FORM 10–K

PAYLESS SHOESOURCE INC /DE/ – PSS

Filed: April 07, 2006 (period: January 28, 2006)

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

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PART I

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10–K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended January 28, 2006

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: 1–14770

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

Delaware (State or other jurisdiction of incorporation or organization)	**48–1813160** (I.R.S. Employer Identification No.)
3231 Southeast Sixth Avenue, Topeka, Kansas (Address of principal executive offices)	**66607–2207** (Zip Code)

(785) 233–5171
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value 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]

Indicate by check mark if the registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes ☐ No ☑

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 ☑ 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. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non–accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b–2 of the Exchange Act.

Large accelerated filer ☑ Accelerated filer ☐ Non–accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b–2 of the Exchange Act).
Yes ☐ No ☑

The aggregate market value of the registrant's common stock held by non–affiliates of the registrant was $1,284 million based on the closing price of $19.42 as reported on the New York Stock Exchange on July 29, 2005, the last trading day of the registrant's

second fiscal quarter.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at April 3, 2006
Common Stock, $.01 par value per share	66,553,965 shares

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated
Proxy Statement for the Annual Meeting of Stockholders to be held on May 25, 2006 (Proxy Statement)	Part III

Forward Looking Statements

This report contains, and from time to time we may publish, forward−looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, new products, future store openings, international expansion, possible strategic alternatives, new business concepts, capital expenditures, fashion trends and similar matters. Statements including the words "expects," "anticipates," "intends," "plans," "believes," "seeks," or variations of such words and similar expressions are forward−looking statements. We note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in our forward−looking statements. The risks and uncertainties that may affect the operations, performance, development and results of our business include, but are not limited to, the following: changes in consumer spending patterns; changes in 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 we source our merchandise; changes in existing or potential duties, tariffs or quotas; changes in relationships between the United States and foreign countries; changes in relationships between Canada and foreign countries; economic and political instability in foreign countries or restrictive actions by the governments of foreign countries in which suppliers and manufacturers from whom we source products are located or in which we operate stores; changes in trade, intellectual property, customs and/or tax laws; fluctuations in currency exchange rates; availability of suitable store locations on appropriate terms; the ability to hire, train and retain associates; general economic, business and social conditions in the countries from which we source products, supplies or have or intend to open stores; the performance of partners in joint ventures; the ability to comply with local laws in foreign countries; threats or acts of terrorism or war; strikes, work stoppages or slowdowns by unions that play a significant role in the manufacture, distribution or sale of product; congestion at major ocean ports; and changes in commodity prices such as oil. See also "Risk Factors." All subsequent written and oral forward−looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We do not undertake any obligation to release publicly any revisions to such forward−looking statements to reflect events or circumstances after the date hereof or thereof or to reflect the occurrence of unanticipated events. See also "Risk Factors."

PAYLESS SHOESOURCE, INC.
FORM 10–K
FOR THE FISCAL YEAR ENDED JANUARY 28, 2006
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401(k) Profit Sharing Plan
Stock Ownership Plan
Computation of Net Earnings Per Share
Subsidiaries of the Company
Consent of Deloitte & Touche LLP
Certification Pursuant to Rules 13(a)–14(a) & 15(d)–14(a)
Certification Pursuant to Rules 13(a)–14(a) & 15(d)–14(a)
Certification Pursuant to 18 U.S.C. 1350
Certification Pursuant to 18 U.S.C. 1350

PART I

ITEM 1. BUSINESS

General

We are the largest family footwear specialty retailer in the Western Hemisphere with 4,605 retail stores as of fiscal year−end 2005, including 22 stores not open for operations at year−end as a result of the hurricanes Katrina, Rita and Wilma. Our Payless ShoeSource retail stores in the United States, Canada, the Caribbean, Central America, South America, and Japan sold over 182 million pairs of footwear during fiscal 2005. Payless ShoeSource stores offer fashionable, quality, private and branded label footwear and accessories for women, men and children at affordable prices in a self−selection shopping format. All references to years are to our fiscal year unless otherwise stated. All data is based on continuing operations unless otherwise specifically stated.

Our Payless ShoeSource® stores sell a broad assortment of quality footwear, including athletic, casual and dress shoes, sandals, work and fashion boots, slippers and accessories, such as handbags and hosiery, at affordable prices. As of fiscal year−end 2005, each Payless ShoeSource store stocked on average 6,700 pairs of footwear. Over 50% of the footwear inventory found in a Payless ShoeSource store is generally stocked based on the demographics and customer profile of that store's location. As part of our strategy to create an emotional connection with our customer, we intend to deliver consumer relevant on−trend fashion and design, at prices that are accessible to everyone.

We offer footwear and accessories for women, men and children of all ages, but we focus our marketing efforts on women consumers between the ages of 18 and 49 with household incomes of less than $75,000. We believe this group of consumers makes a disproportionately large share of household footwear purchasing decisions. We believe that approximately 40% of these target consumers purchased at least one pair of footwear from our stores last year.

We operate our stores in a variety of real estate formats, including shopping malls, central business districts, free−standing buildings, strip centers, and leased departments in other retailers. We generally lease our stores with initial terms of five to ten years and either one or two renewal options.

In 2005, we generated net sales from continuing operations of $2.67 billion, as compared with $2.66 billion in 2004.

History

We were founded in Topeka, Kansas in 1956 with a strategy of selling low−cost, high−quality family footwear on a self−service basis. In 1962, we became a public company. In 1979, we were acquired by The May Department Stores Company of St. Louis, Missouri. On May 4, 1996, we became an independent public company as a result of a spin−off from The May Department Stores Company. Our common stock is listed for trading on the New York Stock Exchange (the "NYSE") under the symbol "PSS." Our principal executive offices are located at 3231 Southeast Sixth Avenue, Topeka, Kansas 66607−2207, and our telephone number is (785) 233−5171. Our investor relations website address is *www.paylessinfo.com*. In addition, footwear can be purchased any time at *www.payless.com* which also includes a link to our investor relations website. Information included or referred to on our website is not part of this annual report on Form 10−K.

Segments and Geographic Areas

We operate our business in two segments, Payless Domestic and Payless International. The Payless Domestic segment includes retail operations in the United States, Guam and Saipan. The Payless International segment includes retail operations in Canada; Puerto Rico; the U.S. Virgin Islands; Japan; the South American Region which includes Ecuador; and the Central American Region which includes Costa Rica, Guatemala, El Salvador, the Dominican Republic, Honduras, Nicaragua, Panama and Trinidad and Tobago. Our operations in the Central and South American Regions and Japan are operated as joint ventures in which we maintain a 60−percent ownership interest.

For a more detailed discussion of our segments and geographic areas please see the discussion contained in Note 19 "Segment Reporting" in the Notes to Consolidated Financial Statements.

Leading Market Share and Brand Recognition

With over 4,600 stores, we have strong brand recognition. In 2005, we sold over 182 million pairs of footwear in our Payless ShoeSource stores, making Payless the largest family footwear specialty retailer in the Western Hemisphere. We average nearly 600 million customer visits per year.

We utilize extensive national and local advertising through multiple formats, including television, radio and print, to strengthen our established brand name, reinforce our broad consumer recognition and support our promotional events. Our new brand essence, "Inspiring fun fashion possibilities for the family−Payless," will help define Payless as the fun fashion source for footwear and accessories for the family.

Flexible Real Estate Strategy

We believe that our real estate strategy provides us with the ability to optimally locate our stores in places that are convenient for large numbers of consumers, as well as the flexibility to react quickly to shifts in consumer demographics and competitive conditions. We strategically locate our stores in a variety of retail formats to maximize convenience and accessibility for our broad consumer base, including central business districts, shopping malls, free−standing buildings, strip centers, and leased departments within other retailers. To maintain flexibility, we generally enter into leases with initial terms of five to ten years and either one or two renewal options.

In 2005, it cost us approximately $200,000 in capital expenditures to open a new store. During 2006, we expect the average capital costs for a new store to increase to approximately $250,000. During 2005, we opened 46 new stores. During the same period, we closed 81 stores. In addition, we also relocated 75 stores.

Experienced Management Team

Our management team is composed of seasoned retail executives. Our 13 most senior executives have an average of 25 years of retail experience.

Strategy

Our mission is to become the first choice for style and value in footwear and accessories for our target customers. We plan to realize this goal by focusing on growing our core footwear and accessories businesses, while growing our profits in the mid−teen range. To achieve this goal, we must execute consistently on the fundamentals of our business.

Positioning Payless ShoeSource® as the leading Mass Specialty Footwear and Accessories Retailer

Our strategy is to position Payless ShoeSource as the leading mass specialty footwear and accessories retailer by executing against the following five strategic themes:

- Establish an emotional connection with target customers by delivering compelling brand and product stories across categories, product types, and price−points communicated through aspirational messaging and imaging.
- Provide product that is on−trend, differentiated and distinctive inspired by select popular fashion trends and pop culture for all target customers with a primary focus on expressive women and expressive moms.
- Improve brand marketing effectiveness through a “house of brands” architecture with consistent positioning by customer segment and use occasion to build distinctiveness and focus in our assortment.
- Provide a great shopping experience through improved customer engagement and leveraging real estate to support the repositioning of our brand.
- Maintain efficient operations by building greater speed and flexibility into the supply chain to deliver the right product to the right store at the right time in the appropriate proportions across the 4,600 store network.

Our International Business

Since opening our first store in Canada in 1997, our international presence has grown substantially; however, future international expansion will be limited to opportunistic growth in proven international markets. As of year−end, we had 578 stores in 11 countries, Puerto Rico and the U.S. Virgin Islands. In September 2000, we entered into a joint venture to operate Payless ShoeSource stores in the Central American Region. In November 2001, we entered into a joint venture to operate Payless ShoeSource stores in South America. However, in 2004, as part of our strategic initiatives, we ceased all operations in Chile and Peru. In 2003, we entered into a joint venture with Nichimen Corporation (which has since become Sojitz Corporation) to test the Payless concept in Japan. Under this arrangement, we opened our first test store in Japan in November 2004.

Stores

As of January 28, 2006, we operated a total of 4,605 stores in a single retail format, Payless ShoeSource. The ten states or Canadian provinces with the largest concentration of our stores as of January 28, 2006, are identified below, along with the total number of stores for each international region in which we operate:

Domestic Segment	No. of Stores	International Segment	No. of Stores
California	544	Ontario, Canada	139
Texas	395	All other Canadian locations	173
Florida	278		
New York	259	Total Canada	312
Illinois	192	Central American Region	147
Pennsylvania	170	Puerto Rico and U.S. Virgin Islands	87
Ohio	145	South American Region	31
Michigan	137	Japan	1
New Jersey	131		
All other	1,776	Total International Segment	578
Total Domestic Segment	4,027		

Payless ShoeSource® Stores

The average size of our Payless ShoeSource stores in the United States and Canada is approximately 3,200 square feet. The average Payless ShoeSource store in the United States and Canada has between four and six associates, including a store manager. During 2005, each Payless store in the United States and Canada carried on average approximately 7,600 pairs of shoes. Payless ShoeSource stores operate in a variety of real estate formats, including shopping malls, central business districts, free−standing buildings, strip centers, and leased departments in ShopKo stores. At year end, 500 locations incorporated a “Payless Kids” area which has approximately 975 additional square feet of selling space devoted to an expanded assortment of children’s shoes. The stores that include a “Payless Kids” area have wider aisles, children−friendly seating and an entertainment center for children. Stores incorporating a “Payless Kids” area are located throughout the United States.

