FORM 10−K

PAYLESS SHOESOURCE INC /MO/ − PSS

Filed: April 25, 1997 (period: February 01, 1997)

Annual report which provides a comprehensive overview of the company for the past year

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark one)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended February 1, 1997
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______________ to ______________

Commission File Number 1-11633

PAYLESS SHOESOURCE, INC.
(Exact name of registrant as specified in its charter)

Missouri	48-0674097
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
3231 Southeast Sixth Street, Topeka, Kansas	66607-2207
(Address of principal executive offices)	(Zip Code)

(913) 233-5171
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	New York Stock Exchange
Preferred stock purchase rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ______

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [x]

The aggregate market value of registrant's common stock held by non-affiliates based on the closing price of $40.50 on April 14, 1997 was $1,616,745,218.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 39,919,635 shares of common stock, $.01 par value, as of April 14, 1997.

Documents incorporated by reference:
1. Portions of Registrant's 1996 Annual Report to Shareowners are incorporated into Part II.

2. Portions of Registrant's 1997 Proxy Statement for the Annual Meeting to be held on May 23, 1997, are incorporated into Part III.

PART I

Item 1. Business

General

Payless ShoeSource, Inc. ("Payless" or "Company") is the largest family footwear retailer in the United States with more than $2.3 billion in sales in 1996. The Company sold approximately 195 million pairs of shoes in 1996, and served more than 130 million customers.

As of February 1, 1997, the Company operated 4,236 Payless stores in 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. The Company's stores feature fashionable, quality footwear for men, women and children, including athletic, casual, dress, sandals, work boots and slippers.
Recent Developments

During 1996, the Company opened 171 new Payless stores and closed 484 Payless stores. The Company opened 4 new Payless stores in Alaska, the only state where the Company had not previously operated any facilities. The Company also announced the planned open market repurchase, pursuant to Rule 10b-18 of the Securities Exchange Act of 1934, of up to $150 million of common stock during 1997-98, contingent upon receipt of a favorable ruling from the Internal Revenue Service and market conditions. The favorable ruling was subsequently received on April 8, 1997. In addition, the Company completed a repurchase of 460,000 shares of its common stock in 1996. As discussed below, in late 1996 the Company initiated the purchase of the Parade of Shoes division of J. Baker, Inc., which consisted of 186 stores operating in 14 states. This transaction was consummated in March, 1997.

History

The Company was founded in Topeka, Kansas in 1956 with a strategy of selling low cost, high quality family footwear on a self-service basis. In 1962, Volume Distributors, as the Company was known at the time, became a public company and its shares were registered on the New York Stock Exchange. In 1979, the Company (then called

"Volume Shoe Corporation") was acquired by The May Department Stores Company of St. Louis, Missouri. The Company changed its name to Payless ShoeSource, Inc. in 1991. On May 4, 1996, Payless became an independent company as a result of its spin-off from The May Department Stores Company. Payless is traded on the New York Stock Exchange under the symbol "PSS."

Payless Stores

The average size of the Company's Payless stores is 3,400 square feet. Each store carries approximately 10,000 pairs of shoes and more than 600 styles. Payless stores operate in a variety of real estate venues formats, including shopping malls, central business districts, free-standing buildings and strip centers. Of the 4,236 Payless locations open at the end of fiscal 1996, 748 incorporated a concept called "Payless Kids" which consists of an additional approximately 1,000 square feet of selling space devoted to an expanded assortment of children's shoes. These stores are located throughout the country and include wider aisles, children-friendly seating and an entertainment center for children.

The Company's Payless stores operate successfully in rural, suburban and urban environments. The 10 states with the largest concentrations of the Company's Payless stores are identified below:

State	No. of Payless Stores
California	654
Texas	368
Florida	282
New York	267
Illinois	196
Pennsylvania	196
Ohio	187
Michigan	154
New Jersey	116
Washington	106
Other	1,712
Total	4,236

The Company's Payless stores are highly automated, each with an electronic point of sale register and a back office computer which not only records transactions from the register, but also serves many other store supporting functions including price look-up, accumulation of associate hours worked and communications with the Company's headquarters in Topeka, Kansas. Store associates receive regular weekly communications from the Company's headquarters describing promotional and display requirements.

The Company's Payless retail operations are directed centrally by a senior officer and small support staff. The retail operations organization is subdivided into six divisions headquartered in the cities of Atlanta, Baltimore, Chicago, Dallas, Denver and Los Angeles. Divisions are directed by a vice president, two to four operations directors and a small support staff.
Each Payless store has a manager and approximately five associates. The stores are organized into districts. District managers, to whom the store managers report, themselves report to the division offices and have full financial responsibility for the stores in their district. Division offices also have loss prevention and inventory control functions. Human resources, merchandising support and other more general support services, are provided from the Company's headquarters.

Parade of Shoes Stores

The Company's Parade of Shoes division, which was acquired in March, 1997, from J. Baker, Inc., of Canton, Massachusetts, emphasizes the retail sale of quality, primarily leather, women's shoes. The Company operates the 186 Parade of Shoes store chain as a division separate from the Payless chain. J. Baker reported sales for the chain of $123 million in 1996.

Parade of Shoes stores are self-service and feature fashionable women's dress, casual and athletic footwear priced in the $20 to $40/pair range. Major markets include Boston, New York City, Chicago, Philadelphia and Washington, D.C. The average size of a Parade of Shoes store is 2,300 square feet. These stores operate in a variety of real estate venues including shopping malls, central business districts, free-standing buildings and strip centers.

Employees

During 1996, the Company's average number of employees was approximately 24,000, including approximately 13,000 full-time associates and 11,000 part-time associates. Approximately 650 of the Company's distribution center associates are covered by collective bargaining agreements. Management believes it has a good relationship with all employees.

The Company is led by a team of senior management executives who have an average of 16 years of retail industry experience, including an average of eight years with the Company.

Products

The Company's Payless stores offer a broad assortment of fashionable footwear to meet the needs of its customers including basic, seasonal and fashion shoes in dress, casual, athletic and work boot categories. Shoes are constructed with leather, canvas and man-made materials. Styling is updated regularly to keep pace with proven fashion trends. During fiscal 1996, the Company's Payless shoes sold at an average retail price of $11.38/pair, with one-third of its women's footwear and two-thirds of its children's footwear selling at $9.99 or less. In addition to shoes, the Company's stores offer accessories, including handbags, shoe polish and hosiery.

The Company's merchandising effort is led by the President and three general merchandise managers with an average of 24 years of retail experience. They direct teams of buyers, planners and distributors that interact with vendors, agents and factory representatives to design, select, produce, inspect and distribute footwear and accessories for the Company. The Company believes that it has good relationships with its vendors.

Customers

The Company sells footwear to women, men and children of all age groups and from households with incomes that represent approximately 85% of the United States population. The Company has significant market penetration with its target customers: women between the ages of 18 and 64. The Company believes that more than 40% of its target customers, regardless of household income, purchased at least one pair of shoes from the Company last year. The Company maintains a leadership position in the children's category as well, selling more pairs of children's shoes than any other U.S. footwear retailer.

Competition

The Company operates in a highly competitive retail market competing primarily with national and regional discount mass-merchandisers, as well as with other self-service discount shoe stores and off-price outlet stores. Competition is based on product selection and quality, availability, price, store location, customer service and efficient promotional activities. The Company has successfully operated in its markets with each of these segments of retailing for many years and has continued to capture increased market share by offering a wider selection of fashionable styles and favorable prices in conveniently located stores; however, the Company is facing increased competition from certain national discount mass-merchandisers.

Seasonality

The retail footwear market is characterized by four high volume seasons: Easter, early Summer, back-to-school and Christmas. The Company must increase inventory levels during these periods to support the increased demand for seasonal styles. Unseasonable weather patterns may affect planned sales of seasonal products such as sandals and boots.

Purchasing

The Company utilizes a network of vendors and factories in 13 foreign countries and the United States to procure its products which are manufactured to meet the Company's specifications and standards. The strength of the Company's relationships with vendors and factories, some dating back over 40 years, has allowed the Company to adapt quickly its sourcing strategies to reflect changing political and economic environments. On several occasions over the past years, many of the Company's vendors and factory owners have played significant roles in developing production in new factories and in new countries without compromising production capacity or product quality. Factories in the People's Republic of China ("China") are a source of approximately 80% of the Company's merchandise. The Company does not purchase "seconds" or "overruns" and does not own any manufacturing facilities. The Company closely integrates its merchandise purchasing requirements with various manufacturers through its sourcing organization which has offices in Topeka, Kansas, and in Taiwan, China and Brazil. Management believes it has good relationships with its suppliers.

On a worldwide basis, approximately two−thirds of the Company's merchandise is acquired through a network of third−party vendors. Payless ShoeSource International, the Company's Taipei, Taiwan office, arranges directly with factories for the design, selection, production management, inspection and distribution of approximately one−third of the shoes acquired for the Company.

Risks inherent in foreign manufacturing (i.e., manufacturing outside the United States) include economic and political instability, transportation delays and interruptions, restrictive actions by foreign governments, the laws and policies of the United States affecting importation of goods, including duties, quotas and taxes, trade and foreign tax laws and fluctuations in currency exchange rates. While the Company has not historically experienced material adverse effects from these risks, there is no assurance that in the future these risks will not result in increased costs and delays or disruption in product deliveries that could cause loss of revenue and damage to customer relationships.

China currently enjoys "most favored nation" ("MFN") status under United States tariff laws, which provides the most favorable category of United States import duties. China's MFN status is annually reviewed by Congress. Extension of this status is subject to political uncertainties. The loss of MFN status for China would likely result in substantially increased costs to the Company in the purchase of merchandise from China until the Company could arrange to shift its merchandise requirements to alternative manufacturers in other countries. The Company believes, however, that its competitors in the footwear industry would be similarly affected.

Quality Assurance

The Company's quality assurance organization sets standards and specifications for product performance and appearance. It communicates those standards and specifications through its copyrighted quality assurance manual. The Company stands behind the quality of the shoes it sells to its customers by permitting return of purchased merchandise with proper documentation.

The quality assurance organization also provides technical design support for the Company's direct purchasing function. It is responsible for review and approval of vendor and factory technical design, for worldwide laboratory testing of materials and components, and for performing in-factory product inspections to ensure that materials and factory production techniques are consistent with Company specifications. The Company locates its field inspection personnel close to the factories and freight consolidation facilities it uses throughout the world.

Production Management

The production management organization manages an ongoing process to qualify and approve new factories, while continually assessing existing factory service and quality of performance. New factories must meet specified quality standards for shoe production and minimum capacity requirements. They must also agree to the Company's production control processes and certify that neither they nor their suppliers use forced or child labor. Factory performance must continually improve or the factory runs the risk of being removed from the list of approved factories. The production management organization utilizes a unique, internally developed production control process by which the Company is electronically linked to its factories and vendors. This process is designed to ensure on-time deliveries of merchandise with minimum lead time and without unnecessary costs.

The Company believes that maintaining strong factory relationships, improving key factory performance factors and improving factory profitability is critical to long-term sourcing stability. Its manufacturing services group, based in Asia, provides direction and leadership to key factories in the areas of overall productivity improvement and lead time reduction.

Merchandise Distribution

The Company believes that its distribution system provides it a competitive advantage. The Company's merchandise distribution teams are able to track shoes by the pair from order placement through sale to the customer by the use of perpetual inventory, product planning and retail price management systems. These systems are maintained by experienced information systems personnel and are enhanced regularly to improve the product distribution process. Distribution analysts review sales and inventory by size and style to maintain availability of product within the Company's stores.

The Company operates a single 765,000 square foot distribution center in Topeka, Kansas, capable of replenishing in-store product levels by style, color and size. This facility operates seven days-a-week and has sufficient capacity to support more than 5,000 stores. Management believes this is one of the most highly-automated and cost-efficient distribution facilities in the industry. Stores receive product at least once a week, maintaining a constant flow of fresh and replenished merchandise.

Industry Segments

The retail footwear industry can be divided into high, moderate and value-priced segments, and is dominated by the Company and national discount mass-merchandisers in the value-priced segment. The high priced segment is controlled by department stores. The moderate priced segment, which is dominated by specialty shoe chains and mass merchants, is declining, in part due to improved product quality in the value priced segment and price competition from the high priced segment.

