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Independent Equity Research

July 5, 2005

INSTITUTIONAL RESEARCH REPORT

Pacific Sunwear of California, Inc. (PSUN)

Rating: Buy/4

Price Target (12 Month): $30.00

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Rating Highlights

Pacific Sunwear of California, Inc. (PacSun) is a leading specialty retailer of everyday casual apparel, accessories, and footwear for teens and young adults. Highlights supporting our Buy/4 rating and target valuation include ...

- **Proven Success.** The company is the dominant player in the board-sport inspired retail apparel market with 4 year historical CAGRs (compound annual growth rates) of 20% sales, 28% operating income, and 28% net income.
- **Outstanding Operations.** Our estimates call for FY05 revenues and net income to tip the scales at $1.4 billion and $134 million, respectively. As a result, we expect the company to make about $1.80 per diluted share during FY05.
- **Excellent Value.** Peer comparisons indicate valuations between $35 and $39. Based on our integrated model, our 12 month price target is $30. Given a recent price of $23, we estimate the shares are undervalued by as much as 23%.
- **Good Store Expansion.** The company is on track to have 1,110 stores and 3.9 million square feet of store space in operation by year-end. The company also plans to introduce a new store concept in FY05. The company's store portfolio provides excellent platform support for its growth strategy.
- **Seasoned Management.** The company is headed by a seasoned management team, including CEO Seth Johnson. Although no longer CEO, PacSun veteran Greg Weaver remains as Executive Chairman of the Board.
- **Risks.** The teen/young adult apparel market is notoriously fickle. Please read about these and other risks in the "Risks" section.
- **Disclosures.** This report contains important disclosures. Please read them thoroughly.

Snapshot
Industry
Apparel Stores
Recent Price
$23.06
Exchange
Nasdaq
52 Week Range
$17 to $29
Market Cap
$1.7 Billion
Shares Outstanding
75 Million
Float
67 Million
Avg Volume (3 Month)
1.8 Million
Fiscal Year Ends
January
Latest Year Sales
$1.2 Billion
Latest Year Profit
$107 Million
Latest Year End Cash
$144 Million
EPS FY04
$1.38
EPS FY05 (Est)
$1.80

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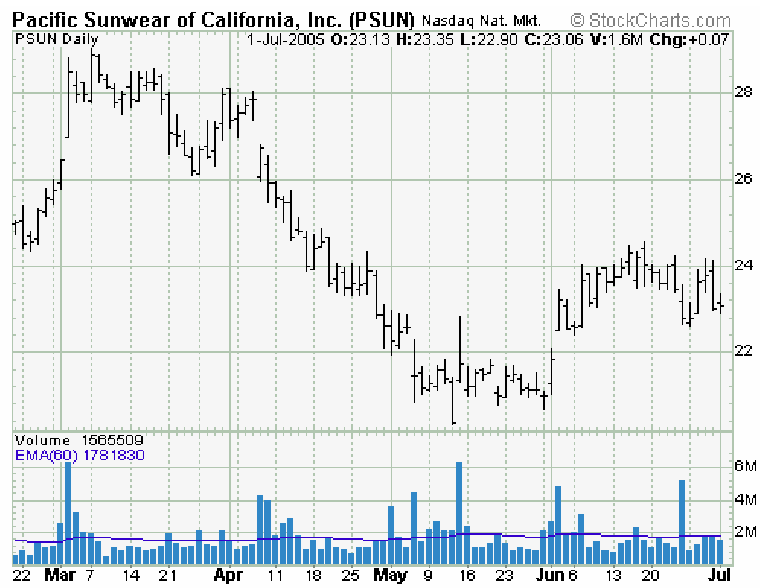
Profile

Pacific Sunwear of California, Inc. -- incorporated in August, 1982 -- is a leading specialty retailer of everyday causal apparel, accessories and footwear targeting the active teen and young adult market. The company operates three mall-based, nationwide retail apparel formats: Pacific Sunwear/PacSun, Pacific Sunwear Outlets/PacSun Outlets, and d.e.m.o.

PacSun and PacSun Outlets carry products based in the company's surf and board-sport inspired roots. d.e.m.o. carries products inspired by the hip hop, urban lifestyle. Both concepts cater to men ("boys") and women ("girls") roughly between the ages of 12 and 24. The company also runs websites for its PacSun concept (www.pacsun.com) and d.e.m.o. concept (www.demostores.com). Both sites offer a broad array of apparel, footwear, and accessories. In addition, PacSun website visitors can login to a variety of "lifestyle" content areas that promote the board-sport inspired and include music, downloads, and contests.



PacSun and d.e.m.o. stores offer a lively, fun, and accessible shopping experience. From music to interior design, the stores fit the lifestyles they promote. The company merchandise model pushes "fashion" and not "fads," with considerable time spent with focus groups, manager feedback, and simple listening. Customer service is attentive but non-intrusive. As of the end of the first fiscal quarter 2005 ending 4-30-05 (FQ105) the company operated 1,013 stores, including 754 PacSun stores, 86 PacSun Outlets, and 173 d.e.m.o. stores. By the end of fiscal 2005 on 1-28-06 (FY05), the company should have about 1,110 stores in operation.

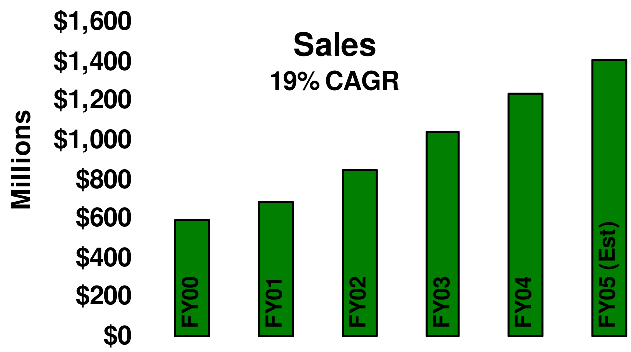
PacSun offers a wide array of board-inspired brands including such surf apparel icons as Quiksilver/Roxy, Billabong, and Volcom. d.e.m.o. offers equally popular brands like Ecko, Phat Farm/Baby Phat, and Apple Bottoms. The company also offers its own, typically higher-margin, proprietary brands.