In 1999, we entered a strategic alliance with ShopKo Stores, Inc., a discount retailer with stores primarily in the Midwest, Western Mountain, and Pacific Northwest regions, through which we operate Payless ShoeSource shoe departments within ShopKo® stores. This alliance provides an additional distribution channel for our products. As of year end, there were 135 of these locations.

Our Central American and South American Regions operate in a variety of real estate formats, including shopping malls, central business districts, free−standing buildings and strip centers. The average size of our Payless ShoeSource stores in the Central American Region is approximately 2,500 square feet. The average size of our Payless ShoeSource stores in the South American Region is approximately 2,900 square feet. At year end, the average Payless ShoeSource store in the Central American Region and South American Region had approximately five and six associates, including a store manager, respectively.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Dyelights(SM)

We also operate one of the world's largest shoe dyeing facilities through our Dyelights(SM) business. Currently, Dyelights shoes are exclusively offered through our Payless ShoeSource stores under the Dyelights® brand. Customers select the color they would like their shoes to be dyed from a color book. Once a shoe is ordered from a store, the shoe is dyed to order. The dyed shoes are generally available for pick–up at the store approximately ten days after the order is placed. The retail price for Dyelights shoes including the dyeing cost is currently $37.99.

Employees

As of January 28, 2006, we had approximately 27,550 employees, including approximately 11,600 United States and 1,400 Canadian full–time associates and 12,600 U.S. and 950 Canadian part–time associates, as well as approximately 800 primarily full–time associates in the Central American and South American Regions and approximately 200 in Asia. Approximately 465 of our distribution center general warehouse associates and 150 of our other associates are covered by collective bargaining agreements. Our management believes that we have a good relationship with our employees.

Store Management and Systems

All of our stores are equipped with electronic point of sale registers and a back office computer except the ShopKo locations which are equipped only with a back office computer. The store computer can provide price look–up, daily communications with our headquarters and other functions. Store associates receive frequent communications through the back office computer from our headquarters describing promotional events, price changes, and time–sensitive operational updates.

In general, each retail location is managed by a Store Manager and is assigned to a district. Store Managers report to District Managers who, in turn, report to Directors of Retail Operations who have full responsibility for the stores in their region. Human Resources, loss prevention, inventory control functions, accounting, logistics support, information technology, and other more general support services are generally coordinated from our Topeka, Kansas headquarters. In addition, we have accounting offices in Costa Rica, Guatemala, El Salvador, Honduras, Nicaragua, Ecuador, Panama, and the Dominican Republic that support the Central and South American Regions. We also have an accounting office in Japan.

Competition

The retail footwear and accessories market is highly competitive. The retail footwear and accessories industry can be divided into three segments: high, moderate and value–priced. The high–priced segment is comprised principally of department and specialty stores. The moderate–priced segment, which includes specialty shoe chains, mass–merchandisers and junior department stores, has no single dominant competitor. The value–priced segment includes Payless and other large national discount merchandisers.

With our breadth of assortment, we face a variety of competitive challenges from domestic and international footwear retailers, including traditional shoe stores, department stores, branded discount stores, sporting goods retailers, mail order retailers, and mass–market discount retailers. In addition, many retailers who have not traditionally carried footwear have added various footwear and accessories including seasonal, specialty and general footwear in their merchandise assortment.

The primary competitive levers to establish a point of differentiation in our industry are merchandise selection, flow and timing, pricing, fashion, product quality and aesthetics, convenience and in–store experience. We seek

to compete effectively by getting to market with differentiated, trend−right merchandise before mass−market discounters such as Wal−Mart, Target and Kmart and at the same time as department and specialty retailers such Kohl's, J.C. Penney Company, Inc. and Nine West but at a more compelling value.

Seasonality

The domestic retail footwear market is characterized by four high volume seasons: Easter, early summer, back−to−school, and winter seasons. During each of these periods, we increase our inventory levels to support the increased demand for our products, as well as offer styles particularly suited for the relevant season, such as sandals in the early summer season and boots during the winter season. The retail footwear market in Central and South America is also seasonal and is characterized by stronger sales in December and the back−to−school season.

Customer Service

Our stores offer customers a broad assortment of quality footwear in a convenient self−selection format. Our self−selection shopping format allows customers to select their own shoes or to seek help from one of our trained associates. Sales associates are trained to use a certified Brannock Device to measure feet, and to check key areas, such as the toe box, for proper fit. Our stores also offer one of the broadest customer satisfaction guarantees in the industry: if a customer is not completely satisfied with a purchase, he or she can return it, generally even if the item is worn. We believe our sales associates provide a level of customer service that is generally not available in mass−market discount stores. Sales associates are trained to sell footwear and complementary accessories, and to provide customers with the assistance needed to guide the purchase decision, support customer satisfaction and to encourage return visits to our stores.

In 2005, we continued the implementation of the SMILES initiative. This initiative was implemented as a result of productivity studies which identified several service related behaviors that, when properly executed by our associates, resulted in higher conversion rates. In 2004, we introduced SMILES to all store managers to educate and inform them about these service behaviors, and how these service behaviors assist in balancing customer engagement with store tasks. In 2005, we began rolling out this training program to all store associates to better engage customers and exhibit the SMILES behavior. In 2006, we will complete the SMILES initiative and will develop training for new hires. Our goal is to develop a long−term, sustainable philosophy focused on driving sales through customer engagement and conversion.

Purchasing and Distribution

Purchasing

We utilize a network of agents and factories in the United States and ten foreign countries to obtain our footwear products. These products are manufactured to meet our specifications and standards. The strength of our footwear relationships with agents and factories, some dating back over 40 years, has allowed us to revise our sourcing strategies to reflect changing political and economic environments. In order to increase quality control and to achieve other efficiencies, we have consolidated our factory base. We rely heavily on several large factory groups. Fifteen core factories accounted for approximately 57% of our footwear purchases in 2005. If any one of them were to be unable to supply our needs consistent with prior performance, we could experience disruptions in shoe deliveries. However, we believe that we could find alternate factories to produce our product and believe our relationships with our factory base to be good. The remainder of our footwear requirements in 2005 were obtained from approximately 133 additional factories. Factories in the People's Republic of China are a direct source of approximately 93% of our footwear based on cost.

We do not purchase “seconds” or “overruns” and do not own any manufacturing facilities. We closely integrate our merchandise purchasing requirements with various manufacturers through our sourcing organization which has offices in Kansas, Taiwan, China, Brazil, Hong Kong, and Vietnam.

Approximately 58% of our merchandise (based on cost) is acquired through a network of third−party agents. A subsidiary in Hong Kong arranges directly with factories for the design, selection, production management, inspection and distribution of approximately 42% of the shoes purchased by us.

Production Management and Quality Assurance

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 our production control processes and certify that neither they nor their suppliers use forced or child labor. Factory performance is regularly monitored. If a factory does not continue to meet or exceed our requirements, the factory risks being removed from our list of approved factories. The production management organization utilizes a unique, internally developed production control process by which we are electronically linked to the factories and agents. This process is designed to ensure on−time deliveries of merchandise with minimum lead time and at reduced costs.

We believe that maintaining strong factory relationships and improving key factory performance factors are critical to long−term sourcing stability. Our manufacturing services group, based in Asia, provides direction and leadership to key factories in the areas of overall productivity improvement and lead time reduction.

Our quality assurance organization sets standards and specifications for product manufacture, performance and appearance. We communicate those standards and specifications to our many factories through our proprietary Quality Works System.

Our quality assurance organization also provides technical design support for our direct purchasing function. It is responsible for review and approval of agent 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 our specifications. We locate our field inspection personnel close to the factories and freight consolidation facilities we use throughout the world.

Merchandise Distribution

Our merchandise distribution system allows us to track shoes by pair from order placement through sale to the customer by the use of perpetual inventory, product planning and sourcing 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 our stores.

We currently operate a single 807,000 square foot distribution center including office space and a 12,000 square foot dyeing facility in Topeka, Kansas. This distribution center is capable of replenishing domestic in−store product levels by style, color and size. Our Topeka distribution center handles substantially all of our replenishments and operates seven days a week, 12 to 24 hours per day. Our remaining domestic distribution needs are handled by a third−party facility in Los Angeles, California. We utilize third−party carriers to ship all products to and from our distribution centers. In February 2003, we began using a third−party distribution facility in Panama to service our stores in the Central and South American Regions. We are also currently planning to open a distribution center on the West Coast in 2007 to better service our stores west of the Rocky Mountains.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

We regularly monitor the capacity of our distribution system and the distribution center. Stores generally receive new merchandise on average twice a week in an effort to maintain a constant flow of fresh and replenished merchandise.

Marketing

We have three primary marketing objectives which are to (i) effectively position the Payless brand, (ii) increase awareness and drive traffic and transactions into our stores through a planned promotional cadence; and (iii) create market excitement for our brand through select public relations events. This is achieved by our multi−dimensional marketing efforts that include nationally broadcast television, radio and magazine advertising. We regularly advertise on television, reaching households across the nation, as well as through free−standing inserts delivered to approximately 30 million homes periodically during the year, in order to support key promotional events. In addition to media support, we utilize in−store promotional materials, including posters, signs and point of sale items, as well as our store associates to convey our message to the customer.

In addition to our in−house marketing team, we collaborate with outside creative and media services. These alliances also take place between in−house and external Insights and Brand groups. In April of 2005 we announced the selection of Martin/Williams as our creative agency of record for all broadcast production in the U.S. general market and Canada.

Intellectual Property

Through our wholly−owned subsidiaries, we own certain copyrights, trademarks, patents and domain names which we use in our business and regard as valuable assets. The trademarks and service marks used in our business include Payless®, Payless ShoeSource®, Payless Kids®, Dyelights(SM), and the yellow and orange logo used in our Payless ShoeSource store signs and advertising. The domain names include Payless.com®, as well as derivatives of Payless ShoeSource.

As of January 28, 2006, in the United States, we had over 100 pending applications and registrations for our trademarks and service marks, as well as several common law marks, under which we market private label merchandise in our Payless ShoeSource stores. We also have over 1,100 pending applications and registrations for our trademarks in foreign countries. In addition, we have registrations or pending applications for the Payless ShoeSource mark in over 61 foreign registries.

Currently, we have agreements in place regarding Champion® and Airwalk® brands that expire on June 30, 2007 and January 31, 2009, respectively. We also currently have the exclusive right to use the Dunkman® brand, and the right to use the Spalding® brand through April 1, 2007. We, through agents, also utilizes various character marks from time−to−time.

Environment

Compliance with federal, state and local statutes, rules, ordinances, laws and other provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, have not had, and are not expected to have, a material effect on capital expenditures, earnings or our competitive position.

Payless Direct

In the fall of 1999, we launched *payless.com* to make Payless ShoeSource more accessible to our existing and new customers. In addition to eCommerce sales and on–line marketing, *payless.com* provides a multi–channel service to our stores by allowing stores to order product from *payless.com* in the event that shoe is not available in a given store. Our eCommerce strategy is evolving with the overall Payless strategy and brand positioning.

Available Information

We maintain an investor relations website at *www.paylessinfo.com*. On our investor relations website, you can access free of charge our reports that are filed with the Securities and Exchange Commission, the Guidelines for our Board of Directors, and the Charter for the Board of Directors and its standing committees, the Audit and Finance Committee and the Compensation, Nominating and Governance Committee. In addition, we maintain a website at *www.payless.com* where our customers can shop at their convenience. This website also provides a link to our investor relations website.