Based on industry data, the United States footwear market is estimated to be $33 billion and one billion pairs, and has stayed relatively flat over the past several years. The value-priced segment as a percent of the total pairs has more than doubled over the past 15 years. Industry data suggests that the quality offered in the value priced segment has improved significantly over the last 15 years, causing the doubling of this segment's share of the market.

The Company considers itself part of the low-priced segment of the footwear industry. In 1996, the Company's share of the estimated $33 billion United States footwear market was 7 percent; this share has grown consistently over the past four decades.

Trademarks

The Company owns certain trademarks which it uses in its business, including "Payless," "Payless ShoeSource," "Payless Kids," and "Parade of Shoes." The Company owns all rights to the yellow and orange logo used in its Payless ShoeSource signs and advertising. In the United States, the Company has registered over 100 key marks and owns over 50 common law marks under which it markets private label merchandise in its Payless ShoeSource stores and owns over 30 registered and common law marks under which it markets private label merchandise in its Parade of Shoes stores. All of the Company's registered trademarks may be renewed indefinitely.

Marketing

The Company's marketing efforts are multi-dimensional, including nationally broadcast television advertising, national magazine advertisements, local market radio and newspaper inserts in support of major promotional periods. In addition to media support, the Company utilizes in-store promotional materials, including posters, signs and point of sale items. Also, the Company advertises its business through promotional funds, media funds, merchants' associations and similar efforts offered by various landlords from whom the Company leases its stores.

The Company's marketing staff is augmented by a full-service advertising concern that provides creative services, media purchase and consumer research.

Environment

Compliance with federal, state and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had, and is not expected to have, a material effect on capital expenditures, earnings or the competitive position of the Company.

Government Contracts

No material portion of the Company's business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. government.

Directors of the Company

Listed below are the names and principal occupations of the Company's Directors:

Name	Principal Occupation
Steven J. Douglass	Chairman of the Board and Chief Executive Officer of the Company
Howard R. Fricke	Chairman of the Board, President and Chief Executive Officer of The Security Benefit Group of Companies (life and other insurance)
Thomas A. Hays	Retired, formerly Deputy Chairman of The May Department Stores Company
Richard A. Jolosky	President of the Company
Michael E. Murphy	Vice Chairman and Chief Administrative Officer of Sara Lee Corporation (food products)
Robert L. Stark	Dean of The Regents Center at the University of Kansas

Executive Officers of the Company

Listed below are the names and ages of the executive officers of the Company and offices held by them with the Company.

Name	Age	Position and Title
Steven J. Douglass	47	Chairman of the Board and Chief Executive Officer
Richard A. Jolosky	62	President and Director of the Company
Duane L. Cantrell	41	Executive Vice President-Retail Operations
Bryan P. Collins	43	Senior Vice President and Division Director for Parade of Shoes
Stephen Farley	42	Senior Vice President-Marketing

Gerald F. Kelly, Jr.	49	Senior Vice President-Logistics/ Information Services
Harris Mustafa	43	Senior Vice President-Merchandise Distribution
Jed L. Norden	46	Senior Vice President-Human Resources
Ullrich E. Porzig	51	Senior Vice President and Chief Financial Officer
William J. Rainey	50	Senior Vice President, General Counsel and Secretary
Thomas L. Rinehart	42	Senior Vice President and General Merchandise Manager-Men's
Gary M. Stone	48	Senior Vice President-Store Development
Larry M. Strecker	38	Senior Vice President of the Company and Managing Director of Payless ShoeSource International
Michael S. Wilkes	43	Senior Vice President and General Merchandise Manager-Children's

Steven J. Douglass has served as Chairman of the Board, Chief Executive Officer and Director of the Company since May, 1996, the date on which the Company's shares were distributed in a spin-off by The May Department Stores Company to its shareowners. Mr. Douglass has been Chairman and Chief Executive Officer of the Company since April, 1995. He joined the Company in 1993 and served as Senior Vice President-Director of Retail Operations from 1993 to January, 1995 and as Executive Vice President-Director of Retail Operations from January, 1995 to April, 1995. Prior to his association with the Company, Mr. Douglass held several positions at divisions of May, serving as Chairman of May Company, Ohio (1990-1993) and Senior Vice President and Chief Financial Officer of J.W. Robinsons (1986-1990).

Richard A. Jolosky has served as President of the Company since January, 1996. He initially joined the Company in September, 1982, serving as Executive Vice President-Merchandising (1982-1984) and then as President (1985-1988). Prior to rejoining the Company in 1996, Mr. Jolosky was President and Chief Executive Officer of Silverman Jewelry Company (1995-1996), and Chief Executive Officer of the Richard Allen Company (1992-1995). Mr. Jolosky has served as a Director of the Company since May, 1996.

Duane L. Cantrell has served as Executive Vice President-Retail Operations since April, 1997 and as Senior Vice President-Retail Operations (1995-1997). He was the Company's Senior Vice President-Merchandise Distribution and Planning (1992-1995) and Senior Vice President-Merchandise Distribution (1990-1992). Mr. Cantrell has been employed by the Company since 1978.

Bryan P. Collins has served as Senior Vice President and Division Director for Parade of Shoes since December, 1996. Prior to that he was Senior Vice President and General Merchandise Manager-Women's since January, 1994. He also served the Company as Senior

Vice President-General Merchandise Manager-Women's Seasonal/Leisure (October, 1991- January, 1994). Mr. Collins has been employed by the Company since 1991 and was previously employed by the Company (1975-1985).

Stephen Farley has served as Senior Vice President-Marketing since July, 1994. Prior to that he was Vice President-Marketing (1993-1994) and Vice President-Advertising (1992-1993). Prior to joining the Company, Mr. Farley was employed by Earl Palmer Brown as Executive Vice President of Client Services (1989-1992).

Gerald F. Kelly, Jr. has served as Senior Vice President-Logistics/ Information Services since February, 1996. Prior to that he was Senior Vice President-Information Services and Chief Financial Officer (1990-1996) and Senior Vice President-Information Services (1986-1990).

Harris Mustafa has served as Senior Vice President-Merchandise Distribution since May, 1995. Prior to that he was Vice President-Financial Planning/Purchasing (1990-1995). Mr. Mustafa has been employed by the Company since 1987.

Jed L. Norden has served as Senior Vice President-Human Resources since July, 1985.

Ullrich E. Porzig has served as Senior Vice President and Chief Financial Officer since February, 1996. Between 1993 and 1996, Mr. Porzig was Senior Vice President-Financial Officer and Treasurer of Petro Stopping Centers L.P. From 1982 to 1993 he was employed by The May Department Stores Company in various capacities including Senior Vice President-Chief Financial Officer of the Company from 1986 to 1988 and Senior Vice President-Finance of Foley's (1988-1993).

William J. Rainey has served as Senior Vice President, General Counsel and Secretary since April, 1996. Prior to joining the Company, Mr. Rainey served as Executive Vice President, General Counsel and Secretary of Fourth Financial Corporation (1994-1996) and Vice President, General Counsel of Cabot Corporation (1991-1993).

Thomas L. Rinehart has served as Senior Vice President and General Merchandise Manager-Men's since December, 1992. Before joining the Company, he was employed by the Custom Shop as President and Chief Operating Officer (1992) and by Club International as President and Chief Executive Officer (1991-1992).

Gary M. Stone has served as Senior Vice President-Store Development since February, 1997. Prior to joining the Company, Mr. Stone was employed by Pepsico, Inc. as Senior Vice President and General Manager (1995-1997) and Vice President, Asset Development (1991-1995).

Larry M. Strecker has served as Senior Vice President of the Company and Managing Director of Payless ShoeSource International since April, 1996. Prior to that, he was Vice President of Worldwide Sourcing (1993-1996). Before joining the Company, Mr. Strecker was employed by Frito-Lay as Director of Service and Distribution (1991-1993).

Michael S. Wilkes has served as Senior Vice President and General Merchandise Manager-Children's since January, 1994. Prior to that he was Senior Vice President-General Merchandise Manager-Women's Dress/Casual (1990-1994). Mr. Wilkes has been employed by the Company since 1986.

Item 2. Properties

The Company leases substantially all of its stores. The leases typically have a primary term of 10 years, with one or two five-year renewal options. Leases usually require payment of base rent, applicable real estate taxes, common area expenses and, in some cases, percentage rent based on the store's sales volume. Its Payless stores average approximately 3,400 square feet. The Company owns and operates a 305,000 square foot central office building and a 765,000 square foot distribution facility both of which are located in Topeka, Kansas.

Item 3. Legal Proceedings

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which registrant or any of its subsidiaries is a party or of which any of their property is the subject.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the 13 weeks ended February 1, 1997.

PART II

Item 5. Market for Company's Common Equity and Related Shareowner Matters

There were approximately 70,000 shareowners of record of the Company's common stock as of February 1, 1997. The information set forth under the headings "Common Stock and Market Prices" (page 15) and "Shareowner Information - Common Stock" (page 28) in the Company's 1996 Annual Report to Shareowners is incorporated herein by reference.

Item 6. Selected Financial Data

The information set forth under the heading "Summary of Selected Historical Financial Information" (page 25) of the Company's 1996 Annual Report to Shareowners is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information set forth under the heading "Management's Discussion and Analysis" (pages 12-15) of the Company's 1996 Annual Report to Shareowners is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

The Financial Statements (pages 16-18), "Notes to Consolidated Financial Statements" (pages 19-23) and "Report of Independent Public Accountants" (page 24) of the Company's 1996 Annual Report to Shareowners are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Company

a) Directors - The information set forth under the heading "The Election of Directors" on pages 1-3 of the Company's Proxy Statement dated April 14, 1997 is incorporated herein by reference.

b) Executive Officers - Information regarding the Executive Officers of the Company as of April 14, 1997 is set forth in Item 1 of this report under the caption "Executive Officers of the Company."

Item 11. Executive Compensation

The information required by Item 402 of Regulation S-K is incorporated herein by reference from the Company's Proxy Statement dated April 14, 1997, as follows: page 3, "Compensation of Directors;" page 4, "Compensation Committee Interlocks and Insider Participation;" pages 5-6, the description of long term awards under the captions "Bonus Opportunities," "Long-Term Stock Incentives," "Spin-off Arrangements," and pages 21-23, under the captions "Annual Awards" and "Long Term Awards;" and pages 9-15, under the caption "Executive Compensation."

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by Item 403 of Regulation S-K is incorporated herein by reference from the Company's Proxy Statement dated April 14, 1997, as follows: pages 25-26, "Beneficial Stock Ownership of Directors, Nominees, Executive Officers and Persons Owning More than Five Percent of Common Stock."

