ role playing and simulation.
- *Pre-owned and Value Video Game Products.* We provide our customers with an opportunity to trade in their pre-owned video game products in our stores in exchange for store credits which can be applied towards the purchase of other products, primarily new merchandise. We believe this process drives our higher market share, particularly at launch. We resell these pre-owned video game products and have the largest selection of pre-owned video game titles. In the U.S., pre-owned video game software titles have an average price of $17, compared to an average price of $48 for new video game software titles, and generate significantly higher gross margins than new video game products. Our trade-in program also allows us to be one of the only suppliers of previous generation platforms and related video games. We also operate refurbishment centers in the United States, Canada, Australia and Europe, where defective video game products can be tested, repaired, relabeled, repackaged and redistributed back to our stores.
- *Video Game Accessories.* Video game accessories consist primarily of controllers, gaming headsets, virtual reality products, memory cards and other add-ons for use with video game hardware and software.
- *Digital.* The proliferation of online game play through Microsoft Xbox Live, the PlayStation Network and PC gaming websites has led to consumer demand for subscription, time and points cards ("digital currency") as well as full-game downloads and digitally downloadable content ("DLC"), for existing console video games. We sell a wide variety of digital currency, and we have developed technology to sell DLC and full-game downloads in our stores and on our U.S. website. We believe we are the worldwide leading retailer of digital currency and DLC for Xbox Live and the PlayStation Network.
- *Collectibles.* Collectibles consist of licensed merchandise, primarily related to the video game, television and movie industries and pop culture themes which are sold through our video game stores, ThinkGeek stores, Zing Pop Culture stores and www.thinkgeek.com.

- *Other Products.* Other products primarily consist of PC entertainment software, gaming-related print media, mobile and consumer electronics, and revenues from PowerUp Pro loyalty members receiving Game Informer magazine in print form. We offer PC entertainment software from many of the largest PC publishers, including Electronic Arts, Take Two and Activision Blizzard across a variety of genres, including sports, action, strategy, adventure/role playing and simulation. We also carry strategy guides, magazines and interactive game figures, such as Amiibos from Nintendo.

	Fiscal Year 2018		Fiscal Year 2017		Fiscal Year 2016	
	Net Sales	Percent of Net Sales	Net Sales	Percent of Net Sales	Net Sales	Percent of Net Sales
New video game hardware[(1)]	$ 1,767.8	21.3%	$ 1,791.8	21.0%	$ 1,396.7	17.5%
New video game software	2,449.7	29.6	2,582.0	30.2	2,493.4	31.3
Pre-owned and value video game products	1,866.3	22.5	2,149.6	25.2	2,254.1	28.3
Video game accessories	956.5	11.5	784.3	9.2	676.7	8.5
Digital	194.0	2.3	189.2	2.2	181.0	2.3
Collectibles	707.5	8.5	636.2	7.4	494.1	6.2
Other[(2)]	343.5	4.3	414.0	4.8	469.0	5.9
Total	$ 8,285.3	100.0%	$ 8,547.1	100.0%	$ 7,965.0	100.0%

	Fiscal Year 2018		Fiscal Year 2017		Fiscal Year 2016	
	Gross Profit	Gross Profit Percent	Gross Profit	Gross Profit Percent	Gross Profit	Gross Profit Percent
New video game hardware(1)	$ 150.0	8.5%	$ 163.1	9.1%	$ 154.2	11.0%
New video game software	525.6	21.5	590.3	22.9	600.4	24.1
Pre-owned and value video game products	810.4	43.4	977.1	45.5	1,044.1	46.3
Video game accessories	312.5	32.7	255.0	32.5	235.2	34.8
Digital	171.6	88.5	162.4	85.8	155.5	85.9
Collectibles	233.3	33.0	208.2	32.7	171.6	34.7
Other(2)	104.7	30.5	128.8	31.1	138.9	29.6
Total	$ 2,308.1	27.9%	$ 2,484.9	29.1%	$ 2,499.9	31.4%

Most of their sales come from new video games software. As for hardware, we should understand that there has been no new consoles from Sony or Microsoft since 2013(remember 2013?) and, therefore, sales from hardware would be less. Just out of curiosity, let’s look at the 2014 annual report (http://news.gamestop.com/static-files/b426d7c6-3fa7-4673-84d1-4d7aefdee78a) immediately. This will give us the numbers for calendar year 2013.

	52 Weeks Ended February 1, 2014		53 Weeks Ended February 2, 2013		52 Weeks Ended January 28, 2012	
	Net Sales	Percent of Total	Net Sales	Percent of Total	Net Sales	Percent of Total
Net Sales:						
New video game hardware	$ 1,730.0	19.1%	$ 1,333.4	15.0%	$ 1,611.6	16.9%
New video game software	3,480.9	38.5%	3,582.4	40.3%	4,048.2	42.4%
Pre-owned and value video game products	2,329.8	25.8%	2,430.5	27.4%	2,620.2	27.4%
Video game accessories	560.6	6.2%	611.8	6.9%	661.1	6.9%
Digital	217.7	2.4%	208.4	2.3%	143.0	1.5%
Mobile and consumer electronics	303.7	3.4%	200.3	2.3%	12.8	0.1%
Other	416.8	4.6%	519.9	5.8%	453.6	4.8%
Total	$ 9,039.5	100.0%	$ 8,886.7	100.0%	$ 9,550.5	100.0%

Sales of New video game hardware did peak in calendar year 2013 (financial year 2014) and they sold less video game hardware in 2013 compared to 2012 because people were waiting for the new ones and not buying an old version. That’s logical. It will be logical if numbers were high in FY 2015 as well since people would still be buying these new hardware for the 2014 holiday seasons. Well, let’s look at the 2015 annual report (http://news.gamestop.com/static-files/3f8d92c9-e03f-4460-8a50-54bd5e4326be).