As of the end of FY04, the company produced $1.2 billion in sales, $170 million in operating income, and $107 million in net income. Cash flow from operations was $143 million and the company had $144 million in cash on hand with no debt.

The company is headed by Seth Johnson, CEO. He as well as his senior management team -- including Gerry Chaney, CFO and Tom Kennedy, President of PacSun -- joined the company in 2004. Prior to joining PacSun, they all built distinguished careers at such retailers as Abercrombie & Fitch, Polo Ralph Lauren, and the Gap. Greg Weaver -- former CEO -- serves the company as Executive Chairman of the Board. His PacSun roots reach back to 1987 and, with a relatively new senior management team in place, provides essential continuity to the company's operations.

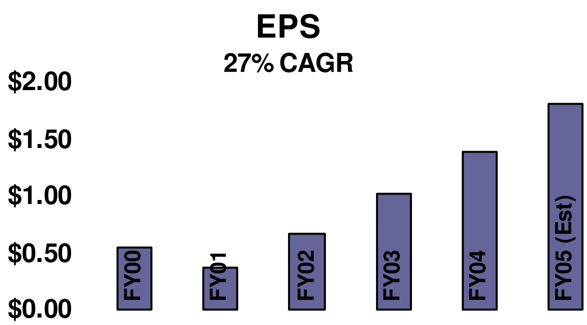
The company's corporate offices and distribution center are located in Anaheim, California and include about 550,000 square feet of space.

Valuation and Current Outlook



PacSun is a robust, well-managed apparel retailer with proven historical success and a positive outlook. The company runs a model that works well while boasting sufficient resources to continue expansion, drive sales, and leverage existing store platforms. To improve matters even further, the company carries no long-term debt and should have sufficient internal cash sources to fund its operations in FY05. Given these factors, PacSun should make about $1.80 per share during FY05. With average price-to-earnings ratio of 21.9 and price-to-sales ratio of 1.9 for PacSun's peers -- many of which with poorer operating performance -- the upside range for a reasonable price target could easily be in the $35 to $39 range. Given discounts and other factors -- including lack-luster FQ105 results, uncertainty regarding the company's new store concept, and comparison to our discounted cash flow model -- our 12 month price target for the shares is $30. Here are some of the company's highlights ...

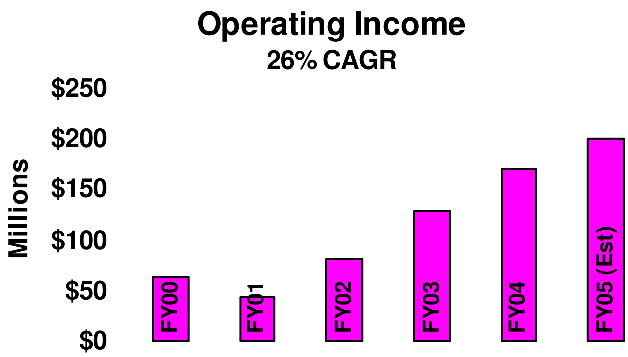
Climbing Sales



PacSun is on target to have 1,110 stores and about 3.9 million square feet of store space operating by the end of FY05. That store portfolio provides an excellent support platform for the company's merchandising and marketing model. And that model -- which is based on board-sport (PacSun) and hip-hop (d.e.m.o.) inspired brands for teens and young adults-- doesn't have direct competition from a similarly resourced, seasoned, mall-based retailer -- a big, big plus.

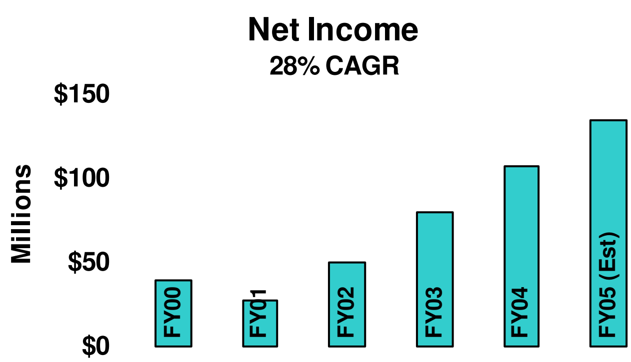
That said, we don't think the company will return to its 25% plus revenue growth rate of years' past. As the company has matured and operating leverage begins to maximize, a revenue growth rate of around 14% -- and comp sales growth of around 7% -- are reasonable for FY05. As a result, we're looking for FY05 sales to hit around $1.4 billion.

The company's FY04 $374 sales-per-square-foot lags competitors but doesn't worry us much: The company's operating margins are solid and management has a proven ability to expand while not de-focusing from store merchandizing and operating needs. The company has also not tried to be all things to all people -- such as Gap has -- and as a result can focus on its primary market: Board-sport inspired "lifestyle" clothing and accessories for teens and young adults. In addition, the company's vendor/private brand mix spreads merchandising risk more broadly than its exclusively private brand competitors.



Operations are Humming

The company has improved its gross margin over the past few years. Now, it's around 36% -- about average with the industry -- and we think it should remain so for FY05. And we don't see any problem with the company continuing to drive operating and net income at an impressive 26% and 28% CAGR, respectively, through FY05. As a result, we think PacSun's FY05 operating income should come in around $200 million and net income around $135 million, or $1.80 per share.

