The Seville Report

A mini report

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Mini Report I

Foreword

There are cases in investment analysis when the numbers and the story don't align. The numbers say buy, buy, buy, but the story says avoid, avoid, avoid. The safe play in this situation is to avoid.

In 2012 I reviewed Game Stop, and the stock graded well, but there were parts of the story that scared me. The video game industry was upset with Game Stop's business model. Instead of video game makers seeing Game Stop as a needed part of the video game ecosystem, game makers saw Game Stop as a threat to their long-term survival. In late 2012 the video game world was anticipating the release of the PlayStation 4 and the X-Box One. Both systems along with the game makers of those systems threatened to go all digital. Going all digital meant that there would be no more physical games to buy at the store. This would have crushed Game Stop, and because of that threat, I didn't buy Game Stop. The PS4 and X-Box One were released in 2013 and physical games for those systems followed. The game makers balked on their threat, and Game Stop's stock went from $16.00 to $57.00.

In 2012 the numbers said buy, but the story said be cautious. I didn't buy, I watched Game Stop's stock rise from the sidelines.

Looking back at the Game Stop analysis I still wonder what is more important, the numbers or the story? When I worked on Wall Street I always heard the saying, buy on rumor, sell on news. If I had remembered that in 2012 I would've bought Game Stop.

As investors we will all have a day where the numbers and the story don't align. Those days when we question ourselves and our analysis. Should we ignore the numbers and go with the story or ignore the story and trust the numbers.

We revisit Game Stop five years later. In 2017 we find Game Stop (GME) trading below $20 per share. Today gamers are able to purchase entire games digitally from the game manufacturer, so the all digital console game is more than a threat now, and cheaper hard drive space and cheap cloud space makes it better for the gamer as well. Along with the all-digital video games, game makers have created another threat for Game Stop.

Take a look at our mini report on Game Stop. In this report we don't have a buy-zone because we aren't buying Game Stop, but we still discuss why Game Stop may be a good investment, and the risk involved.

If you're a gamer or an investor, let us know what you think on Twitter @SevilleReport.

We hope this adds value to your investing.

Thanks for reading,

Paul Black

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C+ GameStop

Ticker: GME **Current Price:** $19.15 **Target Price:** N/A **Sector:** Service **Industry:** Retail

52 Week Range: $18.47 - $28.58 **Market Cap:** $1.94B **R.O.E.:** 15.27%[1] **R.O.A:** 8.35%[1]

GameStop
POWER TO THE PLAYERS®

3 Year Revenue Growth	✖
3 Year Income Growth	✖
Dividend	✔
Share Buyback/Share Repurchase	✔
Quality Growth Prospects	✖
Insider Buying	✖
Passing Driver Grade	✖
Final Grade	C+

Game Stop (GME)
GME P/E (Price-to-Earnings): 5.78x[1]
Industry P/E: 14.3x[2]
GME P/S (Price-to-Sales): 0.22x[1]
Industry P/S: 0.3x[2]
GME P/B (Price-to-Book): 0.84x[1]
Industry P/B: 3.2x[2]
GME P/CF (Price-to-Cash Flow): 8.05x[1]
Industry P/CF: 6.9x[2]

What does Game Stop do?

Game Stop Corp. is a video game retailer. The company sells video game hardware, physical and digital video games software, video game accessories, as well as mobile and consumer electronic products and other merchandise. Game Stop operates in the United States, Canada, Australia, and Europe.

Why Invest in Game Stop?

A review of Game Stop's income statements, balance sheets, and cash flow statements over the last five years has produced a buy signal in our models. The company graded out at a C+. We do like that the company is repurchasing shares and pays a dividend. Game Stop's R.O.A. (8.35%) and R.O.E. (15.27%) compared to its industry and sector averages was also attractive. Game Stop's assets, liabilities, and income warrant a higher stock price than what it is currently trading for. However, we find it hard to invest in Game Stop because of the obstacles the company faces in the video game industry.

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What are the Investment Risk?

The risk with an investment in Game Stop is extremely high. It appears Game Stop is being phased out by the video game industry.

Game Stop sells video game hardware and software. Video game hardware like the Microsoft X-Box, the Sony PlayStation, and the Nintendo Switch. Game Stop also sells accessories for these systems such as cables and controllers. Along with the hardware, Game Stop sells the video games or software for these systems. More than selling games and consoles to customers, Game Stop has a business purchasing games and consoles from customers and reselling these items. If a consumer doesn't mind waiting a few months, they can get a used console and a used game from Game Stop a lot cheaper than it cost to purchase a brand new one. This is what attracted video game players to Game Stop. If the player completed a game or the gamed maxed out its usefulness, the player could sell the game to Game Stop and use that money to purchase a new game. It was a great business model, but you don't make money hand over fist without getting someone else upset.

The video game makers were losing money on the sale and purchase of used games from Game Stop. So to make up for their lost revenue video game producers created Downloadable Content or DLC. Downloadable content is additional content distributed over the Internet by the video game creators. An example would be a gamer purchases a popular game like "Call of Duty" made by Activision (ATVI) for $69. A few months later Activision may release a DLC Pack with extra levels, or maps, or characters, or character uniforms for an additional $2 to $15. This DLC is distributed through the Internet to the player's console and available to play once the download is complete. Some DLCs can extend a games life for years, leaving a gamer with no need to purchase a replacement. The video game makers have found a way to cut Game Stop out of the loop. The DLC issue facing Game Stop is just one of many.