Item 13. Certain Relationships and Related Transactions

Not applicable.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Documents filed as part of this report:

(1) Financial Statements. The following financial statements are incorporated herein by reference to the Company's 1996 Annual Report to Shareowners:

	Page in Annual Report
Financial Statements-	
Consolidated Statements of Earnings for the three fiscal years ended February 1, 1997	16
Consolidated Statements of Shareowners' Equity for the three fiscal years ended February 1, 1997	16
Consolidated Balance Sheets - February 1, 1997, and February 3, 1996	17
Consolidated Statements of Cash Flows for the three fiscal years ended February 1, 1997	18
Notes to Consolidated Financial Statements	19-23
Report of Independent Public Accountants	24

(3) Exhibits:

Number	Description
2.1	Distribution Agreement, dated as of April 2, 1996, between The May Department Stores Company ("May") and the Registrant.1
3.1	Amended and Restated Articles of Incorporation of the Registrant.2
3.2	Amended and Restated Bylaws of the Registrant.*
4.1	Rights Agreement, dated as of April 2, 1996, between the Registrant and The Bank of New York, as Rights Agent.1
10.1	Tax Sharing Agreement, dated April 2, 1996, between May and the Registrant.3
10.2	Sublease, dated as of April 2, 1996, between May and the Registrant.1
10.3	Multi-Currency Credit Agreement, dated as of April 22, 1996, among the Registrant, several financial institution and Bank of America National Trust and Savings Association.4
10.4	Administrative Services Agreement, dated as of April 2, 1996, between May and the Registrant.1
10.5	Payless ShoeSource, Inc. 1996 Stock Incentive Plan, as amended.5
10.6	Payless ShoeSource, Inc. Spin-Off Stock Plan.1
10.7	Payless ShoeSource, Inc. Spin-Off Cash Plan.1
10.8	Payless ShoeSource, Inc. Restricted Stock Plan for Non-Management Directors.1
10.9	Form of Employment Agreement between the Registrant and certain executives of the Registrant. The Registrant has entered into Employment Agreements in the form contained in this exhibit with each of the named executive officers which expire at various dates on or before May 31, 2001, and which provide for annual base salaries at rates not less than the amounts presently paid to them.1
10.10	Payless ShoeSource, Inc. Supplementary Retirement Plan.1
10.11	Payless ShoeSource, Inc. Profit Sharing Plan.1
10.12	Payless ShoeSource, Inc. Deferred Compensation Plan.
10.13	Payless ShoeSource, Inc. Executive Incentive Compensation Plan for Payless Executives.6

10.14	Form of Management Severance Agreement. The Registrant has entered into Severance Agreements with the named executive officers in the form contained in this exhibit.1 The agreement with Mr. Douglass also provides for a "tax gross-up" payment to ensure that the above-mentioned payments are not subject to net reduction due to imposition of excise taxes which are payable under Section 4999 of the Internal Revenue Code. The agreement with Mr. Jolosky provides for 50% of such payment.
10.15	Form of Indemnification Agreement.1
11.1	Computation of Net Earnings Per Share.*
12.1	Computation of Ratio of Earnings to Fixed Charges.*
13.1	Payless ShoeSource, Inc. 1996 Annual Report to Shareowners (only those portions specifically incorporated by reference shall be deemed filed with the Commission).*
21.1	Subsidiaries of Registrant*
23.1	Consent of Independent Public Accountants.*
24.1	Power of Attorney
27.1	Financial Data Schedule*

* Filed herewith

1) Incorporated by reference from the correspondingly numbered Exhibit to Registrant's Registration Statement on Form 10 Dated February 23, 1996 as amended through April 15, 1996.
2) Incorporated by reference from Exhibit 3.1 of the Registrant's Form 10-Q (file Number 1-11633) for the quarter ended May 4, 1996.
3) Incorporated by reference from Exhibit 10.1 of the Registrant's Form 10-Q (file Number 1-11633) for the quarter ended May 4, 1996.
4) Incorporated by reference from Exhibit 10.2 of the Registrant's Form 10-Q (file Number 1-11633) for the quarter ended May 4, 1996.
5) Incorporated by reference from Appendix A(pages A-1 to A-13) Registrant's April 14, 1997, Proxy Statement relating to its May 23, 1997 annual meeting of shareowners.
6) Incorporated by reference from Exhibit 10.5 of the Registrant's Form 10-Q (file Number 1-11633) for the quarter ended May 4, 1996.

(3) Reports on Form 8-K: None

All other schedules and exhibits of the Company for which provision is made in the applicable regulations of the Securities and Exchange Commission have been omitted, as they are not required or are inapplicable or the information required thereby has been given otherwise.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PAYLESS SHOESOURCE, INC.

Date: April 24, 1997 By: /s/ Ullrich E. Porzig

Ullrich E. Porzig
Senior Vice President and
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of registrant and in the capacities and on the dates indicated.

Principal Executive Officer:

Date: April 24, 1997 By: /s/ Steven J. Douglass

Steven J. Douglass
Chairman and
Chief Executive Officer

Principal Financial and
Accounting Officer:

Date: April 24, 1997 By: /s/ Ullrich E. Porzig

Ullrich E. Porzig
Senior Vice President and
Chief Financial Officer

Directors:

Date: April 24, 1997	By: /s/ Steven J. Douglass* ---------------------------------- Steven J. Douglass Chairman and Chief Executive Officer
Date: April 24, 1997	By: /s/ Richard A. Jolosky* ---------------------------------- Richard A. Jolosky President and Director
Date: April 24, 1997	By: /s/ Howard R. Fricke* ---------------------------------- Howard R. Fricke Director
Date: April 24, 1997	By: /s/ Thomas A. Hays* ---------------------------------- Thomas A. Hays Director
Date: April 24, 1997	By: /s/ Michael E. Murphy* ---------------------------------- Michael E. Murphy Director
Date: April 24, 1997	By: /s/ Robert L. Stark* ---------------------------------- Robert L. Stark Director

*Executed by William J. Rainey, attorney-in-fact, on behalf of the indicated Director pursuant to Power of Attorney dated April 17, 1997.

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Exhibit 3.2

AMENDED AND RESTATED BYLAWS

OF

PAYLESS SHOESOURCE, INC.

(Amended and Restated as of March 20, 1997)

ARTICLE I
OFFICES

Section 1. The registered office of the Corporation shall be in the City of St. Louis, State of Missouri, or at such other place within the State of Missouri as the Board of Directors may at any time and from time to time designate.

Section 2. The Corporation may also have offices at such other places both within and without the State of Missouri as the Board of Directors may from time to time determine or the business of the Corporation may require.

ARTICLE II
MEETINGS OF SHAREHOLDERS

Section 1. All meetings of the shareholders shall be held either within or without the State of Missouri as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting or in a duly executed waiver of notice thereof.

Section 2. The annual meeting of shareholders shall be held at such place within or without the State of Missouri, at such hour and on such date, not earlier than May 1 and not later than July 10 in each year as the Board of Directors may specify in the call of such meeting, at which meeting the shareholders shall elect by a plurality vote directors as described in Article III below, by a majority of shares entitled to vote thereon and represented in person or by proxy at the meeting, and transact such other business as may properly be brought before the meeting.

Section 3. Except as otherwise required by law, written notice of the annual meeting stating the place, date and hour of the meeting shall be given by mail, postage prepaid, not less than ten or more than seventy days before the date of the meeting, to each shareholder entitled to vote at such meeting at such address as shall appear on the books of the Corporation.

Section 4. The Secretary of the Corporation shall prepare and make, at least ten days before every meeting of shareholders, a complete list of the shareholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each shareholder and the number of shares registered in the name of each shareholder. Such list shall be open to the examination of any shareholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, at the registered office of the Corporation. The list shall also be produced and kept open at the time and place of the meeting during the whole time thereof, and may be inspected by any shareholder who is present.

Section 5. Special meetings of the shareholders, for any purpose or purposes, may be called by the Board of Directors, the Chairman of the Board of Directors, or the President. Special meetings of shareholders may not be called by any other person or persons. The business transacted at a special meeting of shareholders shall be confined to the purpose or purposes specified in the notice therefor.

Section 6. Except as otherwise required by law, written notice of a special meeting stating the place, date and hour of the meeting and the purpose or purposes for which the meeting is called, shall be given by mail, postage prepaid, not less than ten nor more than seventy days before the date of the meeting, to each shareholder entitled to vote at such meeting at such address as shall appear on the books of the Corporation.

Section 7. The holders of a majority of the stock issued and outstanding and entitled to vote at any meeting, present in person or represented by proxy, shall constitute a quorum at all meetings of the shareholders for the transaction of business except as otherwise provided by law or by the Articles of Incorporation. If, however, such quorum shall not be present or represented at any meeting of the shareholders, the shareholders entitled to vote thereat, present in person or represented by proxy even though less than a quorum, shall have the power successively to adjourn the meeting to a specified date not longer than ninety days after such adjournment, without notice other than announcement at the meeting. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally called. If the adjournment is for more than thirty days, a notice of the adjourned meeting shall be given to each shareholder of record entitled to vote at the meeting.

For purposes of determining a quorum, shares represented by a proxy which directs that the shares abstain from voting or that a vote be withheld on a matter shall be deemed to be represented at the meeting; shares as to which voting instructions are given as to at least one of the matters be voted on shall also be deemed to be so represented; if the proxy states how shares will be voted in the absence of instructions by the shareholder, such shares shall be deemed to be represented at the meeting.

Section 8. When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which by express provision of law or the Articles of Incorporation, a different vote is required, in which case such express provision shall govern and control the decision of such question. Shares represented by a proxy which directs that the shares abstain from voting or that a vote be withheld on a matter shall not be deemed to be represented at the meeting as to such matter. Shares represented by a proxy as to which voting instructions are not given as to one or more matters to be voted on shall not be deemed to be represented at the meeting for purposes of the vote as to such matter or matters. A proxy which states how shares will be voted in the absence of instructions by the shareholder as to any matter shall be deemed to give voting instructions as to such matter.

Section 9. Except as otherwise provided by the Articles of Incorporation, each shareholder of record shall at every meeting of the shareholders be entitled to one vote for each share of capital stock of the Corporation entitled to vote thereat held by such shareholder. Such votes may be cast in person or by proxy, but no proxy shall be valid after eleven months from the date of its execution unless otherwise provided in the proxy. Subject to applicable law, the Board of Directors shall prescribe the rules and regulations for voting at all meetings of the shareholders; provided, however, the vote for the election of directors, and upon the direction of the presiding officer of the meeting, the vote on any other question before the meeting, shall be by written ballot.

Section 10. Except as otherwise provided by the Articles of Incorporation, any action required or permitted to be taken at any annual or special meeting of shareholders may be taken without a meeting of the shareholders only if consents in writing, setting forth the action so taken, are signed by all of the shareholders entitled to vote with respect to the subject matter thereof.

Section 11. To be properly brought before the annual or any special shareholders' meeting, business must be either (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (b) otherwise properly brought before the meeting by or at the direction of the Board of Directors, or (c) otherwise properly brought before the meeting by a shareholder. In addition to any other applicable requirements, for business to be properly brought before the annual or any special shareholders' meeting by a shareholder, the shareholder must have given timely notice thereof in writing to the Secretary of the Corporation. To be timely, a shareholder's notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than 75 days nor more than 90 days prior to the meeting; provided, however, that in the event that less than 90 days' notice or prior public disclosure of the date of the meeting is given or made to shareholders, notice by the shareholder to be timely must be so received not later than the close of business on the 15th day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made, whichever first occurs. Such shareholder's notice to the Secretary shall set forth as to each matter the shareholder proposes to bring before the meeting (i) a brief description of the business desired to be brought before the meeting and the reasons for conducting such business at the meeting, (ii) the name and record address of the shareholder proposing such business, (iii) the class and number of shares of common stock of the Corporation which are beneficially owned by the shareholder and (iv) any material interest of the shareholder in such business.

Notwithstanding anything in these Bylaws to the contrary, no business shall be conducted at the annual or any special meeting except in accordance with the procedures set forth in this Section 11, provided, however, that nothing in this Section 11 shall be deemed to preclude discussion by any shareholder of any business properly brought before the meeting.

The chairman of the meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting in accordance with the provisions of this Section 11, and if he should so determine and declare, any such business not properly brought before the meeting shall not be transacted.

Section 12. Except as provided in Section 3 of Article III, only persons who are nominated in accordance with the following procedures shall be eligible for election as directors. Nominations of persons for election to the Board of Directors of the Corporation at the annual meeting may be made at the meeting by or at the direction of the Board of Directors, by any nominating committee or person appointed by the Board of Directors or by any shareholder of the Corporation entitled to vote for the election of directors at the meeting who complies with the notice procedures set forth in this Section 12. Such nominations, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the Corporation. To be timely, a shareholder's notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than 75 days nor more than 90 days prior to the meeting; provided, however, that in the event that less than 90 days' notice or prior public disclosure of the date of the meeting is given or made to shareholders, notice by the shareholder to be timely must be so received not later than the close of business on the 15th day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made, whichever first occurs. Such shareholder's notice to the Secretary shall set forth (a) as to each person whom the shareholder proposes to nominate for election or re-election as a director, (i) the name, age, business address and residence of the person, (ii) the principal occupation or employment of the person, (iii) the class and number of shares of common stock of the Corporation which are beneficially owned by the person, and (iv) any other information relating to the person that is required to be disclosed in solicitations for proxies for election of directors pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended; and (b) as to the shareholder giving the notice (i) the name and record address of the shareholder and (ii) the class and number of shares of common stock of the Corporation which are beneficially owned by the shareholder. Such notice shall be accompanied by the executed consent of each nominee to serve as a director if so elected. The Corporation may require any proposed nominee to furnish such other information as may reasonably be required by the Corporation to determine the eligibility of such proposed nominee to serve as a director of the Corporation.