Directors of the Company

Listed below are the names and present principal occupations or, if retired, most recent occupations of the Company's Directors:

Name	Principal Occupation
Management Director	
Matthew E. Rubel(2*)	Chief Executive Officer and President of the Company
Independent Directors	
Howard R. Fricke(1)(2)(4)	Retired Chairman of the Board of the Security Benefit Group of Companies
Daniel Boggan Jr.(4)	Retired Senior Vice President of the National Collegiate Athletic Association
Michael A. George(3)	Chief Executive Officer of QVC, Inc.
Judith K. Hofer(3)	Retail Consultant
Mylle H. Mangum(2)(3*)	Chief Executive Officer of IBT Enterprises, LLC
John F. McGovern(4)	Founder and Partner of Aurora Capital LLC and former Executive Vice President/Chief Financial Officer of Georgia–Pacific Corporation
Michael E. Murphy(2)(4*)	Retired Vice Chairman and Chief Administrative Officer of Sara Lee Corporation
Michael A. Weiss(3)	Retired President and Chief Executive Officer of Express, a subsidiary of Limited Brands, Inc.
Robert C. Wheeler(3)	Chairman and Chief Executive Officer of Hill's Pet Nutrition, Inc.

(1) Non–Executive Chairman of the Board

(2) Executive Committee member

(3) Compensation, Nominating and Governance Committee member

(4) Audit and Finance Committee member

* Chairman

Executive Officers of the Company

Listed below are the names and ages of the executive officers of the Company as of April 1, 2006 and offices held by them with the Company.

Name	Age	Position and Title
Matthew E. Rubel	48	Chief Executive Officer and President
Jay A. Lentz	62	Senior Vice President
Michael J. Massey	41	Senior Vice President, General Counsel and Secretary
Darrel J. Pavelka	50	Senior Vice President
Ullrich E. Porzig	60	Senior Vice President, Chief Financial Officer and Treasurer

Matthew E. Rubel is 48 years old and has served as Chief Executive Officer and President of Payless since July 18, 2005. Prior to joining Payless, Mr. Rubel was Chairman and Chief Executive Officer for Cole Haan from 1999 to July 2005. He served as Executive Vice President, J. Crew Group and Chief Executive Officer of Popular Club Plan from 1994 to 1999, and in November 1998, led the sale of Popular from J. Crew to Fingerhut. While at J. Crew Group, Mr. Rubel was responsible for all licensing and international activities, as well as brand marketing and served on its Group Executive Committee. Mr. Rubel has also served as President and Chief Executive Officer of Pepe Jeans USA, and President of the Specialty Division of Revlon. Mr. Rubel has served as a Director of Payless since July 2005.

Jay A. Lentz is 62 years old and has served as Senior Vice President — Human Resources since May 2001. Prior to that he was Vice President of Organization Development from 1992 to 2001; and 1985 to 1990. From 1990 to 1992 he served as Senior Vice President of Human Resources for Payless Cashways Inc. He previously worked for Pizza Hut Inc., a division of PepsiCo, Inc., as Senior Director of Management Development, Arthur Young Co. as Manager, Organization Development Consulting, and The University of Missouri as a consulting psychologist.

Michael J. Massey is 41 years old and has served as Senior Vice President — General Counsel and Secretary since March 2004. Prior to that he served as Vice President of International Development during 2001, Vice President of Contract Manufacturing during 2000, Vice President, Group Counsel Intellectual Property from 1998 to 2000, and Senior Counsel from 1996 to 1998. Prior to joining Payless, Mr. Massey was an attorney for The May Department Stores Company from 1990 to 1996.

Darrel J. Pavelka is 50 years old and has served as Senior Vice President — Merchandise Distribution, Planning and Supply Chain since September 2004. Prior to that he was Senior Vice President — International Operations from March 2003 to September 2004. He also served as Senior Vice President — Merchandise Distribution from 1999 to 2003, Vice President of Retail Operations for Division R from 1997 to 1999, Vice President of Stores Merchandising from 1995 to 1997, Director of Stores Merchandising from 1990 to 1995, Director of Distribution for Women's from 1987 to 1990, Manager of Stores Merchandising for Division R from 1983 to 1987, and Manager of the Northeast store expansion from 1980 to 1983.

Ullrich E. Porzig is 60 years old and has served as Senior Vice President — Chief Financial Officer and Treasurer since February, 1996 and from 1986 to 1988. Between 1993 and 1996, Mr. Porzig was Senior Vice President–Chief 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–Finance and Chief Financial Officer of Foley's from 1988 to 1993.

ITEM 1A. RISK FACTORS

We May be Unable to Compete Effectively in the Competitive Worldwide Footwear Retailing Industry

We face a variety of competitive challenges from other domestic and international footwear retailers, including a number of competitors that have substantially greater financial and marketing resources than we do. These competitors include mass−market discount retailers such as Wal−Mart Stores, Inc., Target Corp. and Kmart Corporation, department stores such as Sears, Roebuck & Co., Kohl's Corp. and J.C. Penney Company, Inc., specialty retailers such as Nine West, branded discount stores and sports outlets. We compete with these footwear retailers on the basis of:

- developing fashionable, high−quality merchandise in an assortment of sizes, colors and styles that appeals to our target consumers;
- anticipating and responding to changing consumer demands in a timely manner;
- ensuring product availability and optimizing supply chain effectiveness;
- the pricing of merchandise;
- creating an acceptable value proposition for consumers;
- providing an inviting, customer friendly shopping environment;
- using a customer focused sales staff to provide attentive, product knowledgeable customer service; and
- providing strong and effective marketing support.

Competition in the retail footwear industry has increased. Mass−market discount retailers such as Wal−Mart aggressively compete with us on the basis of price and have added significant numbers of locations, gaining market share as a result. Accordingly, there is substantial pressure on us to maintain the value proposition of our footwear. In addition, it is possible that mass−market discount retailers will increase their investment in their retail footwear operations, thereby achieving greater market penetration and placing additional competitive pressures on our business. If we are unable to respond effectively to these competitive pressures, our business, results of operations and financial condition could be adversely affected.

A Majority of our Operating Expenses are Fixed Costs that are not Dependent Upon our Sales Performance. As a result, Declines in our Operating Performance are Magnified because We are Largely Unable to Reduce Expenses in Response to a Potential Sales Shortfall

A majority of our operating expenses are fixed costs that are not dependent on our sales performance, as opposed to variable costs, which increase as sales performance increases. These fixed costs include the leasing costs of our stores, our interest expenses and the majority of our labor expenses. If our sales were to decline, we would be unable to reduce these fixed operating expenses in the short term. Accordingly, the effect of any sales decline is magnified because a larger percentage of our earnings is committed to paying these fixed costs. As a result, our earnings and cash flow would be disportionately negatively effected as a result of decline in sales.

We May be Unable to Maintain or Increase our Sales Volume and Margins

We have a substantial market presence in all 50 states and the District of Columbia and we currently derive approximately 86% of our revenue from our U.S. stores. Because of our substantial market presence, and because the U.S. footwear retailing industry is mature, for us to increase our sales volume on a unit basis and margins in the United States, we must capture market share from our competitors. Because many of our competitors have more financial and marketing resources than we do, it will be difficult for us to capture this additional market share. We have attempted to capture additional market share through a variety of strategies; however, if we are

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

not successful we may be unable to increase or maintain our sales volumes and margins in the United States, adversely affecting our business, results of operations and financial condition.

We Must Provide Consumers with Seasonally Appropriate Merchandise, Making our Sales Highly Dependent on Seasonable Weather Conditions

The domestic retail footwear industry is characterized by four high volume seasons: Easter, early summer, back−to−school and the winter seasons. During each of these seasons, we increase our inventory levels to support the increased demand for our products, as well as offer styles particularly suited for the relevant season, such as sandals in the early summer season and boots during the winter season. If the weather conditions for a particular season vary significantly from those typical for such season, such as an unusually cold early summer or an unusually warm winter, consumer demand for the seasonally appropriate merchandise that we have available in our stores could be adversely affected and negatively impact net sales and margins. Lower demand for seasonally appropriate merchandise may leave us with an excess inventory of our seasonally appropriate products and/or basic products, forcing us to sell both types of products at significantly discounted prices and adversely affect our net sales margins and operating cash flow. Consequently, our results of operations are highly dependent on favorable weather conditions.

We May be Unable to Adjust to Constantly Changing Fashion Trends

Our success depends, in large part, upon our ability to gauge the evolving fashion tastes of our consumers and to provide merchandise that satisfies such fashion tastes in a timely manner. The worldwide retailing footwear industry fluctuates according to changing fashion tastes and seasons, and merchandise usually must be ordered well in advance of the season, frequently before consumer fashion tastes are evidenced by consumer purchases. In addition, the cyclical nature of the worldwide footwear retailing industry also requires us to maintain substantial levels of inventory, especially prior to peak selling seasons when we build up our inventory levels. As a result, if we fail to properly gauge the fashion tastes of consumers, or to respond in a timely manner, this failure could adversely affect retail and consumer acceptance of our merchandise and leave us with substantial unsold inventory. If that occurs, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow−moving inventory, which would negatively impact financial results.

The Worldwide Footwear Retailing Industry is Heavily Influenced by General Economic Cycles

Footwear retailing is a cyclical industry that is heavily dependent upon the overall level of consumer spending. Purchases of footwear and related goods tend to be highly correlated with the cycles of the levels of disposable income of our consumers. As a result, any substantial deterioration in general economic conditions could adversely affect our net sales and results of operations.

We May be Unsuccessful in Opening New Stores or Relocating Existing Stores to New Locations, Adversely Affecting our Ability to Grow

Our growth is largely dependent upon our ability to expand our retail operations by opening and operating new stores, as well as relocating existing stores to new locations, on a profitable basis. In 2005, we opened 121 new Payless ShoeSource stores, of which 75 were relocations. In 2006, we intend to open approximately 210 new Payless ShoeSource stores, of which 130 are expected to be relocations.

Our ability to open new stores and relocate existing stores to new locations on a timely and profitable basis is subject to various contingencies, some of which are beyond our control. These contingencies include our ability to:

- locate suitable store sites;
- negotiate acceptable lease terms;
- build−out or refurbish sites on a timely and cost effective basis;
- hire, train and retain qualified managers and personnel;
- obtain adequate capital resources; and
- successfully integrate new stores into our existing operations.

In addition, the opening of stores outside of the United States is subject to a number of additional contingencies, including compliance with local laws and regulations and cultural issues and, because we operate a number of our international stores under joint ventures, issues may arise in our dealings with our joint venture partners or their compliance with the joint venture agreements.

We may be unsuccessful in opening new stores or relocating existing stores for any of these reasons. In addition, we cannot assure you that, even if we are successful in opening new stores or relocating existing stores, those stores will achieve levels of sales and profitability comparable to our existing stores.

We Rely on Third Parties to Manufacture and Distribute Our Products

We depend on contract manufacturers to manufacture the merchandise that we sell in our stores. If these contract manufacturers are unable to secure sufficient supplies of raw materials, or maintain adequate manufacturing and shipping capacity, they may be unable to provide us with timely delivery of products of acceptable quality. In addition, if the prices charged by these contractors increases for reasons such as increases in the price of raw materials, increases in labor costs or currency fluctuations, our cost of manufacturing would increase, adversely affecting our results of operations. We also depend on third parties to transport and deliver our products. Due to the fact that we do not have any independent transportation or delivery capabilities of our own, if these third parties are unable to transport or deliver our products for any reason, or if they increase the price of their services, including as a result of increases in the cost of fuel, our operations and financial performance may be adversely affected.