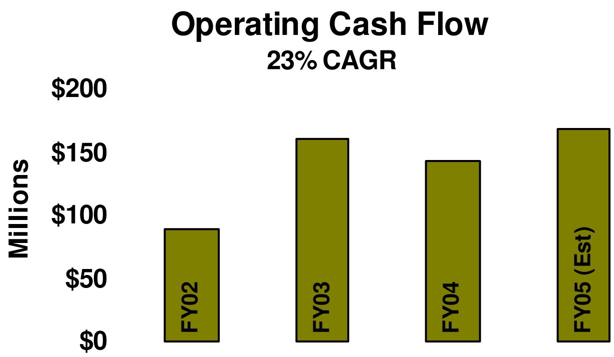


Cash Flow and Capital Expenditures (Capex)

The company expects to spend about $89 million for new and relocated stores during FY05. Since they generated $143 million in operating cash flow during FY04 -- and we expect them to generate another $169 million in FY05 -- we don't foresee any cash flow or capex problems going forward. The company has access to a $50 million credit facility, but has not borrowed against it. The company also carries no long-term debt.

Stock Repurchases: A Positive Sign

During FY04, the company repurchased about 5.3 million shares of its stock for about $110 million. The Board of Directors had authorized purchases up to $125 million. In May 2005, the Board authorized another repurchase for $100 million.



Repurchases improve shareholder value by reducing outstanding shares. Plus, they are a positive signal from management about the company's future prospects. With PacSun's ample resources, we view these repurchases as a positive move.

A Note about PacSun's Accounting Restatements

During December, 2004, the company initiated a review of its lease accounting practices and found that some of its practices regarding rent holiday periods and landlord incentives were incorrect. As a result the company has restated key financial data From FY00 to the current period. The restatements did not have a material effect on the company's bottom-line for the restated periods. As a result, the restatements are not a worry to us. Deloitte & Touche gave the company's financial an unqualified ("clean") opinion on their 10-K dated April 5, 2005.

Valuation Details

Pacific Sunwear
Key Financial Data
In Thousands except per Share Data

	FY00	FY01	FY02	FY03	FY04	FY05
Revenue	589,707	685,352	847,150	1,041,456	1,229,762	1,408,054
Cost of Goods Sold	388,317	459,364	554,829	668,807	781,828	895,319
Gross Margin	201,390	225,988	292,321	372,649	447,934	512,735
Selling, General, and Admin. Exp.	137,767	181,717	211,101	244,422	277,921	312,182
Operating Income	63,623	44,271	81,220	128,227	170,013	200,553
Int Inc (Exp)	1,344	470	-594	732	1,889	1,086
Income before Income Tax Exp.	64,967	44,741	80,626	128,959	171,902	201,639
Income Tax Exp.	25,213	17,182	30,960	48,759	64,998	67,109
Net Income	39,754	27,559	49,666	80,200	106,904	134,530
EPS Fully Diluted	0.54	0.37	0.66	1.02	1.38	1.80
Shares Out. Fully Dil.	73,234,000	74,488,000	75,147,000	78,850,000	77,464,000	74,579,000
Revenue Margin	100%	100%	100%	100%	100%	100%
Cost of Goods Sold	66%	67%	65%	64%	64%	64%
Gross Margin	34%	33%	35%	36%	36%	36%
Selling, General, and Admin. Exp.	23%	27%	25%	23%	23%	22%
Operating Income	11%	6%	10%	12%	14%	14%
Int Inc (Exp)	0%	0%	0%	0%	0%	0%
Income before Income Tax Exp.	11%	7%	10%	12%	14%	14%
Income Tax Exp.	4%	3%	4%	5%	5%	5%
Net Income	7%	4%	6%	8%	9%	10%
Revenue Growth	35%	16%	24%	23%	18%	14%
Comp Sales/Rev Growth	10%	-15%	41%	57%	40%	48%
Operating Cash Flow			89,488	161,004	143,012	168,967
CF/Sales			0.11	0.15	0.12	0.12
CF/Share			1.19	2.04	1.85	2.27
Stores open at period end	589	718	791	877	990	1,110
Stores Sq Ft	1,764,123	2,319,149	2,647,343	2,996,635	3,447,850	3,865,771
Avg Sales per Store (000)	1,082	1,031	1,102	1,229	1,290	1,269
Avg Sales per Sq Ft	368	321	330	363	374	364.24
Comp Sales	3.5%	-2.5%	9.7%	13.1%	7.3%	7.0%
Sales/Share						18.88
Capex (000)	77,398	108,065	53,288	49,568	81,992	89,000
Working Capital	79,799	78,899	109,305	242,992	257,508	
Total Assets	318,629	413,173	469,993	644,487	677,788	
Long-term Debt	0	24,597	1,102	228	0	
Shareholders' Equity	213,131	247,949	302,373	428,732	458,034	

Beginnings: A Newport Beach Surf Shop

1980s

Pacific Sunwear -- incorporated in August 1982 -- began as a little surf shop in 1980 Newport Beach, California. It wasn't called Pacific Sunwear then and wasn't that much different from the other surf shops selling surfboards and wax.

All that changed when Tom Moore and another surfing buddy decided to take their ideas to where their customers could avoid the typically cool Southern California winters: The Mall. In 1981, the company opened its fist mall location in Santa Monica Place. Soon after seven more mall stores opened up and down the coast in places like Torrance, Thousand Oaks, and West Los Angeles. By 1987, Pacific Sunwear boasted 21 stores.

Meanwhile, surf-inspired clothing brands -- like Gotcha, CatchIt, and Quicksilver -- were springing up all over Orange County, California. The momentum was building. Then one day a guy walked into a PacSun store with an arm load of super-long board shorts. They were snatched up before they were out of the box and the brand -- Billabong -- was on its way to becoming a surf apparel icon.