The chairman of the meeting shall, if the facts warrant, determine and declare to the meeting that a nomination was not made in accordance with the foregoing procedure, and if he should so determine and declare, the defective nomination shall be disregarded.

ARTICLE III
DIRECTORS

Section 1. Except as otherwise required by law or the Articles of Incorporation, the business and affairs of the Corporation shall be managed by or under the direction of the Board of Directors.

Section 2. The number of directors of the Corporation shall be fixed in the manner provided in the Articles of Incorporation. Except as otherwise provided in Section 3 of this Article III, the directors of the Corporation shall be elected by the shareholders of the Corporation, and at each such election the nominees receiving the greatest number of votes, up to the number of directors then to be elected, shall be the persons then elected.

Section 3. Except as otherwise required by the Articles of Incorporation, any vacancy in the Board of Directors resulting from any increase in the number of directors and any other vacancy occurring in the Board of Directors may be filled by the Board of Directors acting by a majority of the directors then in office, although less than a quorum, or by the sole remaining director, and any director so elected to fill a vacancy shall hold office until the next election of directors by the shareholders of the Corporation (subject, however, to such director's earlier death, resignation, disqualification or removal from office). In no event shall a decrease in the number of directors shorten the term of any incumbent director.

Section 4. The Board of Directors may hold its meetings, both regular and special, and cause the books of the Corporation to be kept, either within or without the State of Missouri at such place or places as they may from time to time determine or as otherwise may be provided in these Bylaws.

Section 5. Subject to Section 8 of this Article III there shall be an annual meeting of the Board of Directors on the day of the annual meeting of shareholders in each year or as soon thereafter as convenient, such annual meeting to be at such place and time (and, if applicable, on such date) as the Chairman of the Board or the Chief Executive Officer shall designate by written notice to the directors, and regular meetings shall be held on such dates and at such times and places either as the directors shall by resolution provide or as the Chairman of the Board or the Chief Executive Officer shall designate by written notice to the directors. Except as above provided, no notice of said annual meeting or such regular meetings of the Board of Directors need be given.

Section 6. Special meetings of the Board of Directors may be called by the Chairman of the Board, the Chief Executive Officer, the President, the Secretary or the Treasurer and shall be called by one of the foregoing officers on the written request of a majority of the entire Board of Directors specifying the object or objects of such special meeting. In the event that one of the foregoing officers shall fail to call a meeting within two days after receipt of such request, such meeting may be called in like manner by the directors making such request. The person or persons calling the special meeting may fix the place, either within or without the State of Missouri, as a place for holding the meeting. Notice of each special meeting, stating the date, place and time of the meeting and the purpose or purposes for which it is called, shall be deposited in the regular or overnight mail, sent by telecopy, telegram or delivered by hand to each director not later than the day preceding the date of such meeting, or on such shorter notice as the person or persons calling such meeting may deem necessary or appropriate in the circumstances.

Section 7. At all meetings of the Board of Directors a majority of the entire Board of Directors in office shall constitute a quorum for the transaction of business and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board of Directors, except as may be otherwise specifically provided by law, the Articles of Incorporation or by these Bylaws. If a quorum, shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 8. Except as otherwise required by the Articles of Incorporation or these Bylaws, any action required or permitted to be taken by the Board of Directors at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing. The Secretary shall file the consents with the minutes of proceedings of the Board of Directors or the committee as the case may be.

Section 9. Any one or more members of the Board of Directors, or any committee designated by the Board of Directors, may participate in a meeting of the Board of Directors or such committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. Participation in a meeting pursuant to this Section 9 shall constitute presence in person at such meeting.

Section 10. The Board of Directors may, by resolution passed by a majority of the entire Board, designate one or more committees, each committee to consist of two or more of the directors of the Corporation. The Board may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. Any such committee, to the extent allowed by law and as provided in the resolution, shall have and may exercise all of the powers and authority of the Board of Directors in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board of Directors.

Section 11. Each committee of the Board shall keep regular minutes of its meetings and report the same to the Board of Directors when required.

Section 12. Directors and members of committees may receive such compensation for their services, and such reimbursement of expenses, as the Board of Directors may from time to time determine. Nothing herein contained shall be construed to preclude any director from serving the Corporation in any other capacity and receiving compensation therefor.

Section 13. No contract or transaction between the Corporation and one or more of its directors or officers, or between the Corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee thereof which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose if (a) the material facts as to his or their relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors or the committee and the Board of Directors or the committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or (b) the material facts as to his or their relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or (c) the contract or transaction is fair as to the Corporation as of the time it is authorized or approved by the Board of Directors, a committee thereof or the shareholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

Section 14. As used in these Bylaws generally, the term "entire Board of Directors" means the total number of directors which the Corporation would have if there were no vacancies.

ARTICLE IV
NOTICES

Section 1. Whenever written notice is required by law, the Articles of Incorporation or these Bylaws, to be given to any director, committee member or shareholder, such requirement shall not be construed to mean personal notice, but such notice may be given in writing, by mail addressed to such director, committee member or shareholder, at his address as it appears on the records of the Corporation, with postage thereon prepaid and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail. Written notice may also be given personally or by telecopy, telegram, telex or cable or by overnight mail. An affidavit of the Secretary or an Assistant Secretary or of the transfer agent of the Corporation that the notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated therein.

Section 2. Whenever any notice is required by law, the Articles of Incorporation or these Bylaws, to be given to any director, committee member or shareholder, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

ARTICLE V
OFFICERS

Section 1. The officers of the Corporation elected by the Board of Directors shall consist of the Chairman of the Board, a President and a Secretary and such other officers as the Board of Directors may deem necessary and proper, including, without limitation, one or more Executive Vice Presidents, one or more Senior Vice Presidents, one or more Vice Presidents, a Treasurer, and one or more Assistant Secretaries or Assistant Treasurers. The Board of Directors shall elect the Chairman of the Board, the President and the Secretary at its first meeting held after each annual meeting of shareholders and may elect such other officers from time to time as it deems necessary or advisable. Any two or more of such offices, excepting the offices of President and Secretary, may be held by the same person, but no officer shall execute, acknowledge, or verify any instrument on behalf of the Corporation in more than one capacity.

Section 2. The Chairman of the Board, the President and such other officer or officers as the Board may from time to time by resolution designate may appoint one or more Vice Presidents, a Controller, and one or more Assistant Controllers, Assistant Secretaries and Assistant Treasurers, who shall also be officers of the Corporation.

Section 3. The Board of Directors may determine or provide the method of determining the compensation of all officers.

Section 4. The officers of the Corporation shall hold office until their successors are chosen and qualify, or until their earlier resignation or removal. Any officer elected or appointed by the Board of Directors may be removed at any time by the Board of Directors. Any vacancy occurring in any office of the Corporation that was filled by the Board of Directors pursuant to Article V, Section 1 also shall be filled by the Board of Directors.

Section 5. Each officer of the Corporation shall be subject to the control of the Board of Directors and shall have such duties in the management of the Corporation as may be provided by appropriate resolution of the Board of Directors and/or provided in these Bylaws.

Section 6. Powers of attorney, proxies, waivers of notice of meeting, consents and other instruments relating to securities owned by the corporation may be executed in the name of and on behalf of the Corporation by the Chairman of the Board, the President or any Vice President and any such officer may, in the name of and on behalf of the Corporation, take all such action as any such officer may deem advisable to vote in person or by proxy at any meeting of security holders of any corporation in which the Corporation may own securities and at any such meeting shall possess and may exercise any and all rights and power incident to the ownership of such securities and which, as the owner thereof, the Corporation might have exercised and possessed if present. The Board of Directors may, by resolution, from time to time confer like powers upon any other person or persons.

Section 7. Any officer, if required by the Board of Directors, shall give bond in such sum and with such security as the Board of Directors may require for the faithful performance of duties.

Section 8. In the case of the absence of any officer of the Corporation, or for any other reason that the Board may deem sufficient, the Board of Directors may delegate the powers or duties of such officer to any other officer or to any other director, or to any other person for the time being.

ARTICLE VI
CERTIFICATES OF STOCK

Section 1. Every holder of stock in the Corporation shall be entitled to have a certificate signed in the name of the Corporation by the Chairman of the Board, the President or a Vice−President and the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary. Such certificate shall certify the number of shares owned by such holder in the Corporation.

Section 2. Where a certificate is countersigned by (i) a transfer agent other than the Corporation or its employee, or (ii) a registrar other than the Corporation or its employee, any other signature on the certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issue.

Section 3. The Board of Directors may direct a new certificate or certificates to be issued in place of any certificate or certificates theretofore issued by the Corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed. When authorizing such issuance of a new certificate or certificates, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate or certificates, or his legal representative, to advertise the same in such manner as the Board of Directors shall require and/or to give the Corporation a bond in such sum as it may direct and with such surety as it may approve, as indemnity against any claim that may be made against the Corporation with respect to the certificate alleged to have been lost, stolen or destroyed.

Section 4. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books.

Section 5. In order that the Corporation may determine the shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment or postponement thereof, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not be more than seventy days before the date of such meeting, nor more than seventy days prior to any other action; provided, however that if the Board of Directors does not set a record date for the determination of the shareholders entitled to notice of, and to vote at, a meeting of shareholders, only the shareholders of record at the close of business on the twentieth day preceding the date of the meeting shall be entitled to notice of, and to vote at, the meeting and any adjournment or postponement of the meeting. A determination of shareholders of record entitled to notice of or to vote at a meeting of shareholders shall apply to any adjournment or postponement of the meeting.

Section 6. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a person registered on its books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by law.

ARTICLE VII
GENERAL PROVISIONS

Section 1. Dividends upon the capital stock of the Corporation, subject to the provisions of the Articles of Incorporation, if any, may be declared by the Board of Directors at any regular or special meeting. Pursuant to law, dividends may be paid in cash, in property, or in shares of the capital stock.

Section 2. Before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the directors may from time to time, in their absolute discretion, deem proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation, or for any proper purpose, and the directors may modify or abolish any such reserve in the manner in which it was created.

Section 3. All checks or demands for money and all notes and other obligations of the Corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may at any time and from time to time designate.

Section 4. The fiscal year of the Corporation shall end on the Saturday closest to the 31st day of January in each year.

Section 5. The corporate seal shall consist of the words "PAYLESS SHOESOURCE, INC. MISSOURI" arranged in a circular form around the words and figures "Corporate Seal 1961" and shall be kept by the Secretary. The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

ARTICLE VIII
AMENDMENTS

These Bylaws may be amended, altered, changed or rescinded, in whole or in part, or new Bylaws may be adopted, in the manner provided in the Articles of Incorporation.

The substance of such amendment, alteration, change, rescission or adoption or the subject matter thereof shall be submitted in writing at a preceding meeting of the Board of Directors or notice thereof shall be given to the directors at least ten days before; waiver of notice by any director being deemed equivalent to such notice to him.

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Exhibit 11.1

PAYLESS SHOESOURCE, INC.

COMPUTATION OF NET EARNINGS PER SHARE

FOR THE LAST THREE FISCAL YEARS

(Thousands, except per share)	Feb. 1, 1997	Feb. 3, 1996	Jan. 28, 1995
Net earnings	$107,702	$ 53,960	$131,453
Common shares outstanding	40,220	40,365	40,365
Net earnings per share	$ 2.68	$ 1.34	$ 3.26
Primary Computation:			
Net earnings	$107,702	$ 53,960	$131,453
Common shares outstanding	40,220	40,365	40,365
Net effect of dilutive stock options based on the treasury stock method	87	0	0
Outstanding shares for primary earnings per share	40,307	40,365	40,365
Primary earnings per share	$ 2.67	$ 1.34	$ 3.26
Fully Diluted Computation:			
Net earnings	$107,702	$ 53,960	$131,453
Common shares outstanding	40,220	40,365	40,365
Net effect of dilutive stock options based on the treasury stock method	131	0	0
Outstanding shares for fully diluted earnings per share	40,351	40,365	40,365
Fully Diluted earnings per share	$ 2.67	$ 1.34	$ 3.26

Note: The Company's fiscal 1995 and 1994 outstanding shares were calculated on the number of Company shares issued and outstanding as of May 4, 1996, the date of the spin-off from The May Department Stores Company.