We require our contract manufacturers to meet our standards in terms of working conditions and other matters before we are willing to contract with them to manufacture our merchandise. As a result, we may not be able to obtain the lowest possible manufacturing costs. In addition, any failure by our contract manufacturers to meet these standards, to adhere to labor or other laws or to diverge from our mandated labor practices, and the potential negative publicity relating to any of these events, could harm our business and reputation.

We do not have long−term agreements with any of our contract manufacturers, and any of these manufacturers may unilaterally terminate their relationship with us at any time. In 2005 we purchased merchandise for our stores from approximately 150 contract manufacturers. In 2005, we purchased 16% of our merchandise from one affiliated group of factories, and 15 factories accounted for approximately 57% of our footwear purchases in 2005. If any one or all of them terminate their relationships with us or are unable to manufacture our merchandise for any reason, we may have difficulty securing the services of alternative contract manufacturers to replace

them. There is also substantial competition among footwear retailers for quality manufacturers. To the extent we are unable to secure or maintain relationships with quality manufacturers, our business could be harmed.

There are Risks Associated with Our Importation of Products

We import finished merchandise into the United States and the other countries in which we operate from the People's Republic of China and 9 other countries. Substantially all of this imported merchandise is subject to:

- customs duties and tariffs imposed by the governments of countries into which this merchandise is imported; and
- penalties imposed for, or adverse publicity relating to, violations of labor and wage standards by foreign contractors.

The countries in which our merchandise is manufactured or imported may from time to time impose additional new quotas, tariffs, duties or other restrictions on our merchandise or adversely change existing restrictions. Any such changes could adversely affect our ability to import our products and the results of operations of our business.

Manufacturers in China are our major suppliers. China was a direct source of approximately 93% of our merchandise based on cost during 2005. In addition to the products we import directly, a significant amount of the products we purchase from other suppliers has been imported from China. Any deterioration in the trade relationship between the United States and China or any other disruption in our ability to import footwear, accessories, or other products from China could have a material adverse effect on our business, financial condition or results of operations.

In addition to the risks of foreign sourcing stemming from international trade laws, there are also operational risks of relying on such imported merchandise. Our ability to successfully import merchandise derived from foreign sources into the United States is dependent on stable labor conditions in the major ports of the United States. Any instability or deterioration of the domestic labor environment in these ports, such as the work stoppage at West Coast ports in 2002, could result in increased costs, delays or disruption in product deliveries that could cause loss of revenue, damage to customer relationships or materially affect our business.

If we are unable to maintain our current Customs–Trade Partnership Against Terrorism ("C–TPAT") status, it would increase the time it takes to get products into our stores. Such delays could materially impact our ability to move the current product in our stores to meet customer demand.

Our International Operations are Subject to Political and Economic Risks

In 2005, approximately 14% of our sales were generated outside the United States and almost all of our merchandise was manufactured outside the United States. We are accordingly subject to a number of risks relating to doing business internationally, any of which could significantly harm our business, including:

- political and economic instability;
- exchange controls and currency exchange rates;
- language and other cultural barriers;
- foreign tax treaties and policies; and

– restrictions on the transfer of funds to and from foreign countries.

Our financial performance on a U.S. dollar denominated basis is also subject to fluctuations in currency exchange rates. These fluctuations could cause our results of operations to vary materially.

From time to time, we enter into agreements seeking to reduce the effects of our exposure to currency fluctuations, but these agreements may not be effective in reducing our exposure to currency fluctuations or may not be available at a cost effective price.

We May be Unable to Effectively Protect Our Trademarks and Other Intellectual Property Rights

Our trademarks and other intellectual property rights are important to our success and competitive position. If we were to lose or were unable to effectively protect such intellectual property rights, our business could be adversely affected.

We are Subject to Liability if We Infringe the Trademarks or Other Intellectual Property Rights of Third Parties

We are subject to liability if we infringe the trademarks or other intellectual property rights of third parties. If we were to be found liable for any such infringement, we could be required to pay substantial damages and could be subject to injunctions preventing further infringement. If this were to happen, it could have a substantial adverse effect on our business. See also “Legal Proceedings,” included in this Form 10−K.

We Rely on Brands We Do Not Own

We are increasing our reliance on brands, some of which we do not own. During the last fiscal year, approximately 22% of our revenues were derived from brands that we do not own. Currently, we have agreements in place regarding Champion® and Airwalk® brands that expire on June 30, 2007 and January 31, 2009, respectively. We currently have the exclusive right to use Spalding® brand through April 1, 2007, and the right to use the Dunkman® brand. We, through our agents, also utilize various character marks from time−to−time. If we are unable to renew or replace any brand or character that accounts for a significant portion of its revenue, our results could be adversely affected.

Adverse Occurrences at Our Topeka Distribution Center Could Negatively Impact Our Business

We operate a distribution center in Topeka, Kansas, which serves as the main source of replenishment of inventory for our stores. In comparison to our total distribution network, the distribution needs of our stores are heavily dependent on products delivered through our Topeka distribution center. In 2005, our Topeka distribution center handled approximately 44% of our stores’ needs. If complications arise with our Topeka distribution center or our Topeka distribution center is severely damaged or destroyed, our other distribution centers may not be able to support the resulting additional distribution demands and we may be unable to locate alternative persons or entities capable of doing so. This may adversely affect our ability to deliver inventory to our stores on a timely basis, which could adversely affect our results of operations.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Integration Risks of New Distribution Facility Could Negatively Impact Our Business

We announced that we intend to open a new distribution facility on the West coast. If we are unable to smoothly transition product flow from one distribution facility in the United States to two facilities in the United States, there could be delays in shipping products to stores. If product arrives late in the selling cycle, we could be forced to mark down or use other promotions to liquidate such inventory which could adversely affect the net sales, margins and operating cash flow.

We May Be Unable to Attract and Retain Talented Personnel

Our success is dependent upon our ability to attract and retain qualified and talented individuals. If we are unable to attract or retain key executives, including senior management, marketing and merchandising personnel, it could adversely affect our business.

Prolonged Work Stoppages Could Adversely Affect our Results of Operations

As of January 28, 2006, approximately 600 of our employees, including substantially all of our non−management employees at our Topeka distribution center, are covered by four separate collective bargaining agreements that expire from June 6, 2006 through July 15, 2008. We cannot assure you that these agreements will be renewed on similar terms or renegotiated on acceptable terms. Any prolonged work stoppages in one or more of our facilities could materially adversely affect our results of operations. Although there have been no work stoppages or disruptions since the inception of these collective bargaining agreements, we cannot assure you that there will be no disruptions in the future.

If more of our employees unionize, it could result in demands that may increase our operating expenses and adversely affect our profitability. If any group of our employees were to unionize and we were unable to reach agreement on the terms of their collective bargaining agreement or we were to experience widespread employee dissatisfaction, we could be subject to work slowdowns or stoppages. In addition, we may be subject to disruptions by organized labor groups protesting the non−union status of the majority of our employees. Any of these events would be disruptive to our operations and could harm our business.

An Outbreak of Asian Flu or Other Similar Infectious Diseases May Have a Material Adverse Effect on Our Ability to Purchase Merchandise from Manufacturers and Our Operations Generally

An outbreak and spread of infectious diseases such as Asian flu in Southern China and other countries in which our manufacturers are located could impact the availability or timely delivery of merchandise. Although our ability to purchase and import our merchandise has not been negatively impacted to date, an outbreak of infectious diseases could prevent the manufacturers we use from manufacturing our merchandise or hinder our ability to import those goods to the countries in which our stores are located, either of which could have an adverse effect on our results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease substantially all of our stores. Our leases typically have an initial term of five or ten years, and either one or two renewal options. During 2006, approximately 889 of our leases are due to expire. This includes 249 leases that, as of January 28, 2006, were month−to−month tenancies or were lease modifications pending

execution. 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.

Payless ShoeSource stores average 3,200, 2,500 and 2,900 square feet in the United States and Canada, the Central American Region, and the South American Region, respectively. We operate a 305,000 square foot world headquarters building, and 807,000 square foot distribution facility including office space and an adjacent 12,000 square foot dyeing facility, all of which are located in Topeka, Kansas. We also lease office space in Toronto, Ontario, Canada; Topeka, Kansas; and at various international locations to support our sourcing, store accounting and operations.

ITEM 3. LEGAL PROCEEDINGS

Other than as described below, there are no material pending legal proceedings other than ordinary routine litigation incidental to the business to which we or any of our subsidiaries are a party or of which any of our or our subsidiaries' property is the subject of the litigation.

On or about February 5, 2004, a complaint was filed against the Company in the U.S. District Court for the Central District of California, captioned K–Swiss, Inc. v. Payless ShoeSource, Inc. The Complaint seeks injunctive relief and unspecified monetary damages for trademark and trade dress infringement, trademark dilution and unfair competition. On May 14, 2005, a First Amended Complaint was filed, to include a breach of contract claim. The Company believes it has meritorious defenses to the claims asserted in the lawsuit and has filed an answer. An estimate of the possible loss, if any, or the range of the loss cannot be made. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position and results of operations.

On or about December 20, 2001, a First Amended Complaint was filed against us in the U.S. District Court for the District of Oregon, captioned Adidas America, Inc. and Adidas–Salomon AG v. Payless ShoeSource, Inc. The First Amended Complaint seeks injunctive relief and unspecified monetary damages for trademark and trade dress infringement, unfair competition, deceptive trade practices and breach of contract. We believe we have meritorious defenses to the claims asserted in the lawsuit and have filed an answer and a motion for summary judgment, which the court granted in part. An estimate of the possible loss, if any, or the range of loss cannot be made. However, the ultimate resolution of this matter could have a material adverse effect on our financial position and results of operations.

On or about January 20, 2000, a complaint was filed against us in the U.S. District Court for the District of New Hampshire, captioned Howard J. Dananberg, D.P.M. v. Payless ShoeSource, Inc. The Complaint sought injunctive relief, unspecified treble monetary damages, attorneys' fees, interest and costs for patent infringement. On March 30, 2006, the Court granted our motion for summary judgment of non–infringement and judgment favorable to us was entered by the Clerk that same day. Plaintiff is expected to appeal the judgment. An estimate of the possible loss, if any, or the range of loss cannot be made. However, the ultimate resolution of this matter could have a material adverse effect on our financial position and results of operations.

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 January 28, 2006.

PART II

ITEM 5. MARKET FOR COMPANY'S COMMON EQUITY, RELATED SHAREOWNER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

There were approximately 12,700 registered holders of the Company's Common Stock as of January 28, 2006, compared to approximately 13,350 registered holders as of January 29, 2005.

Common Stock and Market Prices

The Company's common stock is listed on the New York Stock Exchange under the trading symbol PSS. The quarterly intraday price ranges of the common stock in 2005 and 2004 were:

	2005		2004	
	Market Price		Market Price	
Fiscal Quarter	**High**	**Low**	High	Low
First	**$16.09**	**$11.49**	$14.87	$12.13
Second	**21.71**	**13.37**	17.72	12.20
Third	**20.18**	**15.02**	13.10	9.20
Fourth	**25.74**	**17.50**	13.35	9.34
Year	**$25.74**	**$11.49**	$17.72	$ 9.20

We have not paid a cash dividend on outstanding shares of common stock since our spin−off from The May Department Stores Company. We are subject to certain restrictions contained in our senior secured revolving credit facility and the Indenture governing our 8.25% Senior Subordinated Notes which restrict our ability to pay dividends. We do not currently plan to pay any cash dividends. During March 2003, we completed a three−for−one stock split effected in the form of a stock dividend.