As discussed in the foreword video Game makers have discussed phasing out physical copies of games all together and making everything digital. If that were to happen, gamers would purchase their games online directly from the game makers. Again like the DLC, the video game would be downloaded directly to the purchaser's console. While this is happening now on a small scale, an all out phase out of physical games would be damaging for Game Stop since there would be no physical game to sell to Game Stop. For context, think about what digital music did to companies like Sam Goody and Virgin Megastore. The revenue Game Stop makes from selling used games would shrink significantly. In 2016 Pre-owned and value video game products accounted for 26.2% of Game Stop's revenue according to Game Stop's annual report, 26% is a large portion of the revenue pie.

When you take away the ability to purchase and sell used games, Game Stop becomes like every other retailer that sells video games. Walmart, Target, Amazon all sell games and consoles, but they don't buy or sell used games.

To summarize, the changes in the video game industry will have a negative impact on Game Stop. Unless the company finds a way to reinvent itself it could be a painful ride for any Game Stop stockholders.

Game Stop Peer Review

Income Statement	GME	WMT	TGT
Revenue	$8.74B	$160.74B	$69.58B
EBITDA	$744.6M	$32.87	$7.14B
Net Income	$340.7M	$12.73	$2.78B
E.P.S.	$3.32	$4.16	$4.95
Balance Sheet	**GME**	**WMT**	**TGT**
Total Assets	$4.9B	$198B	$37.4B
Total Liabilites	$2.7B	$121B	$12.7B
Cash Flow Statement	**GME**	**WMT**	**TGT**
Operating Cash Flow	$537M	$27.96B	$6.87B
Levered Free Cash Flow	$400M	$15.62B	$4.72B
Margins	**GME**	**WMT**	**TGT**
Profit Margin	3.90%	2.60%	3.99%
Operating Margin	6.68%	4.60%	6.90%

When Game Stop's niche of selling used games and hardware goes away, they are just another retailer that sells video game products.
(Data by Yahoo.com)

What is Wall Street Saying?

8/25/17 Oppenheimer has GME as a **"Hold"**

8/23/17 Robert W. Baird has GME as a **"Buy"**

8/22/17 Loop Capital has GME as a **"Buy"**

Summary

Top Reasons to Buy Game Stop
1. The company pays a dividend and is repurchasing shares.
2. The company's R.O.A and R.O.E compared to the industry and sector averages are good.
3. The approaching holiday season will bring demand for the X-Box One X, PlayStation 4 Pro, and Nintendo Switch as well as the video games that are released between now and the end of the holiday season.

Top Reasons to Avoid Game Stop
1. Game Stop as a company faces a lot of obstacles within the video game industry.
2. Downloadable content will continue to cut into Game Stop's revenue.
3. The threat of all video games becoming digital. All digital video games would hurt Game Stop severely, possibly pushing the company out of business.

Glossary

Book Value-to-Market Value: This is a metric used to find a company's value by comparing its book value to its market value.
Side Note: This became a key metric in our review after reading the Fama-French research reports.

Capex: Capital Expenditure: This is money spent by a company to maintain or acquire fixed assets like equipment, land, and buildings.

Dividend: A sum of money paid regularly by a company from company profits to its shareholders. Payments are typically made quarterly.

Insider Buying: The purchase of shares of a company's stock by someone employed by the company.

Market Cap: Market Capitalization: This represents the value of a company traded in the stock market. The Market Cap is obtained by multiplying the outstanding number of shares to the current share price.

Net Debt: This is a metric we use to compare the amount of debt the company carries with the amount of cash the company carries. (When we note that the company has negative net debt, this means the company has more debt than it has cash and cash equivalent).

P/B: Price-to-Book, a metric used to compare a stocks market value to its book value. The Price-to-Book is calculated by dividing the current price of the stock by the company's latest quarter's book value per share. The lower the P/B the more attractive the investment.

P/CF: Price-to-Cash Flow, a metric used to measure a company's stock price to its cash flow per share. It is calculated by dividing the company's share price by the company's cash flow per share. A company with a low P/CF is said to have value when compared to other stocks in its industry or sector.

P/E: Price-to-Earnings, or price multiple: The P/E is a metric used to measure the value of a company by dividing the company's current stock price by its earnings per share. The lower the P/E the more attractive the investment**.**

P/S: Price-to-Sales, a metric used to value each dollar the company earns in revenue. The Price-to-Sales is calculated by dividing the companies market capitalization by its total revenue. The lower the P/S the more attractive the investment

R.O.A.: Return on Assets: This metric is used to determine how profitable a company is relative to its total assets. It gives an investor an ideal of how effective management is in using its assets to generate revenue.

R.O.E.: Return on Equity: This metric is used to determine how profitable a company is relative to its shareholders equity. It gives an investor an ideal of how effective management is in using money shareholders have invested to generate revenue.

Share buyback/ Share Repurchase: When a company buys back its own shares from the marketplace, reducing the number of outstanding shares.

Winners Circle: The Winner Circle is a group of stocks that we have reviewed in the past that went on to increase in value, at times hitting the expected target and others times exceeding the target price. We compare stocks currently under review to the Winners Circle to get a broader reference about the stock.

10K: The company's yearly report. This is where the company reveals to the public how much money it has made or lost in the last year of business. The 10K also reveals the company's assets, liabilities, and cash flow for the last year.

10Q: The company's quarterly report. This is where the company reveals to the public how much money it has made or lost in the last quarter. The 10Q also reveals the company's assets, liabilities, and cash flow for the last quarter.

Footnotes

[1] Data provided by Yahoo.com

[2] Data provided by E-Trade.com

Additional data provided by Reuters.com

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