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Exhibit 12.1

PAYLESS SHOESOURCE, INC.

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

FOR THE LAST THREE FISCAL YEARS

(Thousands)	Feb. 1, 1997	Feb. 3, 1996	Jan. 28, 1995
Earnings Available for Fixed Charges:			
Pretax earnings	$179,159	$ 88,932	$217,077
Fixed Charges (Interest expense plus interest component of rent)	81,576	88,432	82,582
	$260,735	$177,364	$299,659
Fixed Charges:			
Gross interest expense	$ 1,166	$ 979	$ 1,109
Interest factor attributable to rent expense	80,410	87,453	81,473
	81,576	88,432	82,582
Ratio of Earnings to Fixed Charges	3.2	2.0	3.6

Note: All costs and expenses of the Company relating to special retention costs and the special non-recurring charge associated with the spin-off are included in the above calculation. Excluding these costs, the fixed charge coverage would be 3.4x, 2.8x, and 3.6x, respectively.

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Exhibit 13.1

[The following "Management's Discussion and Analysis" section is a reproduction of the same section included in the paper format Annual Report on pages 12-15.]

Management's Discussion and Analysis

(dollars in millions, except per share, shoe prices and where otherwise noted)

Payless ShoeSource (Payless) is reporting its first year of sales and earnings as an independent public company. On May 4, 1996, Payless was spun off from The May Department Stores Company (May) in a tax-free distribution to May shareowners.

Sales in fiscal 1996 were $2.33 billion, an increase of 1.4 percent over 1995 sales of $2.30 billion on a 52-week basis. Store-for-store sales for 1996 increased 3.6 percent. Store-for-store sales increases for the four quarters of fiscal 1996 were 5.3 percent, 5.0 percent, 1.5 percent and 2.5 percent, respectively. During 1996 Payless closed 484 underperforming stores and opened 171 stores, which included 37 relocated stores. The cost of the store closing program was recorded as a charge to earnings in the fourth quarter of 1995. Year-end store count for 1996 was 4,236 compared with 4,549 in 1995.

Payless achieved $2.68 in earnings per share from operations in 1996, a 100 percent increase over last year's $1.34 ($2.42 excluding special and nonrecurring items). Net earnings totaled $107.7 compared with $54.0 last year ($97.5 excluding special and nonrecurring items). Return on sales was 4.6 percent in 1996 and 2.3 percent in 1995. Return on equity was 14.3 percent in 1996 and 6.8 percent in 1995 (computed as net earnings divided by beginning shareowners' equity). Return on net assets was 15.5 percent in 1996 and 13.9 percent in 1995.

On January 14, 1997, Payless announced the acquisition of the Parade of Shoes division (Parade) from J. Baker, Inc. The acquisition was completed on March 10, 1997. Parade sells women's footwear and accessories in 186 stores in 14 states. Parade offers fashionable leather private-label footwear, priced $20 to $40 a pair, in self-service stores. Parade had sales of $123 in 1996. Payless plans to operate Parade as a separate division supported by existing Payless sourcing, distribution, information systems, real estate and financial organizations.

Our expansion plans for 1997 include 50 net new Payless stores, 200 remodels and the recently completed acquisition of Parade. The 1997-2000 expansion plans include adding 150 net Payless stores and 250 Parade stores. During this period, Payless will invest $220 for new stores and will spend an additional $98 to remodel existing stores. These are the major components of a $455 capital plan.

The following discussion summarizes the significant factors affecting the Payless operating results for the fiscal years ended February 1, 1997 (1996), February 3, 1996 (1995) and January 28, 1995 (1994). Results for 1995 and 1994 have been restated as if Payless were an independent public entity. This discussion and analysis should be read in conjunction with the financial statements and notes to the financial statements included in this annual report.

Review of Operations

NET EARNINGS

Net earnings totaled $107.7 in 1996, compared to $54.0 in 1995 and $131.5 in 1994. Total company return on sales was 4.6 percent, 2.3 percent and 6.2 percent for 1996, 1995 and 1994, respectively. Excluding the special and nonrecurring items, 1995 net earnings were $97.5 and return on sales was 4.2 percent.

Results for the past three years were as follows:

	1996<F1>		1995<F1>		1994<F1>	
	$	% of Sales	$	% of Sales	$	% of Sales
Net retail sales	$2,333.7	100.0	$2,330.3	100.0	$2,116.4	100.0
Cost of sales	1,660.9	71.1	1,693.4	72.7	1,492.3	70.5
Selling, general and administrative expenses	487.3	20.9	475.2	20.4	405.9	19.2
Special and nonrecurring items	12.6<F2>	.5	71.8<F3>	3.1	--	--

Interest (income) expense, net	(6.2)	(.2)	1.0	--	1.1	--
Earnings before income taxes	179.1	7.7	88.9	3.8	217.1	10.3
Provision for income taxes	71.4	39.9<F4>	34.9	39.3<F4>	85.6	39.4<F4>
Net earnings	$ 107.7	4.6	$ 54.0<F3>	2.3	$ 131.5	6.2
Earnings per share	$ 2.68		$ 1.34		$ 3.26	

<FN>

<F1>The Payless fiscal year ends on the Saturday closest to January 31. Fiscal year 1995 contains 53 weeks.

<F2>Executive retention costs associated with the spin-off.

<F3>During the 1995 fourth quarter, in connection with the spin-off, Payless committed to close or relocate underperforming stores during 1996.

<F4>Effective income tax rate.

NET RETAIL SALES

Net retail sales, on a 52-week basis, represent the sales of stores operating during the period. Sales percent increases (decreases) for 1996 and 1995 were as follows:

1996 vs. 1995		1995 vs. 1994	
Total	Store-for-Store<F*>	Total	Store-for-Store<F*>
1.4%	3.6%	8.8%	(3.7)%

<FN>

<F*>Store-for-store sales represent sales of those stores open during comparable periods.

The 1996 stronger sales and store-for-store increases reflect the benefits from a more balanced merchandising strategy, plus consolidation in the footwear industry, including the closing of 484 underperforming stores by Payless during the year.

The 1995 store-for-store decrease reflects an overall sluggish retail environment, combined with some cannibalization of sales as a result of the acquisition of locations from Kobacker Companies and a sales decline in the Payless Mexican border stores caused by the devaluation of the peso.

Average sales per store were as follows:

(dollars in thousands)

1996	1995	1994	1996 vs. 1995 Increase	1995 vs. 1994 (Decrease)
$538	$511	$534	5.3%	(4.3)%

COST OF SALES

Cost of sales includes cost of merchandise sold, buying and occupancy costs. Cost of sales was $1,660.9 in 1996 compared with $1,693.4 in 1995, a 1.9 percent decrease. As a percent of net retail sales, cost of sales was 71.1 percent in 1996 compared with 72.7 percent in 1995. Higher gross margins in 1996 reflect improved markdown performance obtained by paring back promotions where possible, while minimizing the impact on sales. Occupancy expense rates were also reduced due to the closure of underperforming stores.

Cost of sales was $1,693.4 in 1995 compared with $1,492.3 in 1994, a 13.5 percent increase. As a percent of net retail sales, cost of sales was 72.7 percent in 1995 compared with 70.5 percent in 1994. The drop in store-for-store sales caused an increase in occupancy cost as a percent of sales. Payless also took additional markdowns to reduce carryover of aged product.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (SG&A)

Selling, general and administrative expenses were $487.3 in 1996 compared with $475.2 in 1995, a 2.5 percent increase. As a percent of net retail sales, selling, general and administrative expenses were 20.9 percent for 1996 compared with 20.4 percent in 1995. The increase was due principally to four factors. First, payroll was increased in the stores to improve the work schedule of our managers, which decreased turnover rates from 35 percent in 1995 to 19 percent in 1996. Second, there were added costs associated with being an independent company. Third, costs related to the Payless performance-based compensation program were higher as a result of the stronger store-for-store sales in 1996. Fourth, advertising was increased in the fourth quarter of 1996 to support sales during the shortened holiday season.

Selling, general and administrative expenses were $475.2 in 1995 compared with $405.9 in 1994, a 17.1 percent increase. The increase was due principally to a 15.1 percent increase in the average number of stores. As a percent of net retail sales, selling, general and administrative expenses were 20.4 percent compared to 19.2 percent in 1994, resulting from a 3.7 percent decline in store-for-store sales. coupled with relatively fixed store staffing costs.

INTEREST (INCOME) EXPENSE

During 1996 interest income was generated by short-term investment of available cash balances. In 1995 and 1994, cash received by Payless in excess of store operating needs was transferred to May on a daily basis; therefore, no interest income was generated. Interest expense is primarily related to capitalized lease obligations.

	1996	1995	1994
Interest expense	$ 1.2	$1.0	$1.1
Interest income	(7.4)	--	--
Interest (income) expense, net	$(6.2)	$1.0	$1.1

SPECIAL AND NONRECURRING ITEMS

During the 1995 fourth quarter, in connection with the spin-off, Payless committed to close or relocate underperforming stores in 1996. In addition, Payless implemented a plan to reduce central office overhead by means of a personnel reduction and initiation of expense control programs. A pretax special and nonrecurring charge of $71.8 was recorded for these initiatives. During 1996 Payless closed or relocated 484 underperforming stores and restructured the central office at a cost of $48.8. The remaining $23.0 reserve will be used to cover remaining lease buyouts, holding costs and fixed asset write-offs for the stores closed in 1996. In addition, it will fund closing costs of an estimated 40 additional underperforming stores to be closed in the spring of 1997.

In connection with the spin-off, Payless initiated a Spin-off Stock Plan and a Spin-off Cash Plan as retention programs. Under these Plans, Payless committed to pay out 408,558 shares of restricted stock and cash payments ranging from 10 percent to 37.5 percent of certain associates' base salaries. These retention incentives are contingent upon continued employment for up to two years after May 4, 1996. The costs related to these incentives are being expensed as earned during the retention period: $12.6 in 1996, $4.6 in 1997 and $0.8 in 1998.

INCOME TAXES

The effective income tax rates were 39.9 percent, 39.3 percent and 39.4 percent in 1996, 1995 and 1994, respectively.

The increase in the 1996 effective income tax rate to 39.9 percent from 39.3 percent in 1995 relates to slightly higher state income tax rates and the discontinuation of the Federal Targeted Jobs Tax Credit. The decrease in the 1995 effective income tax rate to 39.3 percent from 39.4 percent in 1994 relates to slightly lower state income tax rates.

IMPACT OF INFLATION

Historically, sales growth and earnings for Payless have not been materially impacted by inflation.

Review of Financial Condition

RETURN ON EQUITY

Return on equity is the company's principal measure in evaluating performance for shareowners and ability to invest shareowners' funds profitably. Return on beginning equity was 14.3 percent in 1996 compared with 6.8 percent in 1995 (12.3 percent excluding the nonrecurring charge) and 19.8 percent in 1994. The 1995 and 1994 returns on beginning equity were computed using financial results stated as if Payless were an independent public company. The 1996 debt-to-capitalization ratio (including present value of future minimum rental payments under operating leases - PVOL) was 49 percent compared to 54 percent for 1995.

RETURN ON NET ASSETS

Return on net assets measures performance independent of capital structure. Return on net assets represents pretax earnings before net interest expense and the interest component of operating leases, divided by beginning of year net assets (including PVOL). Return on net assets was 15.5 percent in 1996 compared with 13.9 percent in 1995 and 20.9 percent in 1994.

CASH FLOW

Cash flow from operations shows continuing strength, as cash flow from operations was $231.6 in 1996. This was 9.9 percent of net sales in 1996 compared with 6.8 percent in 1995 and 11.1 percent in 1994. Internally generated funds will continue to be the most important component of the company's capital resources and are expected to fund capital expansion.

