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Sent via Email

GameStop Corp.
625 Westport Parkway
Grapevine, TX 76051

GameStop Board of Directors:

Hestia Capital Management, LLC has been a shareholder of GameStop Corp. (the "Company" or "GameStop") since 2012. Our investment approach leverages our strategic and operational background by investing in quality companies, such as GameStop, whose competitive positioning and environment we believe to be misunderstood by the market.

We are writing to express our thoughts on the Company's path forward in the wake of the recently terminated strategic process, and to make current CEO candidates aware of the views and concerns of long-standing shareholders. While the outcome of the process was unfortunate, we believe that the Board has a tremendous opportunity to create value for its shareholders by returning significant capital to equity holders, and by hiring a CEO who is properly incentivized to focus on leveraging the Company's competitive advantages and on improving operational efficiency.

Returning Capital to Shareholders

GameStop's Board has the ability to create substantial shareholder value through significant share repurchases. Based on Company guidance and SEC filings, the Company likely ended Fiscal Year 2018 with at least $1.5B in cash. In its recent press releases, the Company highlighted three uses of its significant cash holdings: debt reduction, stock repurchase, and acquisition.

We believe that acquisition as a use of capital, other than for small strategic deals, should be off the table until the Company has fully pursued internal strategic opportunities and cost cuts.

With respect to debt reduction, retiring the Oct 2019 debt is more than adequate. The Company's strong free cash flow (FCF) easily covers interest on the remaining $475M of 2021 Senior Notes. After meeting cyclical Q1 working capital needs and repaying the Oct 2019 debt, the Company should have more than $800M in cash and will generate significant positive FCF on a go forward basis.

With a market cap hovering below $1.2B, this $800M could be used to initiate a "public LBO" of the Company. We urge the Board to immediately fund a $500M to $700M share repurchase, via a modified Dutch auction tender, and continue using FCF to fund an ongoing buyback program, so long as GameStop's stock remains undervalued.

The following table depicts the results of a $600M initial repurchase at an estimated share price of $14 (a 24% premium to the stock's 2/11/19 closing price of $11.30), followed by $100M per year in additional repurchases:

($s in millions)	Initial Repurchase	FY 2019	FY 2020	FY 2021	FY 2022
Starting Cash	**1,500**	**550**	**547**	**561**	**611**
Debt Reduction	(350)	-	-	-	-
Share Repurchase	(600)	(100)	(100)	(100)	(100)
Baseline FCF		175	160	175	225
Post-Tax SG&A Cuts		12	35	50	50
Dividend		(90)	(82)	(75)	(69)
Ending Cash	**550**	**547**	**561**	**611**	**717**
Q1 FCF		(359)	(376)	(388)	(388)
Cyclical Low Cash		**188**	**184**	**223**	**329**
Beginning Shares	102	59	54	49	46
Shares Repurchased	(43)	(6)	(5)	(3)	(3)
Ending Shares	59	54	49	46	43
FCF Multiple		5.75x	6.00x	6.25x	6.50x
Share Price	***$ 14.00***	***$ 18.18***	***$ 21.81***	***$ 28.67***	***$ 39.23***

Assumptions: A slow decline in baseline FCF through 2020 followed by an uptick starting in 2021 due to the assumed 2020 release of the PS5, incremental benefits from SG&A cuts (discussed later in this letter) starting at $12.5M (post-tax) in 2019 and growing to $50M per year by 2021, a share price multiple which begins at 5.75x FCF and slowly expands to 6.5x, the retirement of 2019 debt, and a refinancing of the 2021 debt.

This simple analysis suggests such a repurchase plan might result in an increase in the share price to $39 by 2022 – 3.5x current levels and almost double our $22 estimate of fair value[1]. We believe cost savings could significantly exceed our modeled amount, and the multiple expansion could be higher than modeled, as investors see improving FCF generation and responsible capital allocation from the Company. Additional benefits of this plan include:

Management Accountability: We believe GameStop's past five years have shown that excess cash can cause management teams to look for easy solutions rather than addressing difficult problems. Our plan would provide sufficient operating capital for the incoming CEO to manage the business, while also creating pressure to improve performance.

Potentially Facilitate Future Transaction: If this "public LBO" doesn't have the effect of significantly driving up the share price, it almost certainly would increase the ease with which a traditional LBO could occur.

Increase Post-Financing Cash Flow: GameStop's 2021 debt pays a post-tax yield of 5.3%, while the Company's stock currently pays a post-tax dividend of 13.4%. Not until the stock price reaches $29 does this yield even out. Assuming the Company is committed to continuing its dividend, share repurchases at prices below $29, rather than debt reduction, would do more to free up future cash flow for strategic investment once the current business is optimized.

[1] This valuation is based on an estimated mid-cycle levered FCF of $225M, excluding Spring Mobile, a 6.5x multiple of FCF, 102M shares outstanding, adjusted for $800M in excess cash.

Hiring and Incentivizing the Right CEO

Aligning Incentives

We believe that GameStop is at a critical crossroads, and hiring a highly qualified CEO is of utmost importance. Furthermore, we understand attracting such a candidate likely will require a rich compensation package.

That said, we believe executive compensation needs to be overhauled at the Company, creating a compensation structure that is better aligned with shareholders. Over the past several years, GameStop executives have enjoyed rich cash salaries and bonuses while the stock price has declined significantly. This practice needs to end.