	52 Weeks Ended January 31, 2015		52 Weeks Ended February 1, 2014		53 Weeks Ended February 2, 2013	
	Net Sales	Percent of Total	Net Sales	Percent of Total	Net Sales	Percent of Total
Net Sales:						
New video game hardware(1)	$ 2,028.7	21.8%	$ 1,730.0	19.1%	$ 1,333.4	15.0%
New video game software	3,089.0	33.2	3,480.9	38.5	3,582.4	40.3
Pre-owned and value video game products	2,389.3	25.7	2,329.8	25.8	2,430.5	27.4
Video game accessories	653.6	7.1	560.6	6.2	611.8	6.9
Digital	216.3	2.3	217.7	2.4	208.4	2.3
Mobile and consumer electronics	518.8	5.6	303.7	3.4	200.3	2.3
Other(2)	400.3	4.3	416.8	4.6	519.9	5.8
Total	$ 9,296.0	100.0%	$ 9,039.5	100.0%	$ 8,886.7	100.0%

Turns out, we were right.

Let’s recap our findings. GameStop will sell less hardware in the year before the release of the latest consoles. When are Microsoft and Sony coming with their new consoles?

[DRUMROLLS]

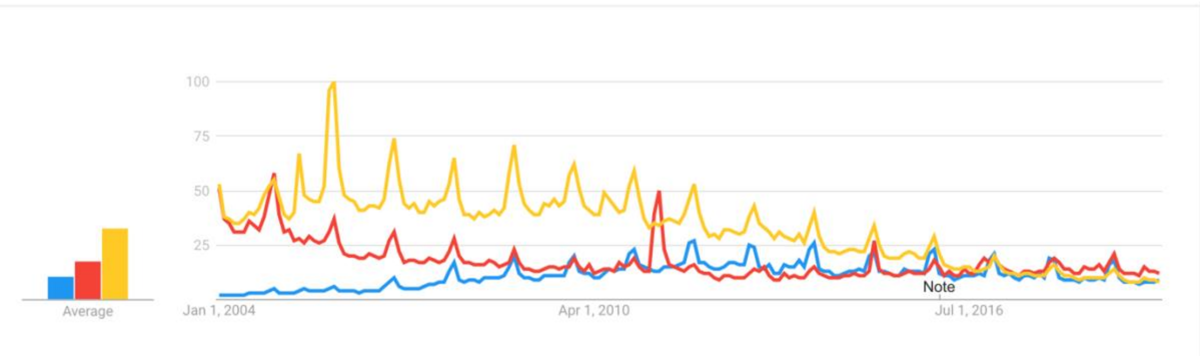
2020.

According to these two articles:

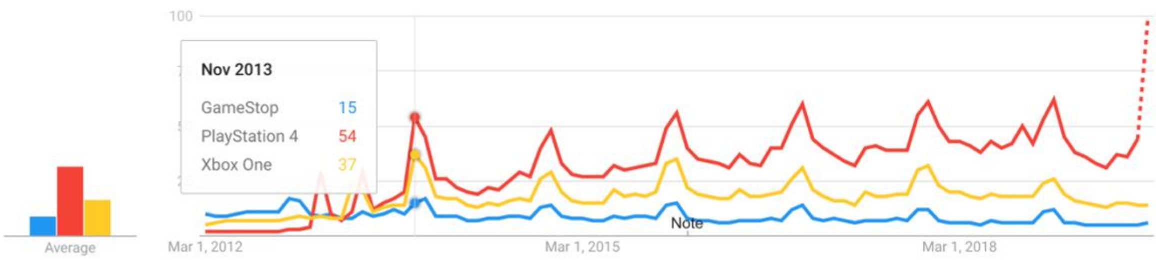
1. https://www.wired.com/story/exclusive-sony-next-gen-console/?verso=true
2. https://www.gamesindustry.biz/articles/2019-06-10-xboxs-phil-spencer-our-next-console-will-have-a-disc-drive

Both Microsoft and Sony are coming with new consoles next year. This means this year, it is to be expected that the company will be selling less hardware.

I like using Google Trends in my analysis of companies. People search for everything on Google and this gives us a lot of information about a particular company. Right now, we will compare Google search for GameStop with Sony PlayStation 4 and Xbox.



There is certainly a correlation between all these terms but nothing special to note apart from the fact that people look more for GameStop and the consoles in December. I was expecting to see a peak in searches for GameStop when the new consoles came out in 2013 but that was unfortunately not the case. Even when I compared GameStop with PlayStation 4 and Xbox One, there was no unusual correlation.



But hardware is not the most important part of their business. New Video Game Software is. Most of the sales come from this segment and it also has a higher gross margin compared to hardware. Will the new consoles coming next year have hard drives? If they don't, then GameStop won't be selling any software to these new consoles. The two articles above answer this question. Both Microsoft and Sony confirmed that their latest consoles would have hard drives. GameStop can still make money from software.

The Pre-owned and value video game product is also an important part to the business. It generates high sales and have good margins.

They are still lacking behind in terms of digital sales although this has the highest margins. The reason is because video game software companies are selling directly to consumers now on the internet and doesn't need to go through a wholesaler. This is actually one their listed business risk.

Technological advances in the delivery and types of video games and PC entertainment software, as well as changes in consumer behavior related to these new technologies, could lower our sales.

The current consoles from Sony, Nintendo, and Microsoft have facilitated download technology. In addition, disc-less consoles may be available to consumers in the near term from certain manufacturers. Downloading of video game content to the current generation video game systems continues to grow and take an increasing percentage of new video game sales. If consumers' preference for downloading video game content continues to increase or these consoles and other advances in technology continue to expand our customers' ability to access and download the current format of video games and incremental content for their games through these and other sources, our customers may no longer choose to purchase video games in our stores or reduce their purchases in favor of other forms of game delivery. As a result, our business and results of operations may be negatively impacted.

Competition

The video game industry is intensely competitive and subject to rapid changes in consumer preferences and frequent new product introductions. We compete with mass merchants and regional chains; computer product and consumer electronics stores; other video game and PC software specialty stores; toy retail chains; direct sales by software publishers; the online environments operated by Sony (PlayStation Network), Microsoft (XBox Live), Nintendo (Nintendo Switch Online), as well as other online retailers and game rental companies. Video game products are also distributed through other methods such as digital delivery. We also compete with sellers of pre-owned and value video game products. Additionally, we compete with other forms of entertainment activities, including casual and mobile games, movies, television, theater, sporting events and family entertainment centers.