Sources and (uses) of cash flows are summarized below:

	1996	1995	1994
Operating Activities:			
Net earnings and noncash items	$200.9	$192.6	$ 220.2
Change in working capital	30.7	(33.3)	13.9
Total operating activities	231.6	159.3	234.1
Total investing activities	(32.9)	(64.7)	(235.0)
Total financing activities	(9.7)	(96.6)	--
Increase (Decrease) in cash and cash equivalents	$189.0	$ (2.0)	$ (0.9)

Cash flow from operations increased $72.3 in 1996 from 1995 primarily due to working capital changes. Inventories decreased $43.2 from 1995 levels as a result of reduction of inventory associated with the closing of unprofitable stores, combined with concerted efforts to increase inventory turnover and reduce the amount of aged inventory. Accounts payable increased due to timing of merchandise purchases. These increases in working capital were partially offset by decreased accrued liabilities, which resulted primarily from the $48.8 decrease in the store closing reserve.

CAPITAL EXPENDITURES

Payless emphasizes return on net assets and internal rate of return as the principal financial measures in evaluating investments in new stores and remodels.

In 1996 Payless capital expenditures totaled $73.4, including $33.3 for new stores, $20.6 for remodels of existing stores and $19.5 for other necessary improvements. This was offset by increased store disposals in 1996 totaling $40.5, resulting from the store closing activity.

Capital expenditures in 1997 are estimated to be $130.0 including $65.0 to open new Payless and Parade of Shoes stores, $26.0 to remodel existing stores and $39.0 to make other necessary improvements.

FINANCING ACTIVITIES

On September 10, 1996, the Payless Board of Directors authorized the repurchase of up to 460,000 shares of outstanding Payless common stock to avoid the dilutive impact of shares issued under the company's benefit programs. This repurchase was completed on October 23, 1996.

On January 14, 1997, the Payless Board of Directors authorized the repurchase of up to an additional $150 million of outstanding Payless common stock in open−market transactions, subject to receipt of a favorable tax ruling from the Internal Revenue Service and market conditions. The purchased shares will be held in the treasury for future employee benefit plan funding, future acquisitions by the company and other corporate purposes.

Prior to being an independent public company, cash received by Payless in excess of store operating needs was transferred to May on a daily basis. The debt and investment levels prior to the spin−off may not be indicative of debt and investment levels had Payless operated as an independent public company during these periods.

AVAILABLE CREDIT

Payless has in place a $200 million revolving credit facility with a bank syndication group on which no amounts were outstanding February 1, 1997.

FINANCIAL CONDITION RATIOS

The debt−to−capitalization ratio was 1 percent, 1 percent and 2 percent at the end of 1996, 1995 and 1994, respectively. For purposes of the debt−to−capitalization ratio, total debt is defined as current and long−term capital lease obligations. Capitalization is defined as current and long−term capital lease obligations, noncurrent deferred income taxes and shareowners' equity. The debt−to−capitalization ratio, including the present value of future minimum rental payments under operating leases as debt and as capitalization, would be 49 percent, 54 percent and 55 percent in 1996, 1995 and 1994, respectively.

Fixed charge coverage, excluding special and nonrecurring items, was 3.4x, 2.8x and 3.6x in 1996, 1995 and 1994, respectively. Fixed charge coverage is defined as earnings before income taxes, gross interest expense and the interest component of rent expense, divided by gross interest expense and the interest component of rent expense. The fixed charge coverage, including special and nonrecurring items, was 3.2x and 2.0x in 1996 and 1995, respectively.

COMMON STOCK AND MARKET PRICES

The company's common stock is listed on the New York Stock Exchange. The quarterly per−share price ranges of the common stock for 1996 were:

	1996 Market Price	
Quarter<F*>	High	Low
Second	$34	$25
Third	37 7/8	31 3/8
Fourth	41 3/4	33 1/4
Year	41 3/4	25

<FN>

<F*>Payless ShoeSource was a subsidiary of The May Department Stores Company for the first quarter of 1996.

Payless has not paid a dividend on its common shares since its spin−off from May in May 1996. Payless has no present intention of commencing dividend payments.

As of February 1, 1997, there were approximately 70,000 Payless common shareowners.

[The following "Consolidated Statements of Earnings" section is a reproduction of the same named section included in the paper format Annual Report on pages 16-18.]

Consolidated Statements of Earnings

(dollars in millions, except per share)

	1996	1995<F*>	1994
Net retail sales	$2,333.7	$2,330.3	$2,116.4
Cost of sales	1,660.9	1,693.4	1,492.3
Selling, general and administrative expenses	487.3	475.2	405.9
Special and nonrecurring items	12.6	71.8	--
Interest (income) expense, net	(6.2)	1.0	1.1
Total cost of sales and expenses	2,154.5	2,241.4	1,899.3
Earnings before income taxes	179.1	88.9	217.1
Provision for income taxes	71.4	34.9	85.6
Net earnings	$ 107.7	$ 54.0	$ 131.5
Net earnings per common share	$ 2.68	$ 1.34	$ 3.26

<FN>
<F*>1995 contains 53 weeks.
See Notes to Consolidated Financial Statements.

Consolidated Statements of Shareowners' Equity

(dollars in millions, shares in thousands, unless otherwise noted)

	Outstanding Common Stock Shares	Outstanding Common Stock Dollars	Additional Paid-in Capital	Unearned Restricted Stock	Retained Earnings	Total Shareowners' Equity
Balance at January 29, 1994	--	$--	$ --	$ --	$661.1	$661.1
Net earnings			--		131.5	131.5
Net transfers with May			--		1.3	1.3
Balance at January 28, 1995	--	--	--	--	793.9	793.9
Net earnings	--	--	--	--	54.0	54.0
Net transfers with May	--	--	--		(95.0)	(95.0)
Balance at February 3, 1996	--	--	--	--	752.9	752.9
Net earnings		--	--	--	107.7	107.7
Shares issued, spin-off	39,971	.4	--	--	(.4)	--
Stock issued under restricted stock plan, net	409	--	12.0	(12.0)	--	--
Amortization of unearned restricted stock	--	--	--	8.9	--	8.9
Purchase of common stock	(460)	--	--	--	(16.5)	(16.5)
Balance at February 1, 1997	39,920	$.4	$12.0	$ (3.1)	$843.7	$853.0

Outstanding common stock excludes shares held in treasury. At February 1, 1997, 39.9 million shares were outstanding and 1.1 million shares were held in treasury. At May 4, 1996, 40.4 million shares were outstanding and .6 million shares were held in treasury.

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

(dollars in millions)

	February 1, 1997	February 3, 1996
Assets		
Current assets:		
Cash and cash equivalents	$ 193.6	$ 4.6
Accounts receivable	4.4	4.4
Merchandise inventories	354.8	398.0
Other current assets	5.4	4.2
Current deferred income taxes	34.0	39.7
Total current assets	592.2	450.9
Property and equipment:		
Land	5.3	6.5
Buildings and leasehold improvements	545.1	574.0
Furniture, fixtures and equipment	275.7	278.7
Property under capital leases	8.0	9.3
Total property and equipment	834.1	868.5
Accumulated depreciation and amortization	(331.6)	(308.5)
Property and equipment	502.5	560.0
Goodwill	2.8	2.9
Other assets	0.4	0.5
Total assets	$1,097.9	$1,014.3
Liabilities and Shareowners' Equity		
Current liabilities:		
Current maturities of capital lease obligations	$ 1.3	$ 1.3
Accounts payable	82.9	65.0
Accrued expenses	119.1	152.6
Total current liabilities	203.3	218.9
Capital lease obligations	8.2	10.3
Deferred income taxes	6.1	8.9
Other liabilities	27.3	23.3
Shareowners' Equity:		
Common stock, $.01 par value, 41,000,000 shares authorized and issued; 39,919,635 shares outstanding	.4	--
Additional paid-in capital	12.0	--
Unearned restricted stock	(3.1)	--
May equity investment	--	752.9
Retained earnings	843.7	--
Total shareowners' equity	853.0	752.9
Total liabilities and shareowners' equity	$1,097.9	$1,014.3

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(dollars in millions)

	1996	1995	1994
Operating Activities:			
Net earnings	$107.7	$ 54.0	$ 131.5
Adjustments for noncash items included in net earnings:			
Depreciation and amortization	90.3	95.3	77.0
Deferred income taxes	2.9	(0.3)	11.7
Special and nonrecurring items	--	71.8	--
Tax benefit on special and nonrecurring charges	--	(28.2)	--
Accounts receivable, net	0.1	0.2	(0.6)
Merchandise inventories	43.2	(4.1)	(20.4)
Other current assets	(1.1)	4.7	(6.9)
Accounts payable	17.9	(36.5)	11.1
Accrued expenses	(33.5)	1.2	26.4
Other assets and liabilities, net	4.1	1.2	4.3
Total operating activities	231.6	159.3	234.1
Investing Activities:			
Capital expenditures	(73.4)	(95.4)	(255.2)
Disposition of property and equipment	40.5	30.7	21.5
Other	--	--	(1.3)
Total investing activities	(32.9)	(64.7)	(235.0)
Financing Activities:			
Repayment of capital lease obligations	(2.1)	(1.6)	(1.3)
Purchase of common stock, net	(7.6)	--	--
Net transactions with May	--	(95.0)	1.3
Total financing activities	(9.7)	(96.6)	--
Increase (Decrease) in cash and cash equivalents	189.0	(2.0)	(0.9)
Cash and cash equivalents, beginning of year	4.6	6.6	7.5
Cash and cash equivalents, end of year	$193.6	$ 4.6	$ 6.6
Cash paid during the year:			
Interest	$ 1.4	$ 1.0	$ 1.2
Income taxes	67.5	--	--

See Notes to Consolidated Financial Statements.

[The following "Notes to Consolidated Financial Statements" section is a reproduction of the same named section included in the paper format Annual Report on pages 19-23.]

Notes to Consolidated Financial Statements

(dollars in millions, except per share)

Summary of Significant Accounting Policies

DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Payless ShoeSource, Inc., a Missouri corporation, is the largest family footwear retailer in the United States. As of February 1, 1997, Payless operated 4,236 self-service family shoe stores. Payless stores are located in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Payless utilizes a network of agents with factories in 13 foreign countries and the United States to source its products, which are manufactured to meet the Payless specifications and standards. Factories in the People's Republic of China are a source of approximately 80 percent of Payless merchandise.

Payless was a subsidiary of The May Department Stores Company until its spin-off was completed on May 4, 1996. The consolidated financial statements for all years presented include entire fiscal year results and the accounts of Payless and all wholly owned subsidiaries.

FISCAL YEAR

The Payless fiscal year ends on the Saturday closest to January 31. Fiscal year 1996 ended on February 1, 1997, and included 52 weeks. Fiscal year 1995, which included 53 weeks, ended February 3, 1996. Fiscal 1994 ended on January 28, 1995, and included 52 weeks. References to years in these financial statements and notes relate to fiscal years rather than calendar years.

RECLASSIFICATION

Certain reclassifications have been made to prior year balances to conform with current year presentation.

NET RETAIL SALES

Net retail sales (sales) represent the sales of all stores operated during the period, are net of returns and exclude sales tax.

COST OF SALES

Cost of sales includes the cost of merchandise sold, buying and occupancy costs.

EARNINGS PER SHARE

For 1996 earnings per share is computed by dividing net earnings by the average common shares outstanding during the period. For periods presented before 1996, earnings per share has been calculated using the number of common shares as of May 4, 1996, the date of the spin-off from May. Average common shares outstanding are 40.2, 40.4 and 40.4 million in 1996, 1995 and 1994, respectively.

CASH AND CASH EQUIVALENTS

Payless considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

ACCOUNTS RECEIVABLE

Sales are made for cash or third party credit; therefore, no customer trade receivables exist. Accounts receivable represents amounts due for damage claims, wholesale of shoes to liquidators and sublease rentals.

MERCHANDISE INVENTORIES

Merchandise inventories are valued by the retail method and are stated at the lower of cost, determined using the first-in, first-out (FIFO) basis, or market.

PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Property and equipment are depreciated on a straight-line basis over their estimated useful lives. Investments in properties under capital leases and leasehold improvements are amortized over the shorter of their useful lives or their related lease terms.