The company expanded outside California in 1989 and ran into problems: Southern California surf brands -- mainly t-shirts and shorts -- didn't fit too well with East Coast winters. The company -- and its vendors -- adjusted, moving into long pants and sleeves.

1990s

Pants and t-shirts took off and so did PacSun. Skate brands like Gypsys & Thieves and Vision came along. Fresh Jive launched baggy jeans and the company introduced private brands like Island Force, Diversion and Shotts.

The company hired former Eddie Bauer head Michael Rayden in 1990 as CEO. In 1993, the company went public with 60 stores under its belt. Expansion was rapid after that with the company adding about 50 new stores each year. In 1996, Rayden left and was replaced by Greg Weaver, who now serves the company as Executive Chairman.

In 1997, the company opened its first non-mall store in New York's Greenwich Village. In 1998, the company opened a dozen d.e.m.o. stores, targeting the hip hop inspired urban lifestyle.

2000s

By 2000, the company launched the PacSun credit card and was selling its clothes on line. The company hired industry veteran Seth Johnson in November, 2004 and was promoted to CEO in April, 2005. Weaver remains as Executive Chairman of the company.

Management

Greg H. Weaver, Executive Chairman

Greg H. Weaver has served as Chairman of the Board since October 1997, as Chief Executive Officer since October 1996 and as a member of the Board of Directors since February 1996. Effective April 1, 2005, Mr. Weaver will serve as Executive Chairman of the Board and will no longer retain the title of Chief Executive Officer. He joined the Company in July 1987 as Vice President of Stores and was promoted many times during his tenure at Pacific Sunwear, holding the titles of Senior Vice President, Executive Vice President, Chief Operating Officer and President until he ascended to his current position. Prior to joining the Company, he was employed for 13 years by Jaeger Sportswear Ltd. in both operational and merchandising capacities for the U.S. and Canadian stores.

Seth R. Johnson, Chief Executive Officer

Seth R. Johnson joined the Company in November 2004 as Chief Operating Officer and a member of the Board of Directors. He assumed the role of Chief Executive Officer beginning April 1, 2005. Prior to joining the Company, he was employed for 12 years by Abercrombie & Fitch, most recently as Chief Operating Officer and a member of their Board of Directors. Prior retail experience included employment at The Limited, BATUS Retail Group and Dayton Hudson, Inc. during a retail career that has spanned 26 years.

Gerald M. Chaney, Chief Financial Officer

Gerald M. Chaney joined the Company in December 2004 as Senior Vice President and Chief Financial Officer. Prior to joining the Company, he most recently served as Chief Financial Officer of Polo Ralph Lauren since November 2000. Prior to that, Mr. Chaney served as Chief Financial Officer of Kellwood Company, Senior Vice President of Administration and Chief Financial Officer of Petrie Retail, Senior Vice President of Operations and Chief Financial Officer at Crystal Brands, and held Director of Finance and Vice President of Finance roles at General Mills Fashion Group and Scott Paper.

Thomas M. Kennedy, President of PacSun

Thomas M. Kennedy joined the Company in May 2004 as Division President of PacSun. In this position, he has responsibility for all merchandising, design and marketing of the PacSun division. Mr. Kennedy has more than 19 years experience in the retail and apparel industries, most recently as Vice President of Global Lifestyle Apparel at Nike, Inc. Prior to that, Mr. Kennedy served in various merchandising positions in roles of increased responsibility, including Buyer, Merchandise Manager, Divisional Merchandise Manager, and Vice President of Men’s Apparel, at The Gap, Inc. from March 1993 to May 2001 at both Gap and Old Navy.

Tim Harmon Retires

Timothy M. Harmon -- who served as President and Chief Merchandising Officer since November 1997 -- retired from the company on July 1, 2005. He joined the Company in September 1991 as Vice President of Merchandising and was promoted three times during his tenure, holding the titles of Senior Vice President and Executive Vice President of Merchandising. Prior to joining the Company, he was Vice President and General Manager of Wide-World MTV Sportswear from 1990 to 1991 and was Vice President and General Manager, Women's Division, of Chauvin International from 1986 to 1990. Prior to that, he served in various merchandising positions at Anchor Blue and at several department stores during a retail career that has spanned over 20 years.

Stores and Products

PacSun Stores Reach Far and Deep

From 11 stores in California in 1986 to 990 the stores across the U.S. as of the end of FY04, PacSun has undertaken aggressive, but manageable, store expansion. Here's a breakdown by state ...

PacSun Stores Reach Far and Deep

	PacSun	Outlets	d.e.m.o.	Total		PacSun	Outlets	d.e.m.o.	Total
Alabama	11	2		13	Nebraska	4			4
Alaska	3		3	6	Nevada	5	2	2	9
Arizona	15	2	3	20	New Hampshire	5	1	1	7
Arkansas	2			2	New Jersey	21	3	7	31
California	83	16	35	134	New Mexico	7		1	8
Colorado	15	3	2	20	New York	35	6	9	50
Connecticut	10		4	14	North Carolina	20	2	3	25
Delaware	3	1	1	5	North Dakota	4			4
Florida	55	6	15	76	Ohio	33	2	5	40
Georgia	21	1	6	28	Oklahoma	5			5
Hawaii	7		1	8	Oregon	8	2	2	12
Idaho	4			4	Pennsylvania	42	4	7	53
Illinois	23	2	8	33	Rhode Island	2			2
Indiana	15	2	3	20	South Carolina	12	2	4	18
Iowa	9			9	South Dakota	2			2
Kansas	7			7	Tennessee	10	2	1	13
Kentucky	8		1	9	Texas	50	4	6	60
Louisiana	10		4	14	Utah	10	1		11
Maine	2	2	1	5	Vermont	3	1		4
Maryland	14	2	4	20	Virginia	20	2	5	27
Massachusetts	20	1	4	25	Washington	20	1		21
Michigan	24	3	7	34	West Virginia	7			7
Minnesota	14	1	3	18	Wisconsin	14			14
Mississippi	3			3	Wyoming	2			2
Missouri	11	3	1	15	Puerto Rico	10	2	3	15
Montana	4			4					
Total	**744**	**84**	**162**	**990**					

As you can see, PacSun's reach is widespread and deep. Highest store concentrations are in typically surf-friendly states like California, Florida, and Texas. But the company demonstrates good penetration in markets far from surf-friendly venues, such as Pennsylvania, New York, and Michigan. That's a key sign that the company's marketing and product mix are flexible enough to appeal to teens and young adults in just about any location. In fact, the company has six stores in Alaska.