In the U.S., we compete with Wal-Mart Stores, Inc. ("Wal-Mart"); Target Corporation ("Target"); Amazon.com, Inc. ("Amazon.com"); and Best Buy Co., Inc. ("Best Buy"), among others. Throughout Europe we compete with Sony, Microsoft, Nintendo, and major consumer electronics retailers such as Media Markt, Saturn and FNAC, major hypermarket chains like Carrefour and Auchan, and online retailer Amazon.com. Competitors in Canada include Wal-Mart and Best Buy. In Australia, competitors include K-Mart, Target and JB HiFi stores.

Since we are talking about risks, let's look at some of the important business risks before we go any further. There's a very big and important one.

First, the company relies on only a few vendors, the largest one being Nintendo.

Our ability to obtain favorable terms from our suppliers may impact our financial results.

Our financial results depend significantly upon the business terms we can obtain from our suppliers, including competitive prices, unsold product return policies, advertising and market development allowances, freight charges and payment terms. We purchase substantially all of our products directly from manufacturers, software publishers and, in some cases, distributors. Our largest vendors are Nintendo, Sony, Microsoft, Take-Two Interactive and Activision Blizzard, which accounted for 23%, 22%, 10%, 6% and 4%, respectively, of our new product purchases in fiscal 2018. If our suppliers do not provide us with favorable business terms, we may not be able to offer products to our customers at competitive prices.

If our vendors fail to provide marketing and merchandising support at historical levels, our sales and earnings could be negatively impacted.

We depend upon the timely delivery of new and innovative products from our vendors.

We depend on manufacturers and publishers to deliver video game hardware, software, and consumer electronics in quantities sufficient to meet customer demand. In addition, we depend on these manufacturers and publishers to introduce new and innovative products and software titles to drive industry sales. We have experienced sales declines in the past due to a reduction in the number of new software titles available for sale. Any material delay in the introduction or delivery, or limited allocations, of hardware platforms or software titles could result in reduced sales.

In short, they rely a lot on vendors. But this not the biggest risk. The biggest risk is on their balance sheet. Actually, there are two things to talk about on their balance sheet.

Let's first have a look at the balance sheet.

(in millions, except par value per share)

	February 2, 2019	February 3, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,624.4	$ 854.2
Receivables, net	134.2	138.6
Merchandise inventories, net	1,250.5	1,250.3
Prepaid expenses and other current assets	118.6	115.2
Assets held for sale	—	660.1
Total current assets	3,127.7	3,018.4
Property and equipment:		
Land	18.7	19.9
Buildings and leasehold improvements	638.2	651.8
Fixtures and equipment	900.2	914.6
Total property and equipment	1,557.1	1,586.3
Less accumulated depreciation	1,235.8	1,235.3
Property and equipment, net	321.3	351.0
Deferred income taxes	147.3	158.2
Goodwill	363.9	1,350.5
Other intangible assets, net	33.5	92.5
Other noncurrent assets	50.6	71.0
Total noncurrent assets	916.6	2,023.2
Total assets	$ 4,044.3	$ 5,041.6

On the assets side, we notice a significant drop in assets by about $1 billion. That's about 20% of the total assets. That's a lot. This drop in assets is a drop in goodwill. Since the market capitalization has been dropping over the last years, they had to impair their goodwill. These are the accounting rules.

Goodwill

Estimate Description. Goodwill results from acquisitions and represents the excess purchase price over the net identifiable assets acquired. We are required to evaluate our goodwill for impairment at least annually or whenever indicators of impairment are present. Our annual test is completed as of the beginning of the fourth fiscal quarter, and interim tests are conducted when circumstances indicate the carrying value of the goodwill may not be recoverable. As of February 2, 2019, our goodwill totaled $363.9 million. See Note 7, "Goodwill and Intangible Assets," to our consolidated financial statements for the allocation of our goodwill balance by reporting unit. In order to test goodwill for impairment, we compare a reporting unit's carrying amount to its estimated fair value. If the reporting unit's carrying value exceeds its estimated fair value, then an impairment charge is recorded in the amount of the excess.

Based on the results of our impairment tests performed in fiscal 2018, we recognized goodwill impairment charges totaling $795.6 million, $28.8 million, $66.4 million and $79.9 million for the United States, Canada, Australia and Europe segments, respectively. As of February 2, 2019, the United States is the only remaining segment with goodwill. The impairment charges were primarily the result of a sustained decline in our market capitalization and lower forecasted cash flows. See Note 7, "Goodwill and Intangible Assets" to our consolidated financial statements for additional information.

Judgment and/or Uncertainty. Considerable management judgment is necessary to estimate the fair value of our reporting units. The discounted cash flows analyses utilize a five- to seven-year cash flow projection with a terminal value, which are discounted using a risk-adjusted weighted-average cost of capital. The projected cash flows include numerous assumptions such as, among others, future sales trends, operating margins, store count and capital expenditures, all of which are derived from our long-term financial forecasts. The projected sales trends include estimates related to the growth rate of the digital distribution of new video game software. In addition, we corroborate the aggregate fair value of our reporting units with our market capitalization, which may impact certain assumptions in our discounted cash flows analyses.

Since then, market capitalization has been going down further. What happened to goodwill? How much down can it go? Let's look at the balance sheet from the latest 10-Q form(http://news.gamestop.com/static-files/6ef5d36f-2245-473e-87f2-a430600d8616)

(in millions, except par value per share)

	August 3, 2019	August 4, 2018	February 2, 2019
ASSETS			
Current assets:			
Cash and cash equivalents	$ 424.0	$ 272.8	$ 1,624.4
Receivables, net	122.4	121.8	134.2
Merchandise inventories, net	948.9	1,130.6	1,250.5
Prepaid expenses and other current assets	143.2	159.5	118.6
Assets held for sale	29.1	640.1	—
Total current assets	1,667.6	2,324.8	3,127.7
Property and equipment, net	312.0	325.8	321.3
Operating lease right-of-use assets	769.7	—	—
Deferred income taxes	157.8	153.6	147.3
Goodwill	—	1,337.9	363.9
Other noncurrent assets	80.8	140.3	84.1
Total assets	$ 2,987.9	$ 4,282.4	$ 4,044.3

They have no goodwill left. That's how low the market cap has fallen.