GOODWILL

Goodwill represents the excess of cost over the fair value of net tangible assets at the dates of acquisition. Substantially all amounts are amortized using the straight-line method over a 40-year period. Goodwill is presented net of accumulated amortization of $1.8 and $1.7 in 1996 and 1995, respectively.

PREOPENING EXPENSES

Costs associated with the opening of new stores are expensed during the year incurred.

INCOME TAXES

Payless was included in the consolidated tax return filed by May for federal, state and local income tax purposes for the years prior to 1996 and will be included in May's 1996 tax return for the period from February 4, 1996, through May 4, 1996. The provision for income taxes for those periods is calculated on a separate return basis.

LONG-LIVED ASSETS
During 1995 Payless adopted Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of. Impairment charges did not have a material effect on the financial statements in 1996. No impairment charges were recognized in 1995.

ADVERTISING COSTS

Advertising costs are expensed at the time the advertising takes place. Included in selling, general and administrative expenses are advertising and sales promotion costs of $66.4, $60.6 and $53.4 in 1996, 1995 and 1994, respectively.

DERIVATIVES POLICY

The Payless policy is to use financial derivatives only to reduce risk in conjunction with specific business transactions. Gains and losses related to hedges of firm commitments or anticipated transactions are deferred and recognized in operating results or included in balance sheet amounts when the transactions occur.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts. While the financial statements reflect all available information and management's judgment and estimates of current conditions and circumstances and are prepared with the assistance of specialists within and outside Payless, actual results could differ from those estimates.

Relationship with May

Prior to 1996, May provided various services to Payless, including legal, benefit administration, risk management and insurance, income and payroll tax management, and treasury services. In anticipation of the spin-off, Payless became solely responsible for substantially all of these services at the beginning of 1996. May continued to provide tax and treasury services until the spin-off was complete. These financial statements include specific charges from May for legal and risk management and insurance services based upon utilization and are representative of May's actual cost. These charges were $0.4, $4.2 and $3.6 in fiscal years 1996, 1995 and 1994, respectively. These costs could have been different had Payless operated as an independent company during these periods.

Prior to February 4, 1996, cash collected by Payless in excess of store operating needs was transferred to May on a daily basis, and all of the Payless cash requirements were funded by May. The cumulative net impact of these cash transfers and other intercompany transactions were recorded as an intercompany payable to May. Intercompany transactions include amounts paid by May for federal, state and local income taxes, payroll taxes and workers' compensation and general liability claims. Accordingly, the 1995 and 1994 financial statements may not be indicative of the debt or investment structure and related interest expense or income that might have resulted had Payless operated as an independent company.

All intercompany debt owed to May was contributed to May equity investment as of February 3, 1996, and therefore has been deemed to be part of the May equity investment in 1995.

Quarterly Results (Unaudited)

Quarterly results of operations are determined in accordance with the annual accounting policies and include certain items based upon estimates for the entire year.

Summarized quarterly results for the last two years are as follows:

	1996				
Quarter	First	Second	Third	Fourth	Year
Net retail sales	$601.4	$632.5	$576.8	$523.0	$2,333.7
Cost of sales<F1>	427.1	443.0	408.0	382.6	1,660.9
Net earnings	$ 24.2	$ 38.9	$ 29.4	$ 15.1	$ 107.7
Earnings per common share	$ .60	$ .96	$ .74	$ .38	$ 2.68

	1995				
Quarter	First	Second	Third	Fourth	Year
Net retail sales	$569.6	$622.7	$586.4	$551.6	$2,330.3
Cost of sales<F1>	404.2	447.2	425.1	416.8	1,693.4
Net earnings<F2>	$ 26.5	$ 34.2	$ 25.7	$(32.4)	$ 54.0

Earnings per common share	$ .66	$ .84	$ .64	$ (.80)	$ 1.34

<FN>

<F1>Certain expenses related to asset disposals have been reclassified from SG&A to cost of sales for 1995 and 1996.

<F2>Net earnings, excluding special and nonrecurring items, are $11.1 for the fourth quarter and $97.5 for the full year.

Special and Nonrecurring Items

During the 1995 fourth quarter, in connection with the spin-off, Payless committed to close or relocate underperforming stores during 1996. In addition, Payless implemented a plan to reduce central office overhead by means of a personnel reduction and initiation of expense control programs. A pretax special and nonrecurring charge of $71.8 was recorded for these initiatives. During 1996, Payless closed or relocated 484 underperforming stores and restructured the central office at a cost of $48.8. The remaining $23.0 reserve will be used to cover remaining lease buyouts, holding costs and fixed asset write-offs for the stores closed in 1996. In addition, it will fund closing costs of an estimated 40 additional underperforming stores to be closed in the spring of 1997.

In connection with the spin-off, Payless initiated a Spin-off Stock Plan and a Spin-off Cash Plan as retention programs. Under these plans, Payless committed to pay out 408,558 shares of restricted stock and cash payments ranging from 10 percent to 37.5 percent of certain associates' base salaries. These retention incentives are contingent upon continued employment for up to two years after May 4, 1996. The costs related to these incentives are being expensed as earned during the retention period: $12.6 in 1996, and $4.6 in 1997, and $0.8 in 1998.

Profit Sharing

As of April 1, 1996, Payless associates began to participate in the Payless Profit Sharing Plan (Payless Plan). Substantially all of the associates' balances in The May Department Stores Company Profit Sharing Plan (May Plan), including amounts invested in May common stock, were transferred to the Payless Plan.

Contributions to the Payless Plan are related to Payless performance each year. At management's discretion each year, Payless expects to contribute 2.5 percent of its pretax net earnings to the Payless Plan. Associates may voluntarily contribute to the Payless Plan on both a before-tax and after-tax basis. Total profit sharing expense was $4.6 in 1996. Payless profit sharing expenses under the May Plan were $1.8 and $2.3 in 1995 and 1994, respectively.

Retirement

Payless has no tax-qualified retirement plan. Before the spin-off, May Retirement Plan expenses were charged to Payless by May based upon the actuarially determined portion of Payless service costs. The expense charged to Payless was $3.6 in 1995, and $3.1 in 1994.

Payless associates who were covered by the May Retirement Plan prior to the spin-off date will continue to vest in the benefits earned under that plan. Benefits accrued through the spin-off date have been "frozen" and will be paid out in the future.

Payless has a supplementary retirement plan (Supplementary Plan) generally covering associates who, at one time, had compensation in a calendar year equal to at least twice the amount of "wages" then subject to the payment of old age, survivor and disability insurance (Social Security) taxes. The Supplementary Plan is unfunded. The accumulated benefit obligation of $1.6 is included in other liabilities at February 1, 1997.

Taxes

The provision for income taxes for the last three years consists of the following:

	1996	1995	1994
Current provision:			
Federal	$49.2	$50.7	$62.6
State and local	11.4	11.0	15.1
Taxes currently payable	60.6	61.7	77.7
Deferred provision:			
Federal	8.7	(22.0)	6.5
State and local	2.1	(4.8)	1.4
Deferred taxes	10.8	(26.8)	7.9
Total provision	$71.4	$34.9	$85.6

The reconciliation between the statutory federal income tax rate and the effective income tax rate for the last three years is as follows:

	1996	1995	1994
Statutory federal income tax rate	35.0%	35.0%	35.0%
State and local income taxes	7.5	7.0	7.6
Federal tax benefit of state and local income taxes	(2.6)	(2.5)	(2.6)
Other, net	(0.0)	(0.2)	(0.6)
Effective income tax rate	39.9%	39.3%	39.4%

Major components of deferred tax assets and (liabilities) are as follows:

	February 1, 1997	February 3, 1996
Accrued expenses and reserves	$ 39.4	$ 40.3
Depreciation/amortization and basis differences	(13.8)	(14.5)
Other deferred income tax liabilities, net	2.3	5.0
Net deferred income taxes	27.9	30.8
Net current deferred income tax assets	34.0	39.7
Noncurrent deferred income taxes	$ (6.1)	$ (8.9)

Taxes other than income taxes consist of:

	1996	1995	1994
Payroll	$31.1	$31.4	$27.4
Real estate and personal property	29.7	31.2	26.2
Total	$60.8	$62.6	$53.6

Accrued Expenses
Components of accrued expenses include:

	February 1, 1997	February 3, 1996
Insurance costs	$ 30.1	$ 27.3
Special and nonrecurring charges	23.0	68.4
Profit sharing, bonus, retention	19.9	2.6
Taxes other than income	14.2	19.3
Construction costs	14.1	9.6
Other operating expenses	8.5	16.7
Interest and rent expense	5.8	5.7
Salaries, wages and employee benefits	3.5	3.0
Total	$119.1	$152.6

Lines of Credit
Payless has in place a $200 unsecured revolving credit facility with a bank syndication group. At February 1, 1997, there were no amounts outstanding.

Lease Obligations

Payless leases substantially all of its stores. Rental expense for the Payless operating leases consist of:

	1996	1995	1994
Minimum rentals	$217.8	$221.3	$184.7
Contingent rentals based on sales	2.7	3.0	4.2
Real property rentals	220.5	224.3	188.9
Equipment rentals	0.8	0.7	0.6
Total	$221.3	$225.0	$189.5

Payless has certain lease agreements that include escalating rents over the lease term. Cumulative expense recognized on the straight-line basis in excess of cumulative payments is $27.3, and is included in accrued expenses and other liabilities.

Future minimum lease payments at February 1, 1997, are as follows:

	Capital Leases	Operating Leases	Total
1997	$ 2.2	$ 196.9	$ 199.1
1998	2.2	180.0	182.2
1999	2.2	162.9	165.1
2000	1.4	142.6	144.0
2001	1.4	117.7	119.1
After 2002	4.7	257.5	262.2
Minimum lease payments	$14.1	$1,057.6	$1,071.7
Less imputed interest component	4.6		
Present value of net minimum lease payments of which $1.3 is included in current liabilities	$ 9.5		

At February 1, 1997, the present value of operating leases was $817.9.

Property under capital leases is summarized as follows:

	February 1, 1997	February 3, 1996
Cost	$ 8.0	$ 9.3
Accumulated amortization	(5.6)	(6.0)
Total	$ 2.4	$ 3.3

Stock Compensation Plans
Under the Payless 1996 Stock Incentive Plan (the Plan), officers and key employees may be granted stock options and other stock-based awards. A total of 2,800,000 shares of Payless common stock has been authorized to be issued under the Plan. As of February 1, 1997, options for 499,344 shares were outstanding under the Plan, including options for 185,994 shares, which represent options that had previously been issued to Payless employees under the stock incentive plan of The May Department Stores Company and were

converted to options under the Payless Plan at the rate of 1.25 Payless options for every May option. The Payless options converted from May options and some of the options granted to senior officers of Payless have an exercise price equal to the average of the high and low trading prices of Payless stock for each of the first 30 days on which the stock was traded. All other options have an exercise price equal to the average of the high and low trading prices of the stock on the date the option is granted. Options converted from May become exercisable in installments of 50 percent per year in each of the first two anniversaries of the grant date. The remaining options become exercisable in installments of 25 percent per year on each of the first through the fourth anniversaries of the grant date. All options have a term of 10 years.

The changes in outstanding stock options for the year ended February 1, 1997, were as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding at beginning of period (May 4, 1996)	--	--
Converted from May options	191,463	$27.03
Granted	321,850	$28.10
Canceled	13,969	$27.58
Outstanding at end of year	499,344	$27.70

Payless applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for its Plan. Accordingly, no compensation expense has been recognized for its stock-based compensation plans other than for restricted stock and performance-based awards. Had compensation cost for the Payless stock options been determined based upon the fair value at the grant date for awards under its Plan consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, net earnings and earnings per share for Payless would have been reduced by approximately $2.1, or $.05 per share, respectively. Options outstanding at February 1, 1997, have a weighted average contractual life of nine years, and there are no shares exercisable. The weighted average fair value of the options granted during 1996 is estimated at $15.83 on the date of grant using the Black-Scholes option-pricing model with the following assumptions: expected dividend yield of zero, volatility of 30 percent, risk-free interest rate of 6.47 percent and an expected life of 10 years.