Store Expansion Continues

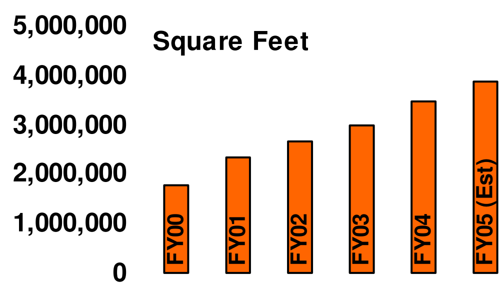
During FY04, the company opened 113 net stores and plans to open another 120 net new stores during FY05, capping a string of store expansions:

As of the end of FQ105, the company operated 1,013 stores, on pace to meet its 1,110 goal by the end of FY05. As of the end of FY04, the company has successfully executed about 70% of the leases needed to meet that goal.

Store Selection Strategy

PacSun select store locations in high-traffic, regional malls that meet criteria for proper population density and household income. Also considered are the mall's sales, performance of other retailers serving teens and young adults, costs, and anchor tenants.

For PacSun and PacSun Outlets, target sizes are 4,000 square feet. For d.e.m.o. stores, target sizes are 3,000 square feet.



Store Operations

The company's stores are open during normal mall business hours. Stores are staffed with a store manager, one or more assistants, and between 6 and 12 part-time associates. District managers supervise 7 to 12 stores and regional directors supervise about 6 to 19 district managers. The company utilizes extensive training programs with significant emphasis on loss prevention. In fact, since 1991 inventory shrinkage is just 0.6% or less of net sales at cost.

New Store Concept and Format

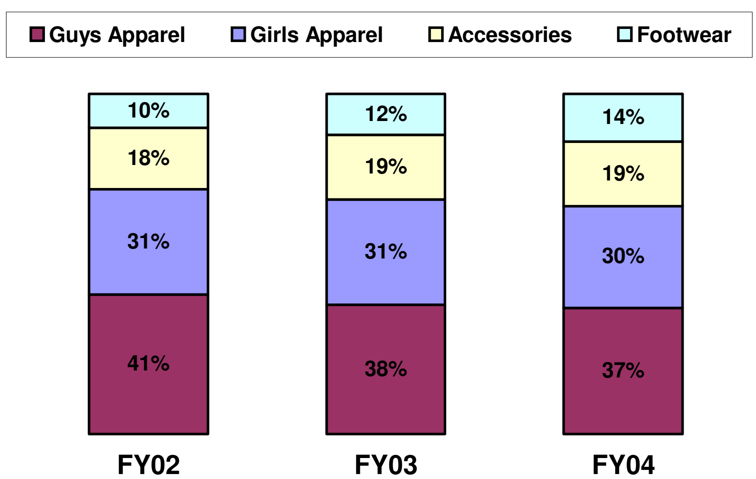
During FY05, the company plans to launch an entirely new store concept. In addition, in July the company will test 3 larger (7,500-9,000 square feet) format PacSun stores.

Merchandising: A Good Mix

PacSun and PacSun Outlets offer a broad array of board-inspired casual apparel, accessories, and footwear. d.e.m.o. stores offer a similar array of hip-hop inspired products. Both store concepts want to be the dominant "lifestyle" retailer for men ("boys") and women ("girls") roughly between the ages of 12 and 24.

The company offers many of the biggest brand names around. For PacSun, that includes Quiksilver/Roxy/DC Shoes, Billabong/Element, Hurley and Volcom. For d.e.m.o., their brand names boast such labels as Ecko, Phat Farm/Baby Phat, and Apple Bottoms.

PacSun's Product Mix



The company limits its significant vendor concentrations. During FY04, Quiksilver made up 10.9% of sales and Billabong accounted for 9.4%. No other branded vendor made up more than 4%, which is a big positive.

Proprietary Brands are Key

The company enhances its branded vendor offerings with its own proprietary brands. PacSun's proprietary brands ...

- Typically carry higher margins than vendor products
- Offer better merchandise flow-control
- Broaden customer reach with comparable quality products at lower prices
- Give management improved agility to respond to shifting styles and tastes

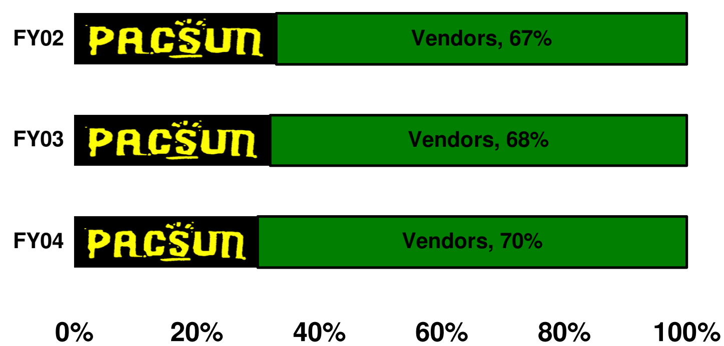
The company uses an in-house design group that, along with the company's buyers, design proprietary merchandise. The company sources its proprietary brand manufacturing both domestically and internationally. The company requires-quality products, production reliability and fit consistency with its sourcing manufacturers.