5. Goodwill

Goodwill represents the excess purchase price over tangible net assets and identifiable intangible assets acquired. Intangible assets are recorded apart from goodwill if they arise from a contractual right and are capable of being separated from the entity and sold, transferred, licensed, rented or exchanged individually. We are required to evaluate goodwill and other intangible assets not subject to amortization for impairment at least annually. This annual test is completed at the beginning of the fourth quarter of each fiscal year or when circumstances indicate the carrying value of the goodwill or other intangible assets might be impaired. Goodwill has been assigned to reporting units for the purpose of impairment testing. We have four operating segments, including the United States, Canada, Australia and Europe, which also define our reporting units based upon the similar economic characteristics of operations within each segment, including the nature of products, product distribution and the type of customer and separate management within these businesses. In order to test goodwill for impairment, we compare a reporting unit's carrying amount to its estimated fair value. If the reporting unit's carrying value exceeds its estimated fair value, then an impairment charge is recorded in the amount of the excess.

During the 13 weeks ended August 3, 2019, we determined that a triggering event occurred as a result of a decline in our market capitalization; therefore, we performed an interim impairment test for our goodwill and indefinite-lived intangible assets. As a result of the interim impairment test, we recognized a goodwill impairment charge totaling $363.9 million related to our United States segment. We have no remaining goodwill as a result of the impairment charge. We estimated the fair value of our United States segment by using a combination of the income approach and market approach. The income approach is based on the present value of future cash flows, which are derived from our long-term financial forecasts, and requires significant assumptions including, among others, a discount rate and a terminal value. The market approach is based on the observed ratios of enterprise value to earnings of the Company and other comparable, publicly-traded companies.

The changes in the carrying amount of goodwill, by reportable segment, for fiscal 2019 were as follows (in millions):

	United States	Canada	Australia	Europe	Total
Balance at February 2, 2019	$ 363.9	$ —	$ —	$ —	$ 363.9
Impairment charge	(363.9)	—	—	—	(363.9)
Balance at August 3, 2019	$ —	$ —	$ —	$ —	$ —
Cumulative goodwill impairment charges	$ 1,173.0	$ 129.1	$ 173.5	$ 499.5	$ 1,975.1

To learn more about Goodwill impairment, I suggest you read the definition from Investopedia: https://www.investopedia.com/terms/g/goodwill-impairment.asp . I may write a lecture about it soon.

Now, let's look at the liabilities side of the balance sheet:

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,051.9	$ 892.3
Accrued liabilities	752.8	950.1
Income taxes payable	27.2	37.5
Current portion of debt, net	349.2	—
Liabilities held for sale	—	50.9
Total current liabilities	2,181.1	1,930.8
Deferred income taxes	0.1	5.0
Long-term debt, net	471.6	817.9
Other long-term liabilities	55.3	73.4
Total long-term liabilities	527.0	896.3
Total liabilities	2,708.1	2,827.1
Commitments and contingencies (Notes 8, 11 and 12)		
Stockholders' equity:		
Class A common stock — $.001 par value; authorized 300.0 shares; 102.0 and 101.3 shares issued, 102.0 and 101.3 shares outstanding, respectively	0.1	0.1
Additional paid-in capital	27.7	22.1
Accumulated other comprehensive (loss) income	(54.3)	12.2
Retained earnings	1,362.7	2,180.1
Total stockholders' equity	1,336.2	2,214.5
Total liabilities and stockholders' equity	$ 4,044.3	$ 5,041.6

At first glance, the liabilities do not look so bad. They have only $471 million in long-term debt. Of course, we should look at the latest ones from the latest 10-Q:

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	$ 368.3	$ 535.8	$ 1,051.9
Accrued and other current liabilities	593.7	714.3	780.0
Current portion of operating lease liabilities	240.3	—	—
Current portion of debt, net	—	—	349.2
Liabilities held for sale	14.5	40.7	—
Total current liabilities	1,216.8	1,290.8	2,181.1
Deferred income taxes	0.1	5.0	0.1
Long-term debt, net	419.1	819.2	471.6
Operating lease liabilities	523.9	—	—
Other long-term liabilities	18.3	63.2	55.3
Total liabilities	2,178.2	2,178.2	2,708.1
Commitments and contingencies (Note 8)			
Stockholders' equity:			
Class A common stock — $.001 par value; 300 shares authorized; 90.5, 101.9 and 102.0 shares issued and outstanding	0.1	0.1	0.1
Additional paid-in capital	—	27.5	27.7
Accumulated other comprehensive loss	(75.1)	(40.4)	(54.3)
Retained earnings	884.7	2,117.0	1,362.7
Total stockholders' equity	809.7	2,104.2	1,336.2
Total liabilities and stockholders' equity	$ 2,987.9	$ 4,282.4	$ 4,044.3

Liabilities didn't change much actually. The total shareholder's equity went down because of the loss in goodwill. What I want you to look at is the change in long-term debt from last year. They halved their long-term debt.

Let's look deeper into which type of debt they currently hold.

	February 2, 2019	February 3, 2018
2019 Senior Notes principal amount	$ 350.0	$ 350.0
2021 Senior Notes principal amount	475.0	475.0
Less: Unamortized debt financing costs	(4.2)	(7.1)
	820.8	817.9
Less: Current portion	(349.2)	—
Long-term debt, net	$ 471.6	$ 817.9

It now makes more sense. They had some debt that they had to pay in 2019 and they already paid it.