Recent Sales of Unregistered Securities

On May 27, 2004 and May 26, 2005, 2,215 shares and 2,075 shares, respectively, were credited to the accounts of our non−management directors under the Company's Restricted Stock Plan for Non−Management Directors. In addition, during the past three years, non−management directors have deferred an aggregate of 70,086 shares under the Deferred Compensation Plan for Non−Management Directors. These grants were made as partial compensation for the recipients' services as directors. The offer and issuance of these securities are exempt from registration under Section 4(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder, as transactions by an issuer not involving any public offering or alternatively, registration of such shares was not required because their issuance did not involve a "sale" under Section 2(3) of the Securities Act of 1933.

Issuer Purchases of Equity Securities

The following table provides information about purchases by the Company (and its affiliated purchasers) during the quarter ended January 28, 2006, of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased(1) (in Thousands)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (in thousands)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in Millions)(2)(3)
10/29/05 – 11/25/05	135	$ 22.50	133	$ 218.9
11/26/05 – 12/30/05	894	24.13	892	197.4
12/31/05 – 1/28/06	1,254	23.69	1,252	167.7
Total	2,283	$ 23.79	2,277	$ 167.7

(1) Includes an aggregate of approximately six thousand shares of our common stock that was repurchased during the quarter ended January 28, 2006, in connection with our employee stock purchase and stock incentive plans.

(2) In 2001, our Board of Directors approved the repurchase of our common stock having a value of up to $250 million in the aggregate.

(3) The timing and amount of share repurchases, if any, are limited by the terms of the Company's Credit Agreement and Senior Subordinated Notes.

New York Stock Exchange Corporate Governance Matters

As a listed Company with the New York Stock Exchange, the Company is subject to certain Corporate Governance standards as required by the New York Stock Exchange and/or the Securities and Exchange Commission ("SEC"). The Certification of the Chief Executive Officer required by Section 303A.12(a) of The New York Stock Exchange Listing Standards relating to the Company's compliance with The New York Stock Exchange Corporate Governance Listing Standards was submitted to The New York Stock Exchange on June 24, 2005. Also, included as Exhibits to this Form 10–K are the required certifications by the Company's CEO and CFO pursuant to Sarbanes–Oxley Act Sections 302 and 906.

ITEM 6. SELECTED FINANCIAL DATA

Our summary consolidated financial information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Notes to Consolidated Financial Statements, included elsewhere in this Form 10–K.

(dollars in millions; except per share; shares in thousands)	Fiscal Year(1)				
	2005	2004	2003	2002	2001
Statements of Earnings (Loss) Data:					
Net sales	**$2,667.3**	$2,656.5	$ 2,662.4	$2,736.1	$2,744.7
Cost of sales	**1,778.9**	1,836.9	1,920.9	1,883.5	1,891.6
Gross margin	**888.4**	819.6	741.5	852.6	853.1
Selling, general and administrative expenses	**770.8**	733.2	715.7	663.0	672.7
Restructuring charges (benefits)(2)	**3.8**	24.9	(0.2)	2.1	27.3
Operating profit from continuing operations	**113.8**	61.5	26.0	187.5	153.1
Interest expense	**19.7**	22.1	20.7	23.5	30.6
Interest income	**(12.3)**	(5.3)	(3.9)	(4.3)	(2.5)
Earnings from continuing operations before income taxes and minority interest	**106.4**	44.7	9.2	168.3	125.0
Provision (benefit) for income taxes	**30.8**	13.2	(4.0)	60.8	48.0
Earnings from continuing operations before minority interest	**75.6**	31.5	13.2	107.5	77.0
Minority interest, net of income taxes	**(1.4)**	3.6	3.7	3.0	1.3
Net earnings from continuing operations	**$ 74.2**	$ 35.1	$ 16.9	$ 110.5	$ 78.3
Loss from discontinued operations, net of income taxes and minority interest	**(3.7)**	(37.1)	(17.0)	(4.6)	(33.1)
Net earnings (loss) before cumulative effect of change in accounting principle	**$ 70.5**	$ (2.0)	$ (0.1)	$ 105.9	$ 45.2
Cumulative effect of change in accounting principle, net of income taxes and minority interest(7)	**(4.1)**	—	—	—	—
Net earnings (loss)	**$ 66.4**	$ (2.0)	$ (0.1)	$ 105.9	$ 45.2
Diluted earnings (loss) per share:					
Earnings from continuing operations	**$ 1.09**	$ 0.52	$ 0.25	$ 1.62	$ 1.16
Loss from discontinued operations	**(0.05)**	(0.55)	(0.25)	(0.07)	(0.49)
Diluted earnings (loss) per share before cumulative effect of change in accounting principle	**$ 1.04**	$ (0.03)	$ (0.00)	$ 1.55	$ 0.67
Cumulative effect of change in accounting principle	**(0.06)**	—	—	—	—
Diluted earnings (loss) per share	**$ 0.98**	$ (0.03)	$ (0.00)	$ 1.55	$ 0.67
Average shares outstanding — diluted	**67,854**	68,020	68,031	68,383	67,775
Balance Sheet Data:					
Working capital	**$ 516.0**	$ 391.6	$ 367.9	$ 291.0	$ 229.9
Property and equipment, net	**386.1**	422.3	423.5	408.1	420.7
Total assets	**1,314.5**	1,239.8	1,204.3	1,169.0	1,091.4
Total debt(3)	**204.6**	204.6	203.7	223.9	311.0
Total equity(4)	**652.0**	595.0	604.4	595.1	463.8
Other Financial Data:					
Capital expenditures(5)	**$ 64.4**	$ 103.0	$ 107.7	$ 97.0	$ 114.4
Present value of operating leases	**945.7**	1,018.2	979.8	918.4	893.8
Net retail sales growth, continuing operations	**0.4%**	(0.2)%	(2.7)%	(0.3)%	(1.5)%
Same–store sales growth, continuing operations(6)	**2.4%**	(0.8)%	(3.3)%	(2.6)%	(2.7)%
Return on equity, including discontinued operations	**11.2%**	(0.3)%	(0.0)%	22.8%	11.1%
Return on net assets, including discontinued operations	**9.9%**	4.4%	4.4%	14.8%	11.1%
Return on invested capital, continuing operations	**9.8%**	5.4%	4.6%	15.0%	12.5%
Stores open (at year–end)	**4,605**	4,640	5,042	4,992	4,964

(1) All years include 52 weeks. During 2003, we changed the reporting for our operations in the Central and South American Regions to use a December 31 year–end.

(2) In 2005 and 2004, the restructuring activity relates to our decision to exit all Parade, Peru and Chile stores, as well as 264 Payless ShoeSource stores. We also eliminated approximately 200 management and administrative positions. In 2003 and 2002, the restructuring activity relates to changes in estimated net costs associated with the restructuring charge recorded in 2001. During 2001, the restructuring activity relates to our decision to close certain domestic division offices, as well as approximately 100 under–performing stores.

(3) Excluded from total debt for all periods are demand notes payable entered into to finance our subsidiaries in the Central American Region, which totaled $2.0 million at January 28, 2006. We maintain certificates of deposit, which totaled $2.0 million at January 28, 2006, in amounts equal to those demand notes, as compensating balances to collateralize those notes payable. The certificates of deposit are reflected as restricted cash in our consolidated balance sheets found elsewhere in this Form 10−K.

(4) During 2001, 2002, 2003, 2004 and 2005, we repurchased $4.1 million (210 thousand shares), $2.1 million (108 thousand shares), $1.7 million (117 thousand shares), $11.4 million (938 thousand shares) and $71.2 million (3.3 million shares), respectively, of common stock under our stock repurchase programs and in connection with our employee stock purchase, deferred compensation and stock incentive plans.

(5) Capital expenditures for fiscal years 2004, 2003, 2002 and 2001 have been restated to reflect adjustments that are further discussed in Note 2 "Restatement of Financial Statements" under the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this Form 10−K.

(6) Same−store sales are calculated on a weekly basis. If a store is open the entire week in each of the two years being compared, its sales are included in the same−store sales calculation for that week. Relocated and remodeled stores are also included in the same−store sales calculation if they were open during the entire week in each of the two years being compared. The same−store sales calculation excludes the South American and Central American Regions and Japan.

(7) As discussed in Note 22 "Change in Accounting Principle" under the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this Form 10−K, we adopted FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations — An Interpretation of FASB Statement No. 143," during the fourth quarter of 2005.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Restatement

The accompanying Management's Discussion and Analysis gives effect to the restatement described in Note 2 to the Consolidated Financial Statements.

Overview

We are the largest specialty family footwear retailer in the Western Hemisphere with retail stores in the United States, Canada, Japan, the Caribbean, and the Central American and South American Regions. The Central American Region is composed of operations in Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama and Trinidad & Tobago. The South American Region is composed of operations in Ecuador. Our stores offer fashionable, quality, private label and branded footwear and accessories for women, men and children at affordable prices in a self−selection shopping format.

During 2004, we substantially completed a series of strategic initiatives as part of a restructuring plan designed to sharpen our focus on our core business strategy, reduce expenses, accelerate decision−making, increase profitability, improve our operating margin and build value for stockholders over the long−term. The strategic initiatives included: 1) closing all Parade stores and related operations, 2) the sale of Chile and Peru entities, 3) closing of approximately 260 Payless ShoeSource stores, 4) ceasing wholesaling businesses with no significant growth opportunity, and 5) eliminating approximately 200 management and administrative positions. As a result of the restructuring, we have reflected the financial information of the Parade, Peru and Chile stores and 26 of the Payless closed stores as discontinued operations in the consolidated financial statements. Unless otherwise noted, the amounts and discussions included in this Management's Discussion and Analysis of Financial Condition and Results of Operations relate to continuing operations.

For the fiscal year 2005, total sales were $2.7 billion, slightly higher than the prior year. Same−store sales increased 2.4 percent from last year. We achieved four consecutive quarters of positive same−store sales growth, something that had not occurred since fiscal year 2000. During 2005, we sold approximately 2.9% less footwear units than the prior year, but our average selling price per unit was approximately 4.6% higher. Gross margin was 33.3 percent of sales in 2005 versus 30.9 percent in the prior year primarily due to a more favorable initial mark−on. The combination of modest sales growth with solid margin expansion and control of our expense

structure contributed to an improvement of $52.3 million in operating profit from continuing operations between years.

We continue to maintain a strong balance sheet. Our cash and cash equivalents balance at the end of 2005 was $378.9 million, an increase of $105.6 million from 2004. Short–term investments at the end of 2005 were $59.0 million, an increase of $37.7 million from 2004. Total inventories at the end of 2005 were $333.0 million, a reduction of $12.3 million from the prior year. Inventory per store declined by 2.8 percent on a cost basis.

During 2005, we redefined our strategy, which provides the architecture and framework for key decisions we will make about our direction, including product creation, brand messaging, store experience, operations and company culture. Our mission is to become the first choice for style and value in footwear and accessories for our target consumers. Creating an emotional connection with our target consumers is the central core element of our overall strategy. Building brand loyalty does not happen overnight, but with a strong focus on relevant on–target product, we believe that becoming our customers' first choice is an attainable goal.

