Pacific Sunwear of California
Fallen Angel

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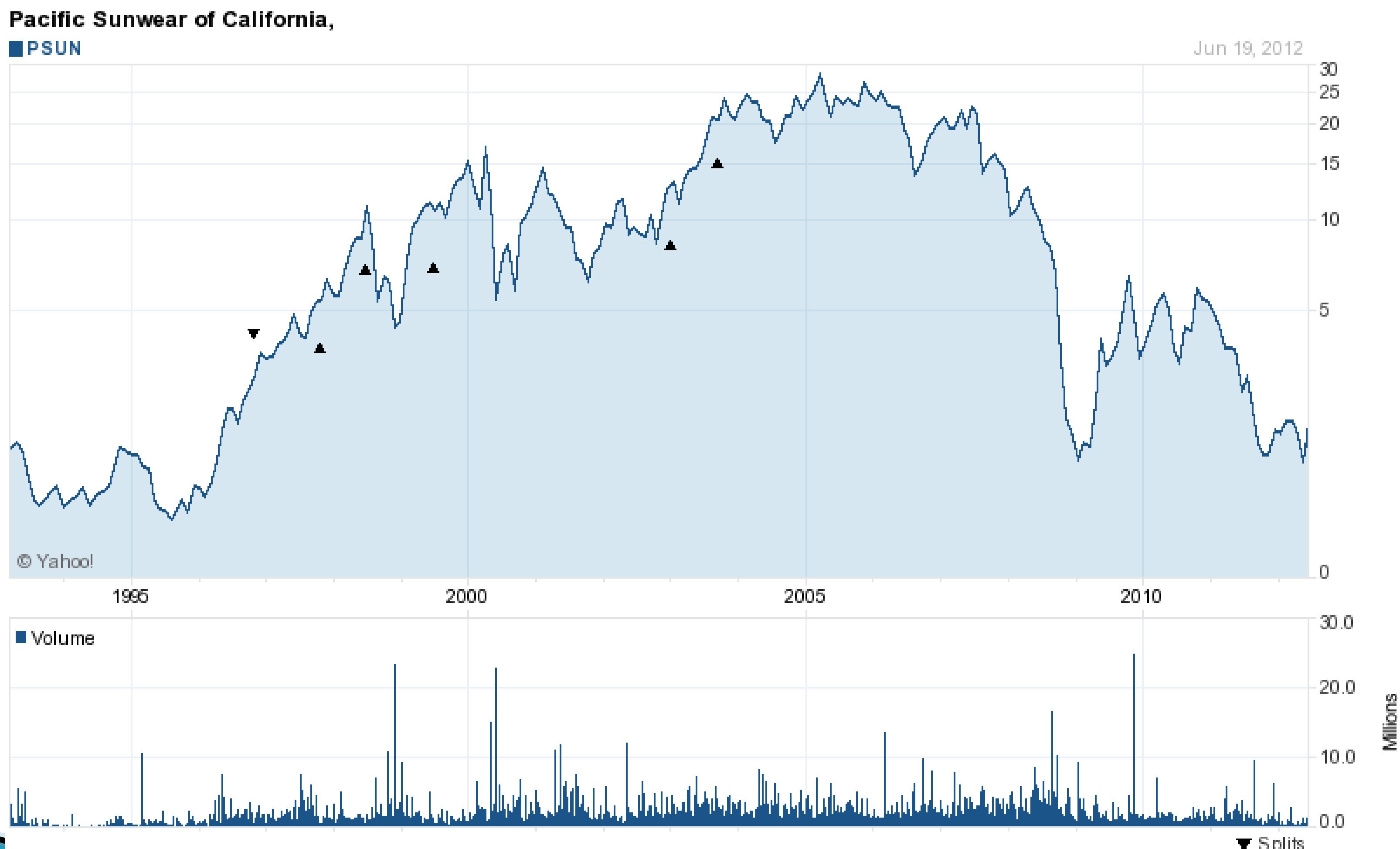
A Brief History

- Started as a surf shop in Newport Beach in 1980 with first mall-based store opened in 1981
- Went public in March 1993 and was one of the best performing stocks up to its peak in 2005
- Became dominate surf and skate retailer with over 965 store footprint in the U.S.
- Diversified business with two other store concepts – d.e.m.o. (hip hop retailer), One Thousand Steps (shoe and accessories)

What happened?