2019 Senior Notes. In September 2014, we issued $350.0 million aggregate principal amount of unsecured 5.50% senior notes due October 1, 2019 (the "2019 Senior Notes"). The 2019 Senior Notes bear interest at the rate of 5.50% per annum with interest payable semi-annually in arrears on April 1 and October 1 of each year beginning on April 1, 2015. We incurred fees and expenses related to the 2019 Senior Notes offering of $6.3 million, which were capitalized during the third quarter of fiscal 2014 and are being amortized as interest expense over the term of the notes. As of February 2, 2019, the 2019 Senior Notes, net of unamortized debt financing costs, are classified as current in our consolidated balance sheet. The 2019 Senior Notes were sold in a private placement and are not registered under the U.S. Securities Act of 1933, as amended (the "Securities Act"). The 2019 Senior Notes were offered in the United States to "qualified institutional buyers" pursuant to the exemption from registration under Rule 144A of the Securities Act and in exempted offshore transactions pursuant to Regulation S under the Securities Act.

On March 4, 2019, we issued a notice of redemption to redeem all of our $350.0 million unsecured senior notes due October 2019. The redemption date will be April 4, 2019 and the redemption price will be equal to $1,000 per $1,000 principal amount of the 2019 Senior Notes, representing 100.0% of the aggregate principal amount being redeemed, plus accrued but unpaid interest. We expect to use cash on hand for the redemption of the 2019 Senior Notes.

2021 Senior Notes. In March 2016, we issued $475.0 million aggregate principal amount of unsecured 6.75% senior notes due March 15, 2021 (the "2021 Senior Notes"). The 2021 Senior Notes bear interest at the rate of 6.75% per annum with interest payable semi-annually in arrears on March 15 and September 15 of each year beginning on September 15, 2016. The net proceeds from the offering were used for general corporate purposes, including acquisitions and dividends. We incurred fees and expenses related to the 2021 Senior Notes offering of $8.1 million, which were capitalized during the first quarter of fiscal 2016 and are being amortized as interest expense over the term of the notes. The 2021 Senior Notes were sold in a private placement and are not registered under the Securities Act. The 2021 Senior Notes were offered in the United States to "qualified institutional buyers" pursuant to the exemption from registration under Rule 144A of the Securities Act and in exempted offshore transactions pursuant to Regulation S under the Securities Act.

They also have debt to be paid in 2021 with a quite high interest rate. This is bad. The debt is bigger than the current market cap of the company. Reminds me of GE. But GameStop has something that GE doesn't have, the revolver option. What's that? They have the option to take further debt in case they need it.

Revolving Credit Facility

We maintain an asset-based revolving credit facility (the "Revolver") with a borrowing base capacity of $420 million and a maturity date of November 2022. The Revolver has a $200 million expansion feature and $50 million letter of credit sublimit, and allows for an incremental $50 million first-in, last-out facility. The applicable margins for prime rate loans range from 0.25% to 0.50% and, for the London Interbank Offered ("LIBO") rate loans, range from 1.25% to 1.50%. The Revolver is secured by substantially all of our assets and the assets of our domestic subsidiaries.

Borrowing availability under the Revolver is limited to a borrowing base which allows us to borrow up to 90% of the appraisal value of the inventory, plus 90% of eligible credit card receivables, net of certain reserves. The borrowing base provides for borrowing of up to 92.5% of the appraisal value during the period between July 15 and October 15 of each year. Letters of credit reduce the amount available to borrow under the Revolver by an amount equal to the face value of the letters of credit. Our ability to pay cash dividends, redeem options and repurchase shares is generally permitted, except under certain circumstances, including if either (1) excess availability under the Revolver is less than 20%, or is projected to be within six months after such payment or (2) excess availability under the Revolver is less than 15%, or is projected to be within six months after such payment, and the fixed charge coverage ratio, as calculated on a pro-forma basis for the prior 12 months, is 1.0:1.0 or less. In the event that excess availability under the Revolver is at any time less than the greater of (1) $30 million or (2) 10% of the lesser of the total commitment or the borrowing base, we will be subject to a fixed charge coverage ratio covenant of 1.0:1.0.

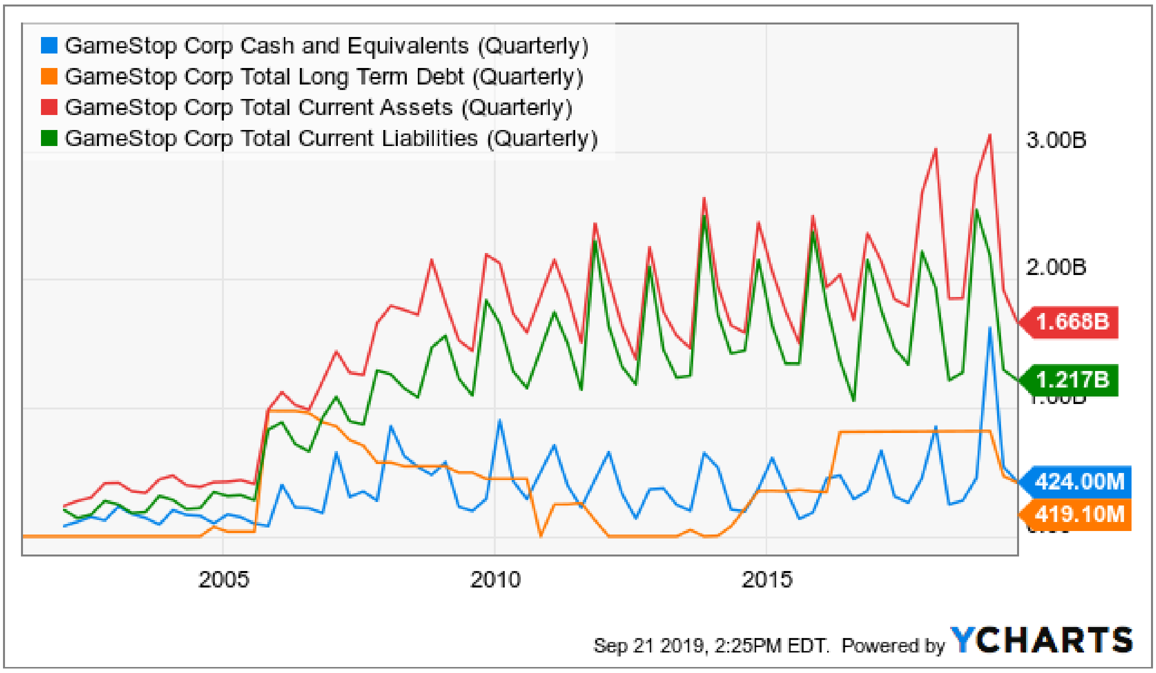
The Revolver places certain restrictions on us and our subsidiaries, including limitations on asset sales, additional liens, investments, loans, guarantees, acquisitions and the incurrence of additional indebtedness. Absent consent from our lenders, we may not incur more than $1 billion of senior secured debt and $750 million of additional unsecured indebtedness to be limited to $250 million in general unsecured obligations and $500 million in unsecured obligations to finance acquisitions valued at $500 million or more.

