BURRITT | RESEARCH

Independent Equity Research

July 5, 2005

PROFILE RESEARCH REPORT

Pacific Sunwear of California, Inc. (PSUN)

Rating: Buy/4

J. Wayne Burritt, President and Director of Research
Burritt Research, Inc.
wburritt@burrittresearch.com
561-842-4689

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

Investment 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 include ...

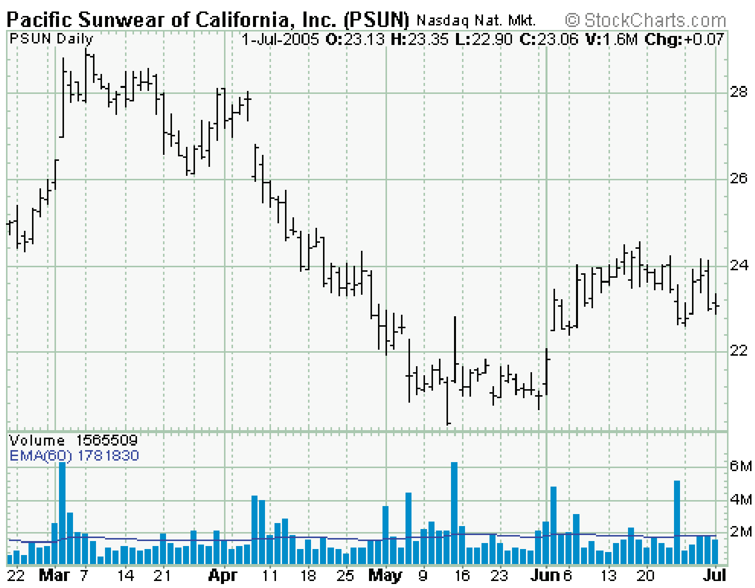
- **Proven Success.** The company is the dominant player in the board-sport inspired retail apparel market with 4 year historical CAGRs (compound annual growth rates) of 20% sales, 28% operating income, and 28% net income.
- **Good Store Expansion.** The company is on track to have 1,110 stores and 3.9 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.
- **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.
- **Great Brands.** 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.
- **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.

Table of Contents

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.

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.

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.

Store Expansion Continues

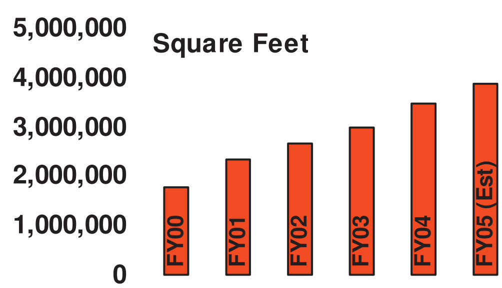
During FY04, the company opened 113 net stores and plans to open another 120 net new stores during FY05, capping a string of store expansions:

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.

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

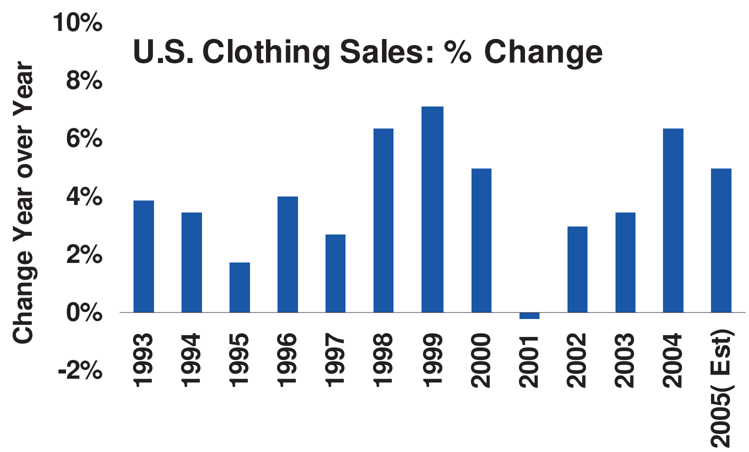
The company uses an in-house design group that, along with the company's buyers, design proprietary merchandise. The company sources its proprietary brand manufacturing both domestically and internationally. The company requires-quality products, production reliability and fit consistency with its sourcing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

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.

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.

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.

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.

Contact Information

Corporate Address

Pacific Sunwear
3450 East Miraloma Avenue
Anaheim, CA 92806-2101
(714) 414-4000

Website

www.pacsun.com

Disclosures

The information and opinions contained in the website and reports of Burritt Research, Inc. (BRI) are solely for informational purposes. If BRI reports include ratings and/or targets they are intended only as our estimates of a company's value, not as recommendations or stock price predictors. Our primary research responsibility is to the investor, not the covered company. The factual statements are taken from sources we believe to be reliable but we in no way warrant or assume responsibility for their accuracy or completeness. The information contained herein is subject to change without notice. BRI is not a Registered Investment Advisor or a Broker/Dealer. These reports are not intended to be construed as an offering or a solicitation of an offer to buy or sell the securities mentioned or discussed. Investing in securities – particularly small cap securities – can be speculative and risky. Users of these reports are responsible for their own trading and investment decisions. We encourage our users to do their own due diligence and research regarding our covered companies while keeping in mind their own objectives and risk tolerance.

Burritt Research, Inc. may use informational sources that may contain forward-looking statements. Forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks and uncertainties, which may cause a company's actual results in the future periods to differ materially from forecasted results. These risks and uncertainties include, among other things, product price volatility, product demand, market competition and risk inherent in the companies operations. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as “expects,” “anticipates,” “plans,” “believes,” “scheduled,” “estimates” and variations of these words and other words and terms of similar meaning in connection with any discussion of future operating or financial performance.

The information provided by Burritt Research, Inc. is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject us to any registration requirement within such jurisdiction or country.

Burritt Research, Inc. is typically paid $24,500 for an Institutional Report, $12,500 for a Profile Report, and $7,500 for a Snapshot Report. Our fees are paid in advance in cash. We accept no equity, debt, or other performance-related compensation. Plus, our analysts are barred from trading in any covered company’s securities for the coverage duration. BRI complies with the letter and spirit of SEC Rule 17(b).

Burritt Research, Inc. was not compensated for this report.

Burritt Research, Inc. is a voting member of the FIRST Research Consortium, the "gold standard" for independent research ethics and standards. For more information about these standards, please visit www.burrittresearch.com/standards.htm.

Analyst Certification

I, J. Wayne Burritt, hereby certify that I have prepared this report, and the content within it, including all opinions, are solely my own.

About Burritt Research, Inc. (BRI)

Burritt Research, Inc. (BRI) is an independent equity research firm headquartered in Palm Beach, Florida. The company provides first-class, institutional quality research for small cap companies. These research solutions are prepaid by the firm's covered companies – similar to the Standard & Poor's model -- and are offered free to investors. BRI distributes its reports through a rich network of contacts and its covered companies can be listed on any of the major US stock exchanges. The firm is headed by industry veteran, J. Wayne Burritt.

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.

Contact BRI

Burritt Research, Inc.
810 Lake Shore Dr. #29
Lake Park, Florida 33403
Tel. 561-842-4689
Fax 561-842-3181

Email info@burrittresearch.com
www.burrittresearch.com

Additional Report Copies

Additional copies of this report are free to all investors at www.burrittresearch.com.