Payless also has established restricted stock programs that are designed to retain key management employees and directors. Total shares authorized under these programs were 975,000, of which 408,558 shares were outstanding at February 1, 1997. The majority of shares were issued under the spin-off retention plan of which one-third of the shares were immediately vested at the time of the spin-off. An additional one-third vest on May 4, 1997, and the remainder on May 4, 1998, provided an employee is still employed by Payless on those dates. Compensation expense is recognized over the restricted period, and was $8.9 for the year ending February 1,1997.

Shareowner Rights Plan

Payless has a shareowner rights plan under which a right is attached to each share of Payless common stock. The rights become exercisable only under certain circumstances involving actual or potential acquisitions of Payless common stock by a person or affiliated persons. Depending on the circumstances, if the rights become exercisable, the holder may be entitled to purchase units of Payless preference stock, shares of Payless common stock or shares of the common stock of the acquiring person. The rights will remain in existence until April 30, 2006, unless they are terminated, extended, exercised or redeemed.

[The following "Report of Independent Public Accountants" section is a reproduction of the same named section included in the paper format Annual Report on page 24.]

Report of Independent Public Accountants

To the Board of Directors and Shareowners of Payless ShoeSource, Inc.:

We have audited the accompanying consolidated balance sheet of Payless ShoeSource, Inc. (a Missouri corporation) and subsidiaries as of February 1, 1997, and February 3, 1996, and the related consolidated statements of earnings, shareowners' equity and cash flows for each of the three fiscal years in the period ended February 1, 1997. These financial statements are the responsibility of the Payless management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Payless ShoeSource, Inc. and subsidiaries as of February 1, 1997, and February 3, 1996, and the results of their operations and their cash flows for each of the three fiscal years in the period ended February 1, 1997, in conformity with generally accepted accounting principles.

/s/ Arthur Andersen LLP
Arthur Andersen LLP
St. Louis, Missouri
February 21, 1997

[The following "Summary of Selected Historical Financial Information" section is a reproduction of the same named section included in the paper format Annual Report on pages 25-26.]

Summary of Selected Historical Financial Information

(dollars in millions, except per share)

The following table presents selected historical financial information for Payless. The information presented below reflects periods during which Payless did not operate as an independent company, and, accordingly, certain assumptions were made in preparing this financial information. Therefore, this information may not necessarily reflect the consolidated results of operations or financial position that would have existed if Payless had been an independent company during the periods shown or the future performance of Payless as an independent company. The financial information below should be read in conjunction with the consolidated financial statements and the notes in this annual report.

Fiscal Year<F*>	1996	1995	1994	1993	1992	1991
Statement of Earnings Data:						
Net retail sales	$2,333.7	$2,330.3	$2,116.4	$1,966.5	$1,787.8	$1,547.5
Cost of sales<F1>	1,660.9	1,693.4	1,492.3	1,367.6	1,225.9	1,058.3
Selling, general and administrative expenses<F1>	487.3	475.2	405.9	377.2	349.6	308.9
Interest (income) expense, net	(6.2)	1.0	1.1	0.9	0.8	1.3
Special and nonrecurring items	12.6<F2>	71.8<F3>	--	--	--	--
Total cost of sales and expenses	2,154.6	2,241.4	1,899.3	1,745.7	1,576.3	1,368.5
Earnings before income taxes	179.1	88.9	217.1	220.8	211.5	179.0
Provision for income taxes	71.4	34.9	85.6	88.0	80.4	68.2
Net earnings	$ 107.7	$ 54.0<F3>	$ 131.5	$ 132.8	$ 131.1	$ 110.8
Balance Sheet Data:						
Working capital	$ 388.9	$ 232.0	$ 242.8	$ 253.5	$ 206.1	$ 191.7
Property and equipment, net	502.5	560.0	590.6	433.9	383.9	343.5
Total assets	1,097.9	1,014.3	1,019.8	840.8	732.7	692.7
Total debt	9.5	11.5	13.1	14.5	16.1	16.9
Total equity<F4>	853.0	752.9	793.9	661.0	571.1	530.9
Other Financial Data:						
Capital expenditures	$ 73.4	$ 95.4	$ 255.2	$ 139.8	$ 119.3	$ 145.6
Present value of operating leases	817.9	885.5	952.1	779.9	688.1	554.0
Earnings before interest, income taxes, depreciation and amortization<F5>	263.2	185.2	295.2	288.7	245.2	226.1
Net retail sales growth	1.4%<F6>	10.1%	7.6%	10.0%	15.5%	13.3%
Store-for-store sales growth	3.6%	(3.7)%	(0.2)%	1.7%	2.8%	2.6%
Number of stores (at year-end)	4,236	4,549	4,435	3,779	3,570	3,295

<FN>

<F*> The Payless fiscal year ends on the Saturday closest to January 31. Fiscal year 1995 includes 53 weeks.

<F1> Certain expenses related to asset disposals have been reclassified from SG&A to cost of sales for all years.

<F2> Payless incurred executive retention costs associated with the spin-off that established Payless as an independent public company.

<F3> During the 1995 fourth quarter, in connection with the spin-off, Payless committed to close or relocate underperforming stores during 1996. In addition, Payless committed to restructure its central office and other personnel. The 1995 net earnings, excluding special and nonrecurring items, is $97.5.

<F4> Prior to 1996, total equity was the total May equity investment.

<F5> EBITDA should not be considered in isolation or as a substitute for measures of performance or cash generation prepared in accordance with generally accepted accounting principles. See the consolidated financial statements and the accompanying notes.

<F6> Growth percentage based on a 52-week comparison.

Management's Responsibilty
- - -------------------------

Report of Management
Management is responsible for the preparation, integrity and objectivity of the financial information included in this annual report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts. Although the financial statements reflect all available information and management's judgment and estimates of current conditions and circumstances, prepared with the assistance of specialists within and outside Payless, actual results could differ from those estimates.

Management has established and maintains a system of accounting and controls to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, that the accounting records provide a reliable basis for the preparation of financial statements, and that such financial statements are not misstated due to material fraud or error. The system of controls includes the careful selection of associates, the proper segregation of duties and the communication and application of formal policies and procedures that are consistent with high standards of accounting and administrative practices. An important element of this system is a comprehensive internal audit program.

Management continually reviews, modifies and improves its systems of accounting and controls in response to changes in business conditions and operations and in response to recommendations in the reports prepared by the independent public accountants and internal auditors.

Management believes that it is essential for Payless to conduct its business affairs in accordance with the highest ethical standards and in conformity with the law. This standard is described in the company's policies on business conduct, which are publicized throughout Payless.

Audit and Finance Committee of the Board of Directors
The Board of Directors, through the activities of its Audit and Finance Committee, participates in the reporting of financial information by Payless. The committee meets regularly with management, the internal auditors and the independent public accountants. The committee reviewed the scope, timing and fees for the annual audit and the results of the audit examinations completed by the internal auditors and independent public accountants, including the recommendations to improve certain internal controls and the follow-up reports prepared by management. The independent public accountants and internal auditors have free access to the committee and the Board of Directors and attend each meeting of the committee.

The members of the Audit and Finance Committee are Thomas A. Hays, Michael E. Murphy and Robert L. Stark. The Audit and Finance Committee reports the results of its activities to the full Board of Directors.

Forward-looking Statements
From time to time, Payless may publish forward-looking statements relating to such matters as anticipated financial perform-ance, business prospects, technological developments, new products, future store openings, possible strategic alternatives and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, Payless notes that a variety of factors could cause its actual results and experience to differ materially from the anticipated results or other expectations expressed in the Payless forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the company's business include, but are not limited to, the following: changes in consumer spending patterns; consumer preferences and overall economic conditions; the impact of competition and pricing; changes in weather patterns; the financial condition of the suppliers and manufacturers from whom Payless sources its merchandise; changes in existing or potential duties, tariffs or quotas; availability of suitable store locations and appropriate terms; and the ability to hire and train associates.

[The following "Shareowner Information" section is a reproduction of the same named section included in the paper format Annual Report on page 28.]

Shareowner Information

CORPORATE HEADQUARTERS
Payless ShoeSource, Inc.
3231 S.E. Sixth Street
Topeka, KS 66607-2207
(913) 233- 5171

1997 ANNUAL MEETING
The Annual Meeting of Shareowners will be held at 10:00 a.m., Central Time, on Friday, May 23, 1997, at:

Bradbury Thompson Center
Washburn University
1700 S.W. College
Topeka, KS

COMMON STOCK
Shares of Payless ShoeSource are listed and traded on the New York Stock Exchange. The trading symbol is PSS.

INFORMATION REQUESTS
Copies of the company's annual report to shareowners, the Form 10-K annual report to the Securities and Exchange Commission (SEC), the Form 10-Q quarterly reports to the SEC, monthly sales releases and quarterly earnings releases are available free of charge to shareowners by writing to Corporate Communications/ Investor Relations at the corporate headquarters or by calling the number shown above.

PAYLESS SHOESOURCE ON THE INTERNET
Recent press releases issued by the company and other information are available on our World Wide Web home page. Visit us at http://www.paylessshoesource.com.

SHAREOWNER INQUIRIES
Shareowner inquiries regarding stock transfer, lost certificates or address changes should be directed to the stock transfer agent and registrar, The Bank of New York, as shown below.

Please address shareholder inquiries to:

Shareholder Relations Department - 11E
The Bank of New York
P.O. Box 11258
Church Street Station
New York, NY 10286
(800) 524-4458

Please send certificates for transfer and address changes to:

Receive and Deliver Department - 11W
The Bank of New York
P.O. Box 11002
Church Street Station
New York, NY 10286

The e-mail address for the bank is: shareowner-svcs@Email.bony.com.

Securities analysts, shareowners and investment professionals should direct inquiries regarding Payless ShoeSource and its business to Steve Frazier, Vice President - Corporate Development, at the corporate headquarters by calling (913) 295-6078.

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Exhibit 21.1

PAYLESS SHOESOURCE INC. AND SUBSIDIARIES

SUBSIDIARIES OF REGISTRANT

The corporations listed below are subsidiaries of Registrant, and all are included in the consolidated financial statements of Registrant as subsidiaries (unnamed subsidiaries, considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary):

Name	Jurisdiction in which organized
Payless ShoeSource Distribution, Inc.	Kansas
Payless ShoeSource Merchandising, Inc.	Kansas
Payless ShoeSource Worldwide, Inc.	Kansas

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Exhibit 23.1

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports included or incorporated by reference in this Form 10-K for the year ended February 1, 1997, into the Company's previously filed Registration Statements on Form S-8 (No. 333-02559).

ARTHUR ANDERSEN LLP
St. Louis, Missouri
April 24, 1997

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EXHIBIT 27 --  THIS SCHEDULE CONTAINS SUMMARY FINANCIAL
INFORMATION EXTRACTED FROM PAYLESS SHOESOURCE, INC. CONDENSED
CONSOLIDATED STATEMENT OF EARNINGS FOR THE 52 WEEKS ENDED FEB 1,
1997, AND CONDENSED CONSOLIDATED BALANCE SHEET AS OF FEB 1, 1997,
AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL
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<F3>Receivables are net after deduction of allowances.
<F4>Consists of Capital Lease Obligations.
<F5>Reflects Retained Earnings and Additional Paid In Capital.
<F6>Reflects net sales.
<F7>Expressed in dollars.
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EXHIBIT 24.1

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven J. Douglass, Ullrich E. Porzig, and William J. Rainey, and each or any one of them acting alone, as his true and lawful attorney-in-fact and agent, with full power of substitution for him and in his name, place and stead, in any and all capacities, to sign the Payless ShoeSource, Inc. Annual Report on Form 10-K for the fiscal year ended February 1, 1997, and any amendments thereto and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises to perfect and complete such filing(s), as fully to all the intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his substitute, may lawfully do or cause to be done by virtue thereof.

Dated this 17th day of April, 1997.

/s/ Steven J. Douglass

Steven J. Douglass

/s/ Richard A. Jolosky

Richard A. Jolosky

/s/ Howard R. Fricke

Howard R. Fricke

/s/ Thomas A. Hays

Thomas A. Hays

/s/ Michael E. Murphy

Michael E. Murphy

/s/ Robert L. Stark

Robert L. Stark

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