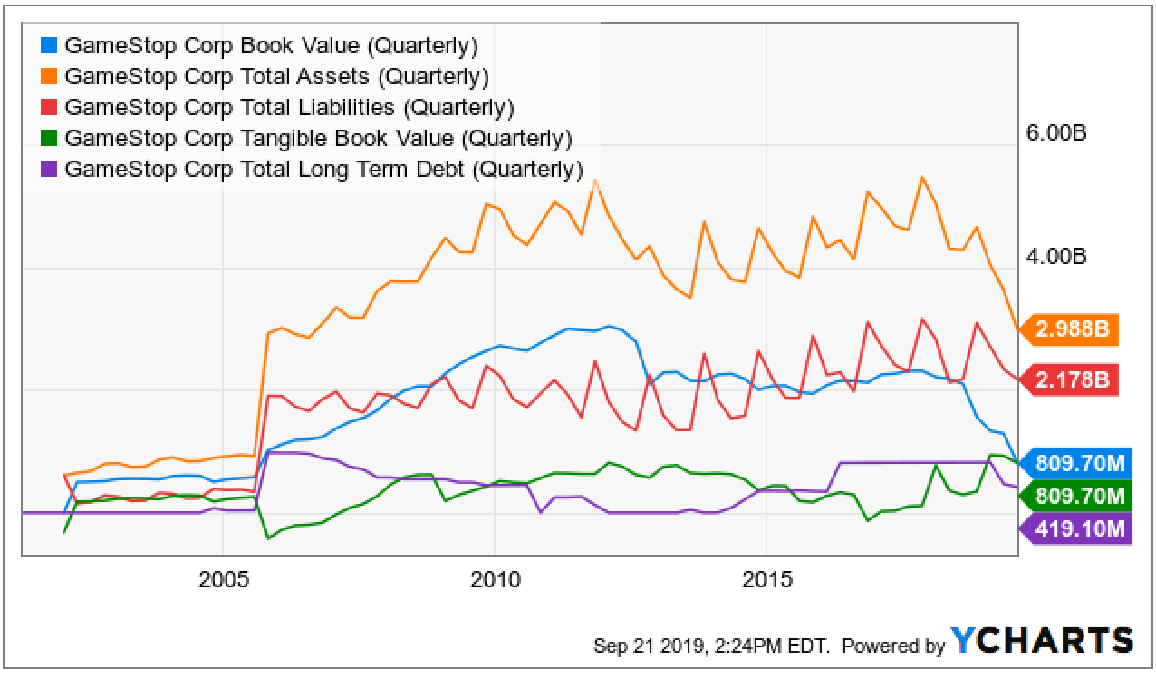
The per annum interest rate under the Revolver is variable and is calculated by applying a margin (1) for prime rate loans of 0.25% to 0.50% above the highest of (a) the prime rate of the administrative agent, (b) the federal funds effective rate plus 0.50% and (c) the LIBO rate for a one month interest period as determined on such day plus 1.00%, and (2) for LIBO rate loans of 1.25% to 1.50% above the LIBO rate. The applicable margin is determined quarterly as a function of our average daily excess availability under the facility. In addition, we are required to pay a commitment fee of 0.25% for any unused portion of the total commitment under the Revolver. As of February 2, 2019, the applicable margin was 0.25% for prime rate loans and 1.25% for LIBO rate loans.

The Revolver provides for customary events of default with corresponding grace periods, including failure to pay any principal or interest when due, failure to comply with covenants, any material representation or warranty made by us or the borrowers proving to be false in any material respect, certain bankruptcy, insolvency or receivership events affecting us or our subsidiaries, defaults relating to certain other indebtedness, imposition of certain judgments and mergers or the liquidation of the Company or certain of its subsidiaries. During fiscal 2018, we cumulatively borrowed $154.0 million and repaid $154.0 million under our revolving credit facility. Average daily borrowings under the facility for fiscal 2018 were $7.5 million and our average interest rate on those borrowings was 3.9%. As of February 2, 2019, total availability under the Revolver was $385.1 million, with no outstanding borrowings and outstanding standby letters of credit of $7.2 million. We are currently in compliance with the financial requirements of the Revolver.

Personally, I don't think GameStop are going to execute this. They have enough cash and cash equivalents to repay this debt by 2022. They could also close more stores. They are actually at a better position that GE right now.

Let’s summarize everything we have seen on the balance sheet on two beautiful charts:





If we ignore the goodwill, their balance sheet looks pretty stable. Because of accounting rules, they had to impair goodwill. But if you think about it, the average customer doesn’t care about the accounting rules. For him/her, the brand value of the company is still here although they have a goodwill of zero. Over 5800 stores, 40 million members in the loyalty program, owns world’s largest print and digital video game publication and website and you’re telling me that they have zero intangible assets?

Before, we look at the valuations of the company, let’s have a look at what Michael Burry had to say.

Why Michael Burry is investing in GameStop?