PacSun Builds Vendor Relationships

The company encourages strong vendor relationships that share a common controlled distribution and merchandise development strategy. Typically, these vendors cater to small boutiques, specialty retailers, and select department stores.

PacSun freely exchanges fashion and trend ideas with its vendors so that product mixes are kept fresh and current. With certain vendors, the company may suggest design and fabrication ideas in order to capitalize on growing or emerging markets.

Proprietary and Vendor Brand Mix



Buying and Distribution

The company's buyers are tasked with maintaining and developing existing and new merchandise lines, targeting emerging fashion trends and concepts, and selecting vendor and proprietary brand merchandise in sufficient quantities, colors, and styles. The company maintains an inventory control function charged with the planning and allocation of inventory levels, supported by information system management.

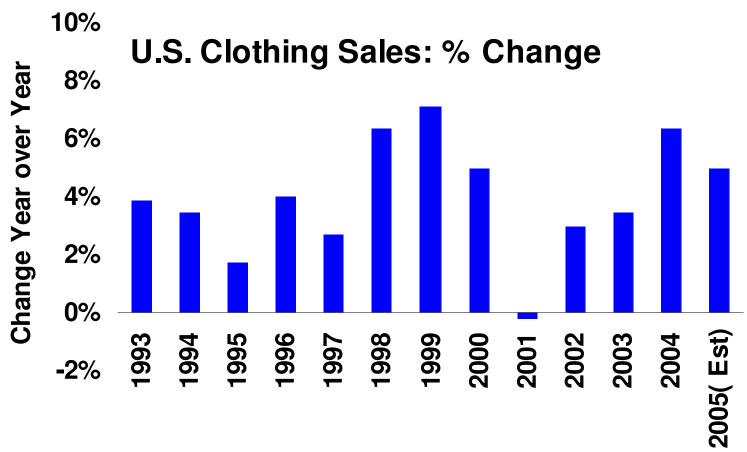
The company maintains a single distribution facility in Anaheim, California where product is centrally received from vendors and centrally allocated to stores or shipped to internet customers. Merchandise is typically shipped to stores 3 to 5 times per week using national and regional carriers.

Market Opportunity

U.S. Clothing: A $199 Billion Market

Clothing sales in the U.S. tipped the scales at $190 billion during 2004. That's a 6.4% increase over 2003 and marks a solid reversal from the bleak days of 2001. In 2005, we expect the trend to continue, albeit at a more moderate 5% pace, and increase the U.S. clothing market to $199 billion. Currently, teens spend about $21 billion on clothing, according to the NPD Group. So, from both a broad and focused perspective, PacSun has a massive market opportunity.

Successful Surf-related IPOs



Also providing lift to the market is the recent successful debuts of surfwear-maker Volcom and extreme sports retailer Zumiez. In fact, the extreme sports space -- once only a niche market -- is quickly becoming a burgeoning mainstream play. And apparel -- rather than hardlines like boards and equipment -- are likely going to lead the charge.

Economic Fundamentals are Positive

Providing market support are considerable, but not super-hot, growth rates for GDP and consumption, currently 3.8% and 3.6% respectively. In fact, consumption currently stands at a staggering $7.8 trillion.

Of course, these growth numbers aren't carved in stone and are subject to loads of risks. These include a significant slow-down in U.S. economic growth, the soaring price of oil, continuing interest-rate tightening from the Federal Reserve board, and the on-going unrest in the Middle East and elsewhere.

PacSun's Growth Strategy

PacSun's primary goal is simple: Become the leading lifestyle retailer of casual fashion for teens and young adults. The company offers apparel, footwear, and accessories for young men and women between the ages of 12 and 24. In essence, PacSun wants to offer a complete wardrobe solution for young people wanting to stay ahead of board-sport inspired fashion trends. And so far, the company has had considerable success achieving this broad goal. To continue that trend, the company's growth strategy includes ...

Market Name Brands and Proprietary Brands

Through the company's three store formats -- PacSun, PacSun Outlet, and d.e.m.o. -- the company offers a carefully chosen array of popular name brands as well as its own proprietary, higher margin private brands. The company's merchandising choices differentiates it from other stores where either name brands or proprietary brands dominate offerings. The company also seeks to stay focused on its age and lifestyle markets: Young people with board-sport inspired lifestyles.

Promote the Company's Brand Images

The company promotes its PacSun and d.e.m.o. brands primarily through national print advertising in major magazines marketed to teens and young adults. The company also maintains websites that promote both brands. And the PacSun website goes even a step further by adding board-sport inspired lifestyle content areas that feature music, downloads, and contests. The ads and websites are lively, well-conceived, and appropriate for the company's target markets. The company also promotes its brands through a third-party credit card.

Discover Merchandise Trends

The company focuses more on trend discovery than promoting the latest fad. To do so, it uses a wide array of techniques, including focus groups, feedback from customers, feedback from store employees, new merchandise tests, and close relationships with vendors and other sourcing relationships. As a result, the company is able to respond effectively to emerging and changing trends and adjust their name brands and proprietary brands mixes accordingly.

Promote Outstanding Vendor Relationships

Vendor relationships are key for any retailer and PacSun is no different. Through its size and scope, the company offers a rich and enticing distribution channel for vendors. In addition, the company is the largest customer to many of its vendors. As a result, PacSun and its vendors work together to capitalize on emerging fashion trends and respond quickly to shifts in the often fickle space. In addition, these powerful relationships mean vendors can supply PacSun with "exclusives" -- merchandise not found at any other retailer.

Provide Outstanding Customer Service

PacSun discovered early on that treating teens with the same level of respect offered their adult counterparts was really good for business. That strategy continues to this day. Customer service is friendly, professional, but not pushy. The company trains its employees to greet each customer, give courteous and meaningful service, and thank the customer for the sale. Store employees stay away from giving a lot of unsolicited advise.

Offer A Lively Shopping Experience

PacSun and d.e.m.o. stores offer shoppers a lively and engaging shopping experience. Merchandise is well organized and displayed effectively with good logo-driven signage. The stores offer a lively, friendly, and social atmosphere with appropriate background music that appeals to young people as well as adults. The shopping experience is pleasant and comfortable.

Expand New Stores, New Format

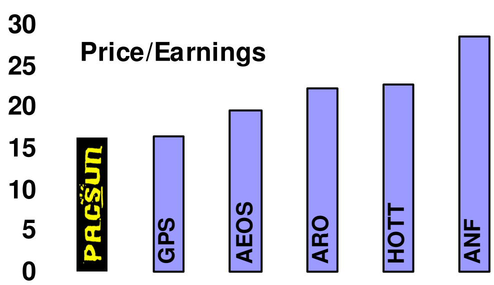
The company plans to continue manageable store growth over the next three years. As of the end FQ105 the company operated 1,013 stores, including 754 PacSun stores, 86 PacSun Outlets, and 173 d.e.m.o. stores. By the end of FY05, the company should have about 1,110 stores in operation. In addition, the company plans to open a fourth store format and test 3 large-format PacSun stores during FY05.

Continue Selling Merchandise Over The Internet

The company sells merchandise for its PacSun and d.e.m.o. concepts through two websites -- www.pacsun.com and www.demostores.com. In addition, the company markets to emails collected from the sites. The website is marketed through internet portals, search engines, in-store signage, merchandise bags, and receipts. The company's internet strategy benefits from a typically internet-savvy market and a strong brand. In addition, customers can return internet-purchased merchandise to their local store, a big plus for customer service.

Competition is Fierce

The retail apparel business is highly competitive. The company's store concepts -- including PacSun, PacSun Outlets, and d.e.m.o. -- compete with national chains, department stores, and local merchants that sell the same and similar merchandise. However, the space narrows considerably when you look at competitors that have a similar mall-based presence, target the teen/young adult apparel market, and have similar resources.



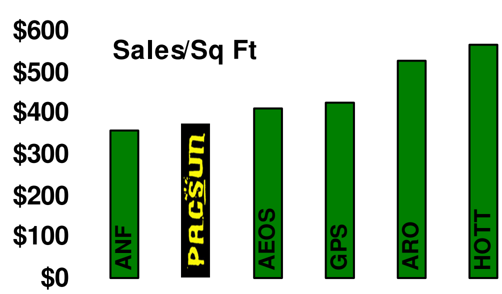
Given the competitive space, PacSun is the dominant player in the board-sport inspired apparel business. In fact, it's relatively pure "board-sport lifestyle" focus, large mall presence, and outstanding operations give it an edge over many of its competitors. These key competitors include ...

Abercrombie and Fitch

Abercrombie & Fitch Co. sells apparel, accessories, and footwear to men, women, teens, and kids. The company operates four different mall-based store concepts: Abercrombie & Fitch, abercrombie, Hollister Co., and RUEHL . As of the end of FY04, the company operated 788 stores in 49 states. The company promotes a "casual luxury" theme among its brands and stores. www.abercrombie.com.

Aeropostale

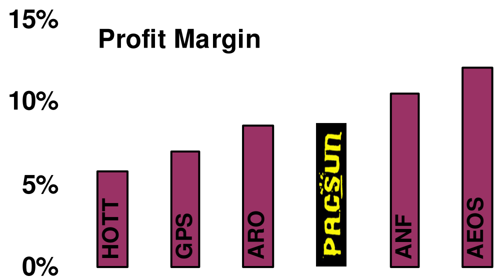
Aeropostale, Inc. is a mall-based casual apparel retailer. The company sells its own brand of merchandise targeting young men and women between 11 and 18. As of the end of FY04, the company operated 561 stores. www.aeropostale.com.



American Eagle Outfitters

American Eagle Outfitters designs and markets casual clothing through its mall-based store operations. The company targets men and women between 15 and 25 and wants to become the "true destination source" for jeans. As of the end of FY04, the company operated 846 stores. www.ae.com.

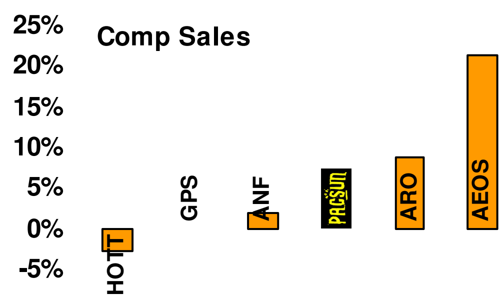
Gap



By far the largest in the space, Gap operates mall-based specialty stores through a variety of store concepts and brands, including Gap, Banana Republic, and Old Navy. The company sells casual apparel, accessories, and personal care items. As of the end of FY04, the company operated 2,994 stores. www.gap.com.

Hot Topic

Hot Topic is a mall-based apparel and accessory retailer operating through two store concepts: Hot Topic and Torrid, which caters to plus-size young women. The company's merchandizing draws its roots from contemporary, punk-inspired music and culture. As of the end of FY04, the company operated 592 stores. www.hottopic.com.