The consumer segments we are targeting are driven primarily by product that allows them to express themselves through fashion. These customer segments not only purchase more shoes, but they also have less price sensitivity. A portion of our customers will continue to be driven more by price in making their purchasing decisions, but fashion is still a consideration. Through elements of promotion and pricing tiers, we plan to maintain market share with the budget–oriented shopper while driving the opportunity to increase market share with the expressive customers. A meaningful proportion of our product will be offered at opening price points that reflect historical pricing levels. However, we plan to inject higher price points for on–trend, higher quality, fashionable product that makes a great value statement with the expressive customer.

The next component of our strategy is brand marketing effectiveness. We intend to build, license or buy appropriate aspirational brands to cover all of our major customer segments. As we continue to increase the proportion of branded footwear in our assortment, we will have more pricing flexibility to increase average retails. This strategy will be implemented over a period of years.

We are working on two new store designs to improve our ability to showcase our merchandise, improve the in–store experience for our customers, and further support the Payless brand identity. We are testing a modified store format and, based on the results of these tests, the majority of our 2006 store openings will incorporate this design. We also continue to work on a completely new store design, which we will be testing in select locations in the Fall of 2006. This is a key part of our strategy, but we plan to approach investing in new store formats thoughtfully, before committing meaningful capital resources.

The last major component of our strategy is improving the efficiency of our operations. We are exploring all of the significant operational elements of our business model; whether that entails achieving more cost effective sourcing, improving the efficiency of our supply chain and physical distribution network, or identifying productivity improvements within the four walls of our stores. An example of this is our recent announcement to develop a West Coast replenishment facility. Where we can realize appropriate returns on capital, we will move quickly but prudently to enhance our overall return on invested capital.

Investing in our business will remain a top priority. These investments will take place on a variety of levels. We are increasing the rate of capital investments we are making for new store expansion, remodeling, technology and in our supply chain. We will continue to invest in all elements of our business that impact the customer experience, while ensuring that an efficient supporting infrastructure is in place.

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Review of Operations

The following discussion summarizes the significant factors affecting operating results for the fiscal years ended January 28, 2006 (2005), January 29, 2005 (2004), and January 31, 2004 (2003). This discussion and analysis should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements. References to years relate to fiscal years rather than calendar years unless otherwise designated. Results for the past three years were as follows:

	2005		2004		2003	
(dollars in millions, except per share)	**$**	**% of Sales**	$	% of Sales	$	% of Sales
Net sales	**$2,667.3**	**100.0%**	$2,656.5	100.0%	$2,662.4	100.0%
Cost of sales	**1,778.9**	**66.7**	1,836.9	69.1	1,920.9	72.1
Gross margin	**888.4**	**33.3**	819.6	30.9	741.5	27.9
Selling, general and administrative expenses	**770.8**	**28.9**	733.2	27.6	715.7	26.9
Restructuring charges (benefits)	**3.8**	**0.1**	24.9	1.0	(0.2)	—
Operating profit from continuing operations	**113.8**	**4.3**	61.5	2.3	26.0	1.0
Interest expense	**19.7**	**0.7**	22.1	0.8	20.7	0.8
Interest income	**(12.3)**	**(0.4)**	(5.3)	(0.2)	(3.9)	(0.1)
Earnings from continuing operations before income taxes and minority interest	**106.4**	**4.0**	44.7	1.7	9.2	0.3
Provision (benefit) for income taxes(1)	**30.8**	**28.9**	13.2	29.5	(4.0)	(43.5)
Earnings from continuing operations before minority interest	**75.6**	**2.8**	31.5	1.2	13.2	0.5
Minority interest, net of income taxes	**(1.4)**	**(0.0)**	3.6	0.1	3.7	0.1
Net earnings from continuing operations	**$ 74.2**	**2.8%**	$ 35.1	1.3%	$ 16.9	0.6%
Loss from discontinued operations, net of income taxes and minority interest	**(3.7)**	**(0.1)**	(37.1)	(1.4)	(17.0)	(0.6)
Net earnings (loss) before cumulative effect of change in accounting principle	**$ 70.5**	**2.7%**	$ (2.0)	(0.1)%	$ (0.1)	0.0%
Cumulative effect of change in accounting principle, net of income taxes and minority interest	**(4.1)**	**(0.2)**	—	0.0	—	0.0
Net earnings (loss)	**$ 66.4**	**2.5%**	$ (2.0)	(0.1)%	$ (0.1)	(0.0)%
Basic earnings (loss) per share:						
Earnings from continuing operations	**$ 1.09**		$ 0.52		$ 0.25	
Loss from discontinued operations	**$ (0.05)**		$ (0.55)		$ (0.25)	
Basic earnings (loss) per share before cumulative effect of change in accounting principle	**$ 1.04**		$ (0.03)		$ (0.00)	
Cumulative effect of change in accounting principle	**$ (0.06)**		$ —		$ —	
Basic earnings (loss) per share	**$ 0.98**		$ (0.03)		$ (0.00)	
Diluted earnings (loss) per share:						
Earnings from continuing operations	**$ 1.09**		$ 0.52		$ 0.25	
Loss from discontinued operations	**$ (0.05)**		$ (0.55)		$ (0.25)	
Diluted earnings (loss) per share before cumulative effect of change in accounting principle	**$ 1.04**		$ (0.03)		$ (0.00)	

Cumulative effect of change in accounting principle	**$ (0.06)**	$ —	$ —
Diluted earnings (loss) per share	**$ 0.98**	$ (0.03)	$ (0.00)
Return on sales from continuing operations	**2.8%**	1.3%	0.6%
Return on equity(2)	**11.2%**	(0.3)%	(0.0)%
Return on net assets(3)	**9.9%**	4.4%	4.4%
Return on invested capital(4)	**9.8%**	5.4%	4.6%

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

(1) Percent of sales columns for the provision (benefit) for income taxes represents effective income tax rates.

(2) Return on equity is computed as net earnings (loss), including discontinued operations, divided by beginning shareowners' equity and measures our ability to invest shareowners' funds profitably. The increase in return on equity from 2004 to 2005 is primarily due to an increase in net earnings. Fiscal 2004 return on equity is flat as compared with the prior year, primarily due to flat net earnings.

(3) Return on net assets is computed as pre−tax net earnings (loss), including discontinued operations, plus net interest expense and the interest component of operating leases, divided by beginning of year net assets, including present value of operating leases ("PVOL"), and represents performance independent of capital structure. The increase in return on net assets from 2004 to 2005 is primarily due to an increase in net earnings. Fiscal 2004 return on net assets is consistent when compared with the prior year, primarily due to flat net earnings.

(4) Return on invested capital is computed as operating profit from continuing operations, adjusted for income taxes at the applicable effective rate, divided by the average amount of long−term debt and shareowners' equity. The increase in return on invested capital from 2004 to 2005 and 2003 to 2004 is primarily due to an increase in operating profit from continuing operations.

Net Sales

Net sales are recognized at the time the sale is made to the customer, are net of estimated returns and current promotional discounts and exclude sales tax. Third−party liquidation sales related to restructuring are recognized at the time the sale is made to the customer, are calculated based upon contractually guaranteed amounts pursuant to our agreements with liquidators and are net of associated fees. Same−store sales are calculated on a weekly basis and exclude liquidation sales. If a store is open the entire week in each of the two years being compared, its sales are included in the same−store sales calculation for that week. Relocated and remodeled stores are also included in the same−store sales calculation if they were open during the entire week in each of the two years being compared.

Sales percent increases (decreases) are as follows:

	2005	2004	2003
Net sales	**0.4%**	(0.2)%	(2.7)%
Same−store sales	**2.4**	(0.8)	(3.3)
Footwear average selling price per unit	**4.6**	6.6	0.2
Footwear unit volume	**(2.9)**	(7.0)	(3.5)
Non−footwear average selling price per unit	**12.2**	16.4	24.6
Non−footwear unit volume	**(17.2)%**	(15.0)%	(9.9)%

Net sales for fiscal 2005 totaled $2.67 billion. During 2005, net sales and same−store sales increased over 2004 primarily due to positive sales performance in the women's category (particularly in the casual and dress departments), and in the women's athletics and children's categories. Weaker categories during 2005 were men's and accessories.

Net sales for fiscal 2004 totaled $2.66 billion. Net sales decreased in 2004 from 2003. During the first six months of 2004, net sales and same−store sales increased over 2003 primarily due to positive sales performance in women's sandals and dress shoes, and accessories. During the second half of 2004, net sales and same−store sales decreased from 2003 primarily due to a competitive environment combined with our strategy to be less promotional than 2003 in order to protect our gross margins.

Cost of Sales

Cost of sales includes cost of merchandise sold and our buying and occupancy costs. Cost of sales was $1.78 billion in 2005 compared with $1.84 billion in 2004, a 3.2 percent decrease. As a percent of net sales, cost of sales was 66.7 percent in 2005, compared with 69.1 percent in 2004. Cost of sales, as a percentage of sales, has decreased primarily due to more favorable initial mark−ons relative to the same period last year.

Cost of sales was $1.84 billion in 2004 compared with $1.92 billion in 2003, a 4.2 percent decrease. As a percent of net sales, cost of sales was 69.1 percent in 2004, compared with 72.1 percent in 2003. Cost of sales, as a

percentage of sales, decreased primarily due to more favorable initial mark–on and fewer markdowns relative to the same period last year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $770.8 million in 2005 compared with $733.2 million in 2004, a 5.1 percent increase. As a percent of net sales, selling, general and administrative expenses were 28.9 percent for 2005 compared with 27.6 percent in 2004. This increase, as a percentage of net sales, primarily reflects a 0.8 percent increase related to the cost of employee incentive programs, a 0.3 percent increase in advertising, and a 0.2 percent increase in professional services primarily related to our brand architecture and customer engagement training initiatives.

Selling, general and administrative expenses were $733.2 million in 2004 compared with $715.7 million in 2003, a 2.4 percent increase. As a percent of net sales, selling, general and administrative expenses were 27.6 percent for 2004 compared with 26.9 percent in 2004. This increase, as a percentage of net sales, primarily reflects a 0.5 percent increase related to the cost of employee incentive programs and a 0.2 percent increase in professional services related to a proxy contest and Sarbanes–Oxley compliance.

Restructuring Charges

In 2005, we incurred pre–tax restructuring charges of $9.7 million primarily relating to contract termination costs in excess of previous estimates and other exit costs associated with our strategic initiatives. The $9.7 million pre–tax charge was comprised of $3.8 million relating to continuing operations and $5.9 million relating to discontinued operations. The 2004 pre–tax restructuring charge of $67.9 million ($24.9 million related to continuing operations and $43.0 million related to discontinued operations) included $34.7 million for asset impairments and net disposal losses, $21.3 million for contract termination costs, $9.3 million for employee severance costs and $2.6 million for other exit costs. Employee severance costs include estimates regarding the amount of severance payments made to certain terminated associates, and contract termination costs include estimates regarding the length of time required to sublease vacant space and expected recovery rates. Actual results could vary from these estimates.