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 13F

OMB APPROVAL	
OMB Number:	3235-0006
Expires:	Oct 31, 2018
Estimated average burden hours per response:	23.8

FORM 13F INFORMATION TABLE

COLUMN 1	COLUMN 2	COLUMN 3	COLUMN 4	COLUMN 5			COLUMN 6	COLUMN 7	COLUMN 8		
			VALUE	SHRS OR	SH/	PUT/	INVESTMENT	OTHER	VOTING AUTHORITY		
NAME OF ISSUER	TITLE OF CLASS	CUSIP	(x$1000)	PRN AMT	PRN	CALL	DISCRETION	MANAGER	SOLE	SHARED	NONE
ALIBABA GROUP HLDG LTD	SPONSORED ADS	01609W102	8,473	50,000	SH		DFND		50,000	0	0
ALPHABET INC	CAP STK CL C	02079K107	9,728	9,000	SH		DFND		9,000	0	0
CARDINAL HEALTH INC	COM	14149Y108	9,420	200,000	SH		DFND		200,000	0	0
CLEVELAND CLIFFS INC	COM	185899101	11,737	1,100,000	SH		DFND		1,100,000	0	0
DISNEY WALT CO	COM DISNEY	254687106	8,378	60,000	SH		DFND		60,000	0	0
FEDEX CORP	COM	31428X106	9,851	60,000	SH		DFND		60,000	0	0
GREENSKY INC	CL A	39572G100	7,374	600,000	SH		DFND		600,000	0	0
SPORTSMANS WHSE HLDGS INC	COM	84920Y106	6,037	1,597,011	SH		DFND		1,597,011	0	0
TAILORED BRANDS INC	COM	87403A107	10,675	1,850,000	SH		DFND		1,850,000	0	0
WESTERN DIGITAL CORP	COM	958102105	11,888	250,000	SH		DFND		250,000	0	0

The last 13-F filing (https://www.sec.gov/Archives/edgar/data/1649339/000156761919016689/0001567619-19-016689-index.htm) from Scion Asset Management doesn't show Michael Burry's investments in GameStop. This means it is a stock he has only been buying this quarter.

Actually, he used to own shares of GameStop and liquidated everything to buy again? All his GameStop transactions prior to this quarter can be seen here: https://whalewisdomalpha.com/michael-burry-activist-gamestop/

Reported via	Event Date	Name	Ticker	Shares *	Change	% of Portfolio	Estimated Event Date Price
13F	12/31/18	Gamestop Corp., Class A	GME	536,862	New	6.54	12.62
13F	3/31/19	Gamestop Corp., Class A	GME	650,000	113,138	6.73	10.16
13F	6/30/19	Gamestop Corp., Class A	GME	0	-650,000		

He has lost money in these investments. Why then would he buy more shares? And at such a fast rate? He now owns 2.75 million shares, more than he had previously owned. To answer this question, we should read the letter he recently sent to the board of directors of the company. The full letter can be found here: https://www.businesswire.com/news/home/20190819005633/en/Scion-Asset-Management-Urges-GameStop-Buy-238

August 16, 2019

Dear Members of the Board,

Scion Asset Management, LLC and its affiliates ("Scion") own approximately 2,750,000 shares, or about 3.05%, of GameStop, Inc. ("GameStop") common stock.

As mentioned in our previous letter to the board, we have concerns regarding capital management at GameStop. Given recent GameStop common stock prices under $4 per share, we must re-state that GameStop complete the remaining $237,600,000 share repurchase at once and with urgency.

Given the market capitalization of GameStop at $290 million at the close on August 15th, completing the authorization would retire over 80% of GameStop's outstanding shares. Depending on the timing and quality of execution, such a repurchase would increase earnings per share dramatically - far more than any other possible action on a *per share* basis.

The numbers are striking and demand action. We estimate that GameStop now has in excess of $480 million of cash, more than enough to complete the share repurchase authorization and still invest in the business and pay down debt.

Through August 15th, a total of 11 trading days, 50,399,534 shares have traded. At this rate, for the month of August and for the third month in a row, the number of shares traded will exceed the total number of shares outstanding. Because of such high volume, we maintain that GameStop could pull off perhaps the most consequential and shareholder-friendly buyback in stock market history with elegance and stealth.

Shareholders staring at all-time lows in GameStop stock see little evidence that GameStop has effectively leveraged its elite position in the gaming universe as the new paradigm came into clear view over the last five years.

The unfortunate reality is that Amazon, not GameStop, bought Twitch in 2014. Instead, in 2014, GameStop started buying wireless store assets. And in 2017, Amazon, not GameStop, bought GameSparks - while less than a year ago GameStop reversed course and sold its wireless store assets. Shareholders are right to worry.

We expect GameStop's business will perk up a bit during 2020 and 2021 as the new console cycle, with associated software updates and introductions, finally gets underway. But what is happening now in the stock is about more than late cycle doldrums or even the streaming paradigm – shareholders do not have faith in current management, and have not been inspired by new leadership policies.

Notably, as of July 31st, 2019, Bloomberg reports short interest in GameStop stock at 57,226,706 shares – this is about 63% of the 90,268,940 outstanding GameStop shares at last report.

We submit that when share prices are at or near all-time lows and more than 60% of the shares are shorted despite cash levels much higher than the current market capitalization, lack of faith in management's capital allocation is the default conclusion.

All of this creates the opportunity to enter 2020 with a dramatically reduced share count along with multi-fold greater impact *per share* for every single other achievement of management. Consider as just one example that if the turnaround is successful, and if GameStop were able to shrink its shares outstanding to 30 million through the share repurchase, the $157 million dividend that was just eliminated would pay out around $5.25 per share.

The Board deemed up to $6.00 per share a good price for a buyback less than two months ago, and the price of the stock today is nearly half that amount.

We again advise the Board to represent shareholders well, and to ensure the execution of the remaining repurchase authorization in full.

Sincerely,

Dr. Michael J. Burry

This is the type of letter one would expect from Carl Icahn who is the most famous activist investor in the world. As for Michael Burry, he has not shown this investing style before. Here's the reason why he has been buying more and more shares recently. Now he has a voice to affect the decisions of the board of directors.

What does Michael Burry want?

He wants the board to execute their share buyback program. This program was voted earlier this year. This can be seen on the 10-K. They were supposed to buyback $300 million shares.

Share Repurchase Program

From time to time, we have repurchased our common shares through open market transactions under share repurchase authorizations approved by our Board of Directors. We have not repurchased any shares of common stock since fiscal 2016. Our share repurchase authorizations do not require us to acquire any specific number of shares and may be terminated at any time. Shares repurchased have been subsequently retired. On March 4, 2019, our Board of Directors approved a new share repurchase authorization allowing our management to repurchase up to $300 million of our Class A Common Stock with no expiration date. The new share repurchase authorization replaces the previous share repurchase authorization, which had $170.2 million remaining. We did not repurchase shares during fiscal 2018 or fiscal 2017. Share repurchase activity for fiscal 2016 is as follows (in millions, except for per share data):

		Fiscal Year 2016
Total number of shares purchased		3.0
Average price per share	$	24.94
Aggregate value of shares purchased	$	75.1

From the latest cash flow statement (on the 10-Q), we can see that GameStop bought back about $63 million of shares.

Cash flows from financing activities:		
Repayment of acquisition-related debt	—	(12.2)
Repurchase of common shares	(62.9)	—
Dividends paid	(40.5)	(79.9)
Borrowings from the revolver	—	154.0
Repayments of revolver borrowings	—	(154.0)
Repayments of senior notes	(404.5)	—
Settlement of stock-based awards	(0.8)	(4.2)
Net cash flows used in financing activities	(508.7)	(96.3)

This is from where Michael Burry gets this number: $237 million of shares. You may wonder why I had to look back in cash flow statement when the number was already on the letter. I don't take anything at face value. You should always do your homework. Just because someone says something, doesn't mean it's true.

When he wrote the letter, the company had a market cap of $290 million and if they retire $237 million worth of shares, it will mean they will reduce the shares outstanding by 80%. This will make a huge difference in the EPS and other per share data. Apple's $75 billion share repurchase last year is nothing comparable to this.

Michael Burry blames the management for the poor performance of the company in recent years. He explains how Amazon was able to outsmart GameStop.

With the new consoles coming next year, he believes the company would do much better next year than this year(we also derived the same hypothesis a little earlier).

For all these reasons, the best use of the $480 million in cash, according to Michael Burry, is to buy back the shares immediately.

Michael Burry sees GameStop as a cigar butt. This would be something in the playbook of Warren Buffett when he just started investing with his partnership. This is also a strategy used by Carl Icahn when investing in failing companies.

I believe that Michael Burry is right by seeing GameStop as a cigar butt but the management certainly doesn't see their company as one. I don't think it will be wise to buyback $290 million worth of shares immediately. They can afford it and repay their debt but this could lead to serious problems if in 2021, they are still in such a hard financial situation and are unable to repay their debt. What are they going to do then? Issue more shares? Wouldn't that just be a waste of money? One thing, they could do is close some more stores, those not performing well. They can increase their cash position and make sure they have enough to buyback the shares and still be able to repay all the debt.

Valuations

Just because Michael Burry thinks that it is a good investment, doesn't mean it's one. We should find the intrinsic value of the company first. Let's use the discounted free cash flow method.

This year, free cash is going to be negative. But next year, they can achieve free cash flow of $200 million. This is my forecast. Let's then assume the company will be able to maintain $200 million per year in free cash flow for eternity. The discount rate which I'm using is 18%. This is quite high but the company is in a quite peculiar situation.

There's a good calculator I here:
http://www.moneychimp.com/articles/valuation/buffett_calc.html

The intrinsic value of the company is $1.11 billion. You can play with the numbers. If you consider the situation in which the free cash flow they can achieve per year for eternity is $100 million, this will give them an intrinsic value of $560 million. As you can see, both these numbers are higher than the current market cap.

I'll be using the intrinsic value of $1.11 billion and taking a margin of safety of 30%, the fair value of the company is $780 million.

Earnings	
Earnings per share (last 12 months):	$ 0.20

Growth Assumptions

Earnings are expected to grow at a rate of 0 % annually
for the next 20 years,
before leveling off to an annual growth rate of 0 % thereafter.

Confidence Margin

How confident are you that these expected future earnings will really materialize?	70 %

Discount Rate

Best available return that you have 100% confidence in (like a Treasury bond):	18 %

Calculate

Results

Stock Value per share:	$ 0.78

With a market cap of $425 million, it is trading both under book value and its intrinsic value.

Will I invest in GameStop?

I already made a small investment in GameStop. It is about 0.78% of my portfolio. Why did I do that. This is a workout and not a long-term investment. Even if we ignore the fact that they are going to buyback shares, GameStop is undervalued today and there is the possibility of a recovery next year with the new consoles coming. This is not a stock I want to hold for more than a year. So let's calculate the expected returns in a year from this investment.

Expectations is calculated as the sum of the products of the outcomes with their respective probabilities.

Gain (outcomes)	20%	50%	100%	200%	-20%	-50%	-100%
Probability	15%	25%	15%	10%	15%	15%	5%
Gain*Probabilty	3.00%	12.50%	15.00%	20.00%	-3.00%	-7.50%	-5.00%
Expectated value	35.00%						

The Expected returns after one year on this investment is 35%. We are here ignoring the possible share buybacks. If these happens, then returns can be even higher. There is also a 5% chance that the company goes bankrupt and a 35% chance, we are losing more than 20% on this investment. This is not an investment in which I'm going to put much money. I don't think it is wise putting more than 4% of my portfolio in this company. I don't have the ability that Michael Burry has to send letters to the board of directors. A gain of 35% would mean a target price of $6.12. If they buy back shares, this would be achieved faster and maybe then, I'll have to change my investments. But as for now, I'll take the opportunity to buy on days when the stock is falling and wait for the price to reach $6.12 to take any new decision.

22nd of September 2019