We encourage the Board to look at a company such as Transdigm Group Inc. (NYSE: TDG) as a model for compensation. Despite having a 20x greater market cap, Transdigm pays its CEO a significantly lower salary than GameStop has historically paid its CEO. Instead, Transdigm heavily weighs incentives toward share price appreciation.

Leveraging GameStop's Competitive Advantages

We have long believed that the move into the AT&T reseller business was doomed to fail because it in no way leveraged your competitive strengths. We believe it is important to hire a CEO who will do the difficult work of leveraging the Company's *existing* strengths, not looking at shareholder cash as an opportunity to buy a way out of current problems.

We believe that GameStop has significant competitive advantages in the gaming industry, despite the market fear that physical media will be made obsolete by digital gaming. In particular, we believe GameStop benefits from a "network effect" in used gaming, used gaming plays a critical role in the gaming ecosystem, and GameStop has a strong connection to the gaming community.

It is our belief that physical games have a far more enduring future than the market appreciates because physical media creates value in the industry by allowing for price discrimination. Effective price discrimination requires an obstacle to getting a lower price. Having to deal in physical media accomplishes this, whereas creating such an obstacle with digital gaming is more difficult. For this reason, we believe the outlook for physical media is weak; but not nearly as dire as many believe[2].

Additionally, GameStop has a strong position in the gaming community due to its knowledge of, and positive relationship with, much of the "hard core" gaming community. An example of your connection is the extensive customer knowledge and loyalty generated from your PowerUp Rewards program. An example of your positive relationship is that Customer Guru estimates your Net Promoter Score to be 13[3], which is the same as Netflix's last known score[4].

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[2] Specifically, we believe that the current contraction of GameStop's used business reflects the "resizing" of the market; not a straight-line decline into oblivion.
[3] https://customer.guru/net-promoter-score/gamestop
[4] https://customer.guru/net-promoter-score/netflix

When evaluating CEO candidates, we would encourage you to try emulate Best Buy's hiring of Hubert Joly in 2012. We were an investor in Best Buy at the time because, unlike many investors, we believed their physical presence was an asset, as it enabled them to be "the marketplace" for electronics. Mr. Joly effectively monetized this competitive advantage by aggressively implementing a "store within a store" concept, essentially selling preferential access to customers in their marketplace.

GameStop already has a significant, valuable strategic position in the market. The Board needs to hire a CEO with a keen strategic mind, demonstrated by a clear plan to improve monetization of GameStop's core competitive assets.

Improving Operating Efficiency

We believe the best first response to industry disruption is to quickly address costs, thereby becoming a more efficient competitor. However, during our seven years as investors in GameStop, we have seen limited evidence that the Company has taken serious steps to eliminate inefficiencies, streamline operations, or take other steps to reduce costs[5].

It is difficult to determine corporate expenses and the size of the cost cutting opportunity, given the Company's disclosure. Nevertheless, we have made a simple effort at analyzing SG&A costs for the Company, excluding the now spun-out Spring Mobile[6]:

Company	TTM	2013	**Tech Biz**	TTM	2013	**Core Biz**	TTM	2013
Rev	9,168	9,039	Rev	729	63	Rev	8,439	8,976
SG&A	2,367	1,894	SG&A	328	28	SG&A	2,039	1,866
						SG&A/Rev	24.2%	20.8%

Assuming a 45% SG&A rate at the Technology Brands business, we can see from Fiscal Year 2013 to the Trailing Twelve Months through Q3 2018 ("TTM"), Non-Tech SG&A has increased $173M, despite revenue declining $537M, leading to 3.4% increase in SG&A as a percent of revenue.

Simply bringing Non-Tech SG&A down to 2013 levels ($1,866M) would increase post-tax[7] profit and FCF by $137M. Bringing the SG&A *rate* down to 2013 levels (20.8%) would increase post-tax profit and FCF by $224M. If we assume a lower (and more realistic) SG&A rate at the Tech Brands business, the growth in Non-Tech SG&A is even more pronounced, suggesting an even greater opportunity.

We recognize that mix change, decreased scale, and other factors could cause these numbers to overstate the potential. Nevertheless, we believe our estimate of $50M in post-tax savings used in our public LBO model is conservative, and it's entirely reasonable to assume there could be significant additional potential cost savings (including stranded costs, post-divestment).

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[5] We reviewed earnings transcripts from the past several years and only saw passing mention of such efforts in the Q3 and Q4 calls of 2016; a meaningful plan was never consistently articulated to shareholders. In our experience, real cost cutting efforts are almost always touted by management teams.
[6] Given that Spring Mobile dominates Tech Brands, we use Tech Brands as a proxy for Spring Mobile
[7] Based on the current 21% tax rate.

In summary, we believe the Board has a singular opportunity to create significant value for its shareholders by hiring a CEO who is properly incentivized to create shareholder value by simultaneously focusing on streamlining corporate operations and leveraging the Company's competitive strengths in the gaming industry. Furthermore, the Board can significantly boost these returns through a substantial, immediate and ongoing return of capital to shareholders. Please do not hesitate to contact us directly should you have any comments or questions regarding the content of this letter.

Sincerely,

Kurtis Wolf
Managing Member and Chief Investment Officer
Hestia Capital Management, LLC