The significant components of the restructuring charge incurred as of January 28, 2006 are summarized as follows:

(dollars in millions)	Total Charges to Date	Accrual Balance as of January 29, 2005	2005 Charges: Costs Incurred	2005 Charges: Accrual Adjustments	2005 Charges: Cash Payments	Accrual Balance as of January 28, 2006
Employee severance costs	$ 9.0	$ 4.2	$ —	$ (0.3)	$ (2.9)	$ 1.0
Contract termination costs	28.5	17.6	—	7.2	(19.3)	5.5
Other exit costs	5.1	—	2.5	—	(2.5)	—
	42.6	$ 21.8	2.5	$ 6.9	$ (24.7)	$ 6.5
Asset impairments and net disposal losses	35.0		0.3			
Total Charges	$ 77.6		$ 2.8			

In 2003, the $0.2 million restructuring benefit relates to changes in estimated net costs associated with the restructuring charge recorded in 2001.

Interest Expense (Income)

Interest expense and income components were:

(dollars in millions)	**2005**	2004	2003
Interest expense	**$ 19.7**	$ 22.1	$ 20.7
Interest income	**(12.3)**	(5.3)	(3.9)
Interest expense, net	**$ 7.4**	$ 16.8	$ 16.8

The decrease in 2005 interest expense is a result of an average lower notes payable balance throughout 2005 versus 2004. The increase in 2005 interest income is a result of increased cash and short−term investment balances over 2004 and an increase in the rate of return earned on available funds. This is offset by a decrease in interest earned on certificates of deposit maintained to collateralize notes payable.

The increase in 2004 interest expense reflects the $200 million of 8.25% Senior Subordinated Notes being outstanding for the entire 2004 year as compared to the term loan that was in place the majority of the first half of 2003 that carried a lower interest rate. This increase in interest expense was partially offset by lower credit facility expense and reductions in demand notes payable during the current year. The increase in 2004 interest income resulted from increased cash and short−term investment balances over 2003, partially offset by a decrease in interest earned on certificates of deposit maintained to collateralize the demand notes payable.

Income Taxes

The effective tax rate from continuing operations was a 28.9 percent provision in 2005 versus a 29.5 percent provision in 2004. The effective tax rate was a 43.5 percent benefit in 2003.

Our effective tax rates for 2005 and 2004 differ from the U.S. statutory rate principally due to the impact of our operations conducted in jurisdictions with rates different than the U.S. statutory rate, the benefit of jurisdictional tax credits, a decrease in income tax reserves due primarily to favorable settlements of examinations by taxing authorities, the impact of repatriating earnings from offshore, and the on−going implementation of tax efficient business initiatives.

The total rate differential on foreign earnings in the rate reconciliation was a 78.3% benefit in 2003 and a 6.5% benefit in 2004. In 2003, 65.2% of the benefit relates to Asian sourcing activities conducted in low−tax jurisdictions. The remainder of the benefit relates to the tax impact of activities conducted in Latin America and Canada. In 2004, 11.6% of the total rate differential on foreign earnings benefit of 6.5% related to Asian sourcing. The 11.6% benefit on the Asian sourcing activities is offset primarily by the inability to provide tax benefit on certain losses generated in Latin America.

The majority of our 2003 foreign tax rate differential relates to our Asian sourcing activities, which are conducted in low−tax jurisdictions. The tax impact of these activities on the effective tax rate is driven largely by the relationship of the magnitude of the tax benefit to the level of pretax income (or loss). In fiscal 2003, the tax benefit of $6.0 million from the sourcing activities on pretax income of $9.2 million, was a 65.2% benefit in the effective tax rate reconciliation (within the foreign rate differential on foreign earnings component). In fiscal 2004, the tax benefit related to Asian sourcing was $5.2 million compared to pretax income of $44.7 million — an 11.6% benefit in the effective tax rate reconciliation. Because the amount of the tax benefit is relatively stable, it is the relationship to the magnitude of pretax income that drives volatility in the effective tax rate.

The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities, which often result in proposed assessments. Our estimate for the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonable foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which our earnings or deductions are realized may differ from our current estimates. As a result, our effective tax rate may fluctuate significantly on a quarterly basis due to discrete events.

At January 28, 2006, deferred tax assets for state and foreign net operating loss carryforwards are $11.9 million, less a valuation allowance of $6.6 million. The net operating losses related to recorded assets will expire as follows: $0.2 million in 2007, $2.3 million in 2010 through 2011, and $2.8 million by 2024. In addition, federal and state income tax credit carryforwards are $11.6 million, less a valuation allowance of $3.3 million. The remaining valuation allowance relates to other deferred tax assets in Latin American countries that do not have a history of earnings. The tax credit carryforwards related to the recorded assets expire as follows: $6.3 million by 2014, and $2.0 million may be carried forward indefinitely.

The American Jobs Creation Act of 2004, enacted on October 22, 2004 (the "Jobs Act"), provides for a temporary 85% dividends received deduction on certain foreign earnings repatriated during a one−year period. To qualify for the deduction, the earnings must be reinvested in the U.S. pursuant to a domestic reinvestment plan established by a company's chief executive officer and approved by its board of directors. Certain other criteria in the Jobs Act must be satisfied as well. During 2005, the Company's Chief Executive Officer established domestic reinvestment plans which were approved by the Board of Directors. Pursuant to the plans, the Company repatriated $85.0 million from foreign subsidiaries during 2005. The repatriation resulted in recognition of income tax expense of $3.7 million, for which the Company provided $2.3 million in 2004 and $1.4 million in 2005. At the close of 2005, the Company has not provided tax on cumulative undistributed earnings of foreign subsidiaries, other than for Puerto Rico operations, because it is the Company's intention to reinvest these earnings indefinitely.

Impact of Inflation

Inflation did not have a material impact on our sales growth or earnings for the three years ended January 28, 2006.

International Segment Operating Results

Our international segment includes retail operations in Canada, the South American Region, the Central American Region, Puerto Rico, the U.S. Virgin Islands, and Japan. The following table summarizes the operating results of the international segment:

dollars in million(s)	**2005**	2004	2003
Revenues from external customers	**$ 361.3**	$ 330.0	$ 295.3
Operating profit from continuing operations	**30.4**	8.0	1.9

In general, 2005 gross margin percentages in our international segment are similar to those in the domestic segment. However, as a percent of revenue, our selling, general and administrative expenses in the international segment are lower than in the domestic segment primarily due to lower payroll−related expenses. Therefore, as a percentage of revenue, operating profits in our international segment exceed those in our domestic segment.

The increase in operating profit from continuing operations from 2004 to 2005 is primarily due to increased sales and improved gross margin percentages in Latin America. We believe that future increases in operating profits are unlikely to occur in this magnitude. The increase in operating profit from continuing operations from 2003 to 2004 is primarily due to improved sales in Canada and improved gross margin percentages in Puerto Rico.

Store Activity

During 2005, we had a net decrease of 35 stores (46 openings and 81 closings). We also relocated 75 stores. As of January 28, 2006, store count was 4,605 stores, including 4,027 stores in the domestic United States, 312 stores in Canada, 87 stores in Puerto Rico and U.S. Virgin Islands, 147 stores in the Central American region, 31 stores in the South American region and one store in Japan.

Our expansion plans for fiscal year 2006 include a net increase of approximately 20 stores. This includes approximately 80 new stores and 60 store closings. We also intend to relocate approximately 130 stores. The current expansion plans for 2006 through 2009 would not materially increase or decrease the net number of Payless ShoeSource stores. We review our expansion plans at least on an annual basis.

Liquidity and Capital Resources

We ended 2005 with a cash and cash equivalents balance of $378.9 million, an increase of $105.6 million over 2004, and short−term investments of $59.0 million, an increase of $37.7 million over 2004. Internally generated cash flow from operations is expected to continue to be the most important component of our capital resources. Sources and (uses) of cash are summarized below:

(dollars in millions)	**2005**	2004	2003
Net earnings from continuing operations	**$ 74.2**	$ 35.1	$ 16.9
Non−cash component of restructuring charges	**—**	10.8	—
Working capital increases	**29.7**	103.5	75.4
Other operating activities	**30.9**	13.8	16.8
Depreciation and amortization	**90.5**	94.6	96.2
Cash flow provided by operating activities	**225.3**	257.8	205.3
Payments for capital expenditures	**(64.4)**	(103.0)	(107.7)
Net purchases of investments	**(36.4)**	(11.3)	(10.0)
Other investing activities	**2.2**	31.0	(7.9)
Cash flow used in investing activities	**(98.6)**	(83.3)	(125.6)
Net purchases of common stock	**(21.6)**	(9.8)	(1.1)
Net payments of debt and deferred financing costs	**(1.3)**	(29.8)	(22.3)
Contributions by minority owners	**0.9**	3.7	4.4
Cash flow used in financing activities	**(22.0)**	(35.9)	(19.0)
Effect of exchange rate changes on cash	**0.9**	(2.0)	4.3
Increase in cash and cash equivalents	**$105.6**	$ 136.6	$ 65.0

Cash Flow Provided by Operating Activities

Cash flow from operations was $225.3 million in 2005 compared with $257.8 million in 2004 and $205.3 million in 2003. The significant changes in cash flow from operations in 2005 as compared to 2004 are due to changes in accrued expenses, accounts payable and inventory, offset by an increase in net earnings. The significant changes in cash flow from operations from 2004 compared with 2003 are due to increases in accrued expenses and net earnings, offset by a change in inventory.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Cash Flow Used in Investing Activities

In 2005, our capital expenditures totaled $64.4 million. The $64.4 million includes $24.1 million for new and relocated stores, $15.3 million to remodel existing stores, $10.2 million for information technology hardware and systems development and $14.8 million for other necessary improvements. We expect that 2006 capital expenditures will be approximately $120.0 million. We intend to use internal cash flow and available financing from our $200 million revolving credit agreement to finance all of these expenditures.

Cash Flow Used in Financing Activities

During 2005, we repurchased 3,279,498 shares of common stock for $71.2 million, which included the repurchase of 3,234,095 shares of common stock for $70.4 million under our stock repurchase program. Under the indenture governing our 8.25% Senior Subordinated Notes, we may repurchase approximately an additional $32.4 million of common stock. This limit may increase or decrease based upon our earnings. We have approximately $167.7 million of remaining common stock repurchase authorization from our Board of Directors. See Note 16 of the Notes to Consolidated Financial Statements for further discussion of common stock repurchases.

In January 2004, we replaced our $150 million senior secured revolving credit facility with a new senior secured revolving credit facility (the “Facility”). Funds borrowed under the Facility are secured by domestic merchandise inventory and receivables. We may borrow up to $200 million through the Facility, subject to a sufficient borrowing base and other terms of the Facility. The Facility bears interest at the London Inter−Bank Offered Rate (“LIBOR”), plus a variable margin of 1.25 percent to 2.0 percent, or the base rate as defined in the Facility. The variable interest rate margin on the Facility varies based upon certain borrowing levels specified in the Facility. The variable interest rate at January 28, 2006, was 4.67 percent. A quarterly commitment fee of 0.30 percent per annum is payable on the unborrowed balance. The Facility is scheduled to expire in January 2008, with a one−year extension to January 2009 at our option. No amounts were drawn under the Facility as of January 28, 2006. As of January 28, 2006, our borrowing base permits us to borrow up to $192.2 million under the Facility, less $25.2 million in outstanding letters of credit.