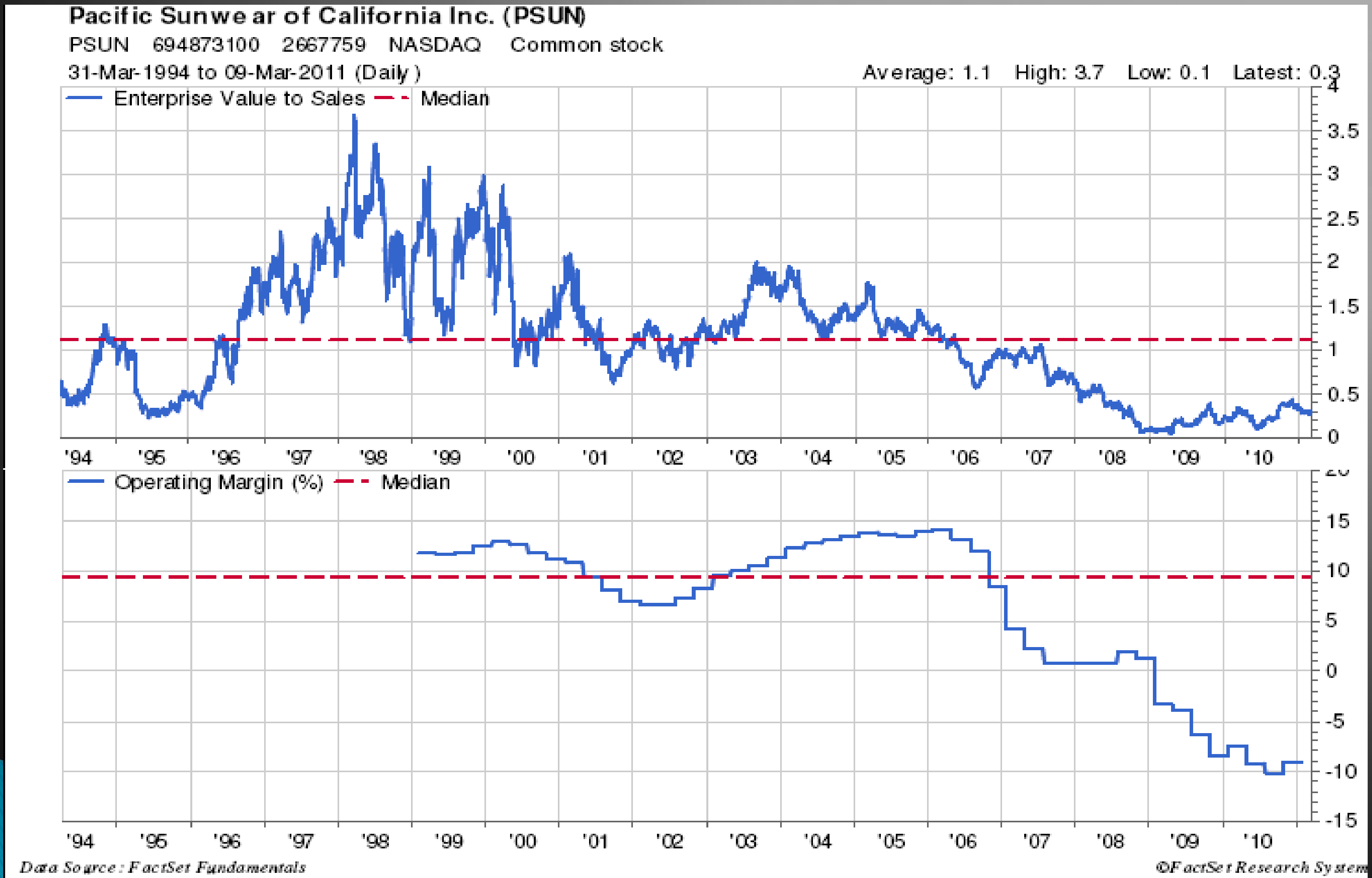


.....lots of things

- Victim of its own success
  - Management teams of high multiple, high growth stocks tend to emphasize growth over returns on equity
  - PSUN kept pushing growth in stores while ROIC was decreasing
  - Forgot who got who made them – neglected heritage brands over higher margin private label.
  - Branched off into unrelated store concepts – d.e.m.o, One Thousand Steps
  - Exited footwear – prior management underestimated correlation between footwear and men's apparel sales
  - New competitors aggressively entered the scene to capitalize on this space – Zumiez, Hollister

- Significant economic slowdown
  - Unveiled how poor the company had been managed in the previous 5 years
  - Sales declines highlighted bad real estate deals (occupancy costs 20%)

.....and valuations compress



Turnaround time

- New Management Team
  - CEO came in mid 2009 replaced most of senior management team by 2010
- Business strategy
  - Focus on heritage brands to get target customer (15-22 year old) reengaged
  - Improve organization and culture
  - Great products drive results -> men's focus on brands, women's revamp the whole deal (customer segmentation, merchandising, speed to market)
  - More intelligent use of market data to properly merchandise stores "localization"
  - Develop a coherent e-commerce strategy
  - Reintroduce footwear and accessories

Roadmap to profitability

- Increase the productivity of the stores
- Get the stores back to positive comps

Shrink to Success

Right-size the business

- Golden Gate Capital loans $60M to provide capital to close underperforming stores and to fund operations
- Store base going from 877 in 2010 to 570 by end of FY2013
- Closing 100-120 stores in 4Q2012
  - Average sales for lower performing stores is $600k vs. $1.1M company average
  - Higher productivity from existing stores will help drive improved gross margin
  - By FY 2013 cash should increase by $10-15M from reduction in inventory needs
  - This exits exposure to C & D properties with remaining 600 in A & B malls

Driving Positive Comps

- Revamp women's business – progress being made, core customer being reengaged
- Broaden out shoes and apparel (currently 425 stores) – men's footwear up 38% in 2011, women's up 42%
- Fine tune merchandising (localization) and e-commerce to drive further sales, optimize inventory needs, and strengthen relationship with customer
- Trending in right direction 2009 (-20%) 2010 (-8%) 2011 (-1%)

Risks

- Balance sheet not strong enough to withstand another two years like 2009 and 2010 without additional capital raise
- Can’t get women’s line right
- Customers move away from surf & skate genre

Some numbers

Price 5/20/2012	1.54
Diluted Shares OS*	67.5
Equity Value	101.79
Plus: LT Debt	74.181
Less: Cash	21.5
Enterprise Value	154.471
Current Ratio	1.5x
Debt/Equity	74%
TA/Equity	3.3x
Short Interest	18%

Analyst Recs	
Buys	1
Hold	8
Sell	1

	PSUN	Industry
P/B	1.1	4.3
P/S	0.23	1.1
P/E	N/A	19.2

Earnings Power

- 2001 store count equal to where management has outlined as part of the strategy
- Not an apples-to-apples comp – 2001 includes 101 demo stores/$900k rev store = total 665 stores
- Company was in hyper growth mode in 2001 (added 100+ new stores in 2002) GP should be higher for more mature stores
- Lots of levers to pull to drive margins – reduce headcount, better inventory management, upside to store revs from here as shoes/apparel added back, potential traffic gains from closed stores, greater e-commerce penetration, etc…

	2001	2011	2013
Sales	685.4	833	626
GP	226	180	200
SGA	181.7	255	165.8
Op Inc	44.3	-68.1	40.69
Total Stores	564	733	570
Avg Sales/Store	1049	1052	1100
Total Square Footage	2319	2862	2243
Avg Sales/sq ft	335.7	269	279.1
EPS	0.37	-0.77	0.50
GPM%	33	21.7	33
SGA%	26.5	30.6	26.5
OM%	6.5	-8.9	6.5
Total Employees	8100	9100	9100
Part-time	5400	6400	6400
Corp HQ	400	530	530
OS	74.85	66.7	81.1*
*incl GGC exer 13.5M shs			

.....but it's still a retail turnaround in crappy environment

- Several have a huge vested interest
  - GGC convert is at $1.75 for 13.5M shares
  - They have $60M of skin in the game
  - The "Greeks" have 30% of the outstanding shares at 2-3x current share price
  - They are still the preferred vendor – QZK, Volcom, etc… need these guys to stay around
- At .2 forward EV/Sales it's worth a look