Competition Financial Highlights

Company	Pacific Sunwear	Abercrombie & Fitch	Aeropostale
Symbol	**PSUN**	ANF	ARO
Recent Price	**$23**	$69	$33
Market Cap	**$1,730 Mil**	$5,980 Mil	$1,860 Mil
Price/Earnings*	**16.1**	28.4	22.1
Price/Sales*	**1.4**	2.7	1.8
Profit Margin*	**8.7%**	10.5%	8.6%
Revenue*	**$1,260 Mil**	$2,160 Mil	$1,010 Mil
Net Income*	**$110 Mil**	$227 Mil	$86 Mil
EPS - Diluted*	**$1.43**	$2.44	$1.52
Cash**	**$161 Mil**	$314 Mil	$177 Mil
Debt**	**$0**	$0	$0
Cash Flow Oper*	**$171 Mil**	$388 Mil	$157 Mil
Avg Vol (3 Mo)	**1.8 Mil**	1.8 Mil	1.2 Mil
Shares Out	**75 Mil**	86 Mil	55 Mil
Stores***	**990**	788	561
Sales/Sq Ft***	**$374**	$360	$526
Comp Sales	**7.3%**	2.0%	8.7%

*Trailing 12 Mo **Most Recent Qtr ***FY04

Company	American Eagle Outfitters	Gap	Hot Topic
Symbol	AEOS	GPS	HOTT
Recent Price	$31	$19	$19
Market Cap	$4,790 Mil	$17,880 Mil	$859 Mil
Price/Earnings*	19.5	16.5	22.8
Price/Sales*	2.4	1.1	1.3
Profit Margin*	12.1%	7.0%	5.8%
Revenue*	$2,000 Mil	$16,230 Mil	$678 Mil
Net Income*	$252 Mil	$1,130 Mil	$39 Mil
EPS - Diluted*	$1.59	$1.20	$0.84
Cash**	$561 Mil	$2,610 Mil	$56 Mil
Debt**	$0	$513	$0
Cash Flow Oper*	$387 Mil	$1,680 Mil	$71 Mil
Avg Vol (3 Mo)	2.6 Mil	4.6 Mil	1.3 Mil
Shares Out	154 Mil	902 Mil	45 Mil
Stores***	846	2,994	592
Sales/Sq Ft***	$412	$428	$568
Comp Sales	21.4%	0.0%	-2.9%

*Trailing 12 Mo **Most Recent Qtr ***FY04

Risks

Merchandise and Fashion Sensitivity

The company's success is tied to its ability to predict and respond to fashion trends in the often fickle teen fashion space. The company's failure to manage these trends and respond accordingly with an effective merchandise mix could have a substantial effect on its operations and profitability.

Vendor Limitations and Concentrations

Some of the company's vendors have limited resources and production capabilities while others limit the amount of product they'll sell to the company. These factors could limit the company's ability to respond to changes in the retail environment. Plus, the company has two significant vendor concentrations: As of the end of FY04, Quiksilver and Billabong accounted for 10.9% and 9.4% of the company's net sales respectively.

Planned Expansion

The company's on-going success depends on its ability to grow by opening new stores and expanding its operations. That expansion is dependent upon the company's ability to acquire favorable mall sites, stock the stores properly, hire the right people, and pay for build-out. Should the company fail to accomplish these goals, profitability and operations could be adversely effected.

Economic Factors

Adverse economic conditions -- including poor economic growth and consumer spending -- could effect the company's ability to expand operations and provide goods at a decent profit margin.

New Retail Concept

The company plans to launch a new retail concept during FY06. The ability of the company to make this new retail concept a success is exposed to a number of potential problems, including an inability to properly gauge the target market, inability to create the proper vendor relationships, and competition from other retailers. Plus, the new concept could strain capital resources and distract management from the company's current operations.

Proprietary Brand Merchandise

The company's proprietary brands comprise a significant portion of total sales and typically carry higher margins. As a result, should the company's ability to expand its own brands deteriorate, profitability and operating margins could be adversely effected.

Comparable Store Sales

Comparable same store sales may fluctuate widely on a monthly, quarterly, and annual basis. Reasons behind this include fashion trend changes, changes in holiday periods, competition, weather, and general economic conditions. As a result, the capital markets' response may cause significant volatility in the company's stock price.

Retain Key Personnel

The company's inability to attract and retail qualified personnel at all levels of the organization could adversely effect the company's business, financial condition, and future prospects.

Single Distribution Facility

The company's distribution function is managed through a single facility in Anaheim, California. Any problems with this facility -- including accidents and system failures -- could have an adverse effect on the company's operations.

Foreign Production Sources

The company and its vendors buy merchandise in foreign markets. As a result, the company is exposed to existing and potential import quotas, tariffs, and duties. In addition, the company maintains no long-term supply contracts.

Credit Facility Covenants

Poor operating results could mean the company cannot meet certain financial performance metrics required by its credit facility. If these metrics are not achieved, the balance under the credit facility could be immediately due and payable.

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J. Wayne Burritt, President & Director of Research

Wayne has over 24 years of experience in financial analysis, investment analysis, and business development. Before starting Burritt Research, Inc. Wayne was a senior equity research analyst and editor for Weiss Research, a nationally acclaimed independent research and advisory firm. He directed all fundamental and editorial aspects of a variety of domestic and international option and stock services. In addition, Wayne designed, developed, and maintained proprietary information systems for the firm's research efforts. He also collaborated on the successful design and delivery of stock research reports based on in-house ratings of over 6,000 securities. Prior to his tenure at Weiss, Wayne was an equity analyst, marketing and trading specialist for Pan-American Financial Advisers, a boutique investment management firm. In that capacity, he provided security analysis, marketing support, and trading services for a large portfolio team engaging institutional and high net worth clients. Wayne also produced and starred in the critically acclaimed stock market radio show Inside the Market while at Pan-American Financial. Wayne has also held positions as Managing Director, Senior Credit Analyst, and Controller. He holds an MBA from Golden Gate University and a BA in English and Philosophy from Indiana University.

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