In July 2003, we sold $200.0 million of 8.25% Senior Subordinated Notes (the “Notes”) for $196.7 million, due 2013. The discount of $3.3 million is being amortized to interest expense over the life of the Notes. The Notes are guaranteed by all of our domestic subsidiaries. Interest on the Notes is payable semi−annually, which began February 1, 2004. The Notes contain various covenants including those that may limit our ability to pay dividends, repurchase stock, accelerate the retirement of other subordinated debt or make certain investments. As of January 28, 2006, we are in compliance with all covenants. The proceeds of the Notes and additional general funds were used to repay the entire $200.0 million term loan portion of our previous credit facility. As of January 28, 2006, the fair value of the Notes is $210.3 million based on recent trading activity of the Notes. On or after August 1, 2008, we may, on any one or more occasions, redeem all or a part of the Notes at the redemption prices set forth below, plus accrued and unpaid interest, if any, on the Notes redeemed, to the applicable redemption date:

Year	Percentage
2008	104.125%
2009	102.750%
2010	101.375%
2011 and thereafter	100.000%

We have entered into $2.0 million of demand notes payable to efficiently finance our subsidiaries in the Central American Region. We maintain cash balances of $2.0 million in certificates of deposit as compensating balances to collateralize these notes payable. The notes payable accrue interest at a weighted average of 6.75%. The certificates of deposit earn interest at a weighted average of 6.00% and are reflected as restricted cash in the accompanying consolidated balance sheet. During 2005, we repaid $1.0 million of the $3.0 million balance outstanding as of the end of 2004.

Financial Commitments

As of January 28, 2006, no amounts were drawn against the $192.2 million borrowing base available under the $200.0 million Facility. However, the availability under the Facility is reduced by $25.2 million in outstanding letters of credit.

Our financial commitments as of January 28, 2006 are described below:

	Payments Due by Period				
(dollars in millions)	Total	Less than One Year	1–3 Years	3–5 Years	More than Five Years
Senior Subordinated Notes	$ 200.0	$ —	$ —	$ —	$200.0
Capital lease obligations (including interest)	0.9	0.4	0.5	—	—
Operating lease obligations	1,154.2	246.1	401.2	273.2	233.7
Interest on notes payable and long–term debt	132.7	16.6	33.4	33.2	49.5
Royalty obligations	30.7	10.3	20.4	—	—
Service agreement obligations	14.4	9.1	3.3	2.0	—
Employment agreement obligations	8.1	5.3	2.8	—	—
Employee severance	4.3	1.8	2.5	—	—
Other long–term debt	6.4	—	2.4	—	4.0
	$1,551.7	$289.6	$466.5	$308.4	$487.2

We lease substantially all of our stores and are committed to making lease payments over varying lease terms. The operating lease obligations presented above represent the total lease obligations due to landlords, including obligations related to closed stores as well as our obligations related to leases that we have sublet. In instances where failure to exercise renewal options would result in an economic penalty, the calculation of lease obligations includes renewal option periods. Our royalty obligations consist of minimum royalty payments for the purchase of branded merchandise. Our service agreement obligations consist of minimum payments for services that we cannot avoid without penalty. Our employment agreement obligations consist of minimum payments to certain of our executives. Employee severance obligations consist of contractually–specified payments associated with our restructuring initiatives and management transition.

Amounts not reflected in the table above:

- We issue cancelable purchase orders to various vendors for the purchase of our merchandise. As of January 28, 2006, we had merchandise purchase obligations in the amount of $183.0 million for which we will likely take delivery.
- As previously discussed, we also have demand notes payable of $2.0 million to efficiently finance our subsidiaries in the Central American Region.
- We have entered into a joint venture agreement to operate Payless ShoeSource stores in Japan. We made a capital contribution of 181.5 million yen, or $1.7 million dollars, in 2005 to our Japanese joint venture. We have committed to making capital contributions to our Japanese joint venture in the amount of 356 million yen in 2006. Additionally, if the Japanese joint venture achieves certain performance targets, we will be committed to contribute an additional 57 million yen in 2007. In U.S. dollars, based on the exchange rate of

116.5 yen to 1 U.S. dollar as of January 28, 2006, the committed contributions are $3.1 million and $0.5 million for 2006 and 2007, respectively. We own 60% of the Japanese joint venture and, therefore, have consolidated the results of such operations in our financial statements.

Financial Condition Ratios

The debt−to−capitalization ratio was 24.0 percent, 25.9 percent, and 28.2 percent for 2005, 2004 and 2003, respectively. The 2005 debt−to−capitalization ratio decreased primarily due to the increase in net earnings, partially offset by a reduction in equity due to repurchase of common stock. For purposes of the debt−to−capitalization ratio, total debt is long−term debt including current maturities, notes payable and borrowings under the revolving line of credit. Capitalization is defined as total debt and shareowners' equity. The debt−to−capitalization ratio, including the present value of future minimum rental payments under operating leases (including certain option periods where failure to exercise such options would result in an economic penalty) as debt and as capitalization, would be 63.8 percent, 67.3 percent and 66.8 percent in 2005, 2004 and 2003, respectively.

Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon our Consolidated Financial Statements, which were prepared in accordance with accounting principles generally accepted in the United States of America. These principles require us to make estimates and assumptions that affect the reported amounts in the Consolidated Financial Statements and notes thereto. Actual results may differ from these estimates, and such differences may be material to the Consolidated Financial Statements. We believe that the following critical accounting policies involve a higher degree of judgment or complexity (see the Notes to our Consolidated Financial Statements for a complete discussion of our significant accounting policies).

Inventories

Merchandise inventories in our stores 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. Prior to shipment to a specific store, inventories are valued at the lower of cost using the FIFO basis, or market. The retail method is widely used in the retail industry due to its practicality. Under the retail method, cost is determined by applying a calculated cost−to−retail ratio across groupings of similar items, known as departments. As a result, the retail method results in an averaging of inventory costs across similar items within a department. The cost−to−retail ratio is applied to ending inventory at its current owned retail valuation to determine the cost of ending inventory on a department basis. Current owned retail represents the retail price for which merchandise is offered for sale on a regular basis reduced for any permanent or clearance markdowns. As a result, the retail method normally results in an inventory valuation that is lower than a traditional FIFO cost basis.

Inherent in the retail method calculation are certain significant management judgments and estimates including initial mark−up, markdowns and shrinkage, which can significantly impact the owned retail and, therefore, the ending inventory valuation at cost. Specifically, the failure to take permanent or clearance markdowns on a timely basis can result in an overstatement of cost under the retail method. We believe that our application of the retail method reasonably states inventory at the lower of cost or market.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight−line basis over their estimated useful lives. The costs of repairs and maintenance are expensed when incurred, while expenditures for store remodels, refurbishments and improvements that significantly add to the product capacity or extend the useful life of an asset are capitalized. Projects in progress are stated at cost, which includes the cost of construction and other

direct costs attributable to the project. No provision for depreciation is made on projects in progress until such time as the relevant assets are completed and put to use.

Property and equipment are reviewed on a store–by–store basis if an indicator of impairment exists to determine whether the carrying amount of the asset is recoverable. Estimated future cash flows are used to determine if impairment exists. We use current operating results and historical performance to estimate future cash flows on a store–by–store basis.

Rent Expense

Certain of the Company's lease agreements provide for scheduled rent increases during the lease term, as well as provisions for renewal options. Rent expense is recognized on a straight–line basis over the term of the lease from the time at which the Company takes possession of the property. In instances where failure to exercise renewal options would result in an economic penalty, the calculation of straight–line rent expense includes renewal option periods. Also, landlord–provided tenant improvement allowances are recorded in other liabilities and amortized as a credit to rent expense over the term of the lease.

Insurance Programs

We retain our normal expected losses related primarily to workers' compensation, physical loss to property and business interruption resulting from such loss and comprehensive general, product, and vehicle liability. We purchase third party coverage for losses in excess of the normal expected levels. Provisions for losses expected under these programs are recorded based upon estimates of aggregate liability for claims incurred utilizing independent actuarial calculations. These actuarial calculations utilize assumptions to estimate the frequency and severity of losses as well as the patterns surrounding the emergence, development and settlement of claims based on historical results.

Accounting for Taxes

We are routinely under audit by the United States federal, state, local or international tax authorities in the areas of income taxes and sales and use taxes. In evaluating the potential exposures associated with our various tax filings, we accrue charges for possible exposures. Based on the quarterly evaluations of tax positions, we believe we have appropriately filed our tax returns and accrued for potential exposures. To the extent we were to prevail in income tax matters for which accruals have been established or be required to pay amounts in excess of reserves, our effective income tax rate in a given financial period might be impacted. We have various federal, state and foreign tax examinations currently in process.

We record valuation allowances against our deferred tax assets, when necessary, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Realization of deferred tax assets (such as net operating loss carryforwards) is dependent on future taxable earnings and is therefore uncertain. We assess the likelihood that our deferred tax assets in each of the jurisdictions in which we operate will be recovered from future taxable income. Deferred tax assets are reduced by a valuation allowance to recognize the extent to which, more likely than not, the future tax benefits will not be realized.

Asset Retirement Obligations

We follow FASB Interpretation No. 47 ("FIN 47"), "Accounting for Conditional Asset Retirement Obligations – An Interpretation of FASB Statement No. 143," which requires entities to record a liability equal to the fair value of the estimated future cost to retire an asset, if the liability's fair value can be reasonably estimated. Our asset retirement obligation ("ARO") liabilities are primarily associated with our personal property and trade fixtures which, at the end of a lease, we are contractually obligated to remove in order to restore the facility back to a

condition specified in the lease agreement. We estimate the fair value of these liabilities based on current store closing costs and discount the removal costs back as if they were to be performed at the inception of the lease. At the inception of such a lease, we record the ARO as a liability and also record a related asset in an amount equal to the estimated fair value of the liability. The capitalized asset is then depreciated on a straight−line basis over the useful life of the asset. Upon retirement of the asset, any difference between the actual retirement costs incurred and the previously recorded estimated ARO liability is recognized as a gain or loss in the consolidated statement of earnings.

In future periods, we may make adjustments to the ARO liability as a result of the availability of new information, changes in labor costs and other factors. The estimate of the ARO liability is based on a number of assumptions requiring professional judgment, and we cannot predict what revisions to these assumptions will be required in future periods.

We adopted FIN 47 during the fourth quarter of 2005. The initial adoption resulted in a charge of $4.1 million (net of income taxes and minority interest), which was recorded as a cumulative effect of a change in accounting principle. The adoption increased net property and equipment by $1.7 million, increased asset retirement obligations by $8.5 million, and increased deferred tax assets by $2.7 million.

New Accounting Standards

In December 2004, the FASB issued SFAS 123(R), "Share−Based Payment" ("SFAS 123(R)"). SFAS 123(R) provides accounting guidance for stock−based payments to employees. SFAS 123(R) revises SFAS 123 by eliminating the choice of using the recognition and measurement provisions of APB No. 25 and requiring all companies to use the fair value method of measuring stock compensation expense. SFAS 123(R) clarifies and expands SFAS 123's guidance in several areas, including measuring fair value, classifying an award as equity or liability, attributing compensation cost to reporting periods as well as adding several new disclosure requirements. SFAS 123(R) also changes the accounting for the tax effects of options, including the presentation of the tax effects on the consolidated statements of cash flows. SFAS 123(R) is effective for public companies with the first interim or annual period that begins after June 15, 2005. We plan to adopt SFAS 123(R) effective January 29, 2006, using the modified prospective application method. This method requires the recognition of compensation expense for previously granted awards that have not yet been vested and all future awards that are granted or modified after adoption of the standard. Upon adoption of SFAS 123(R), we plan to value future grants using a binomial option pricing model and amortize compensation expense over the applicable service period using the straight−line method. Previous grants were valued using the Black−Scholes option pricing model and amortized using tranche specific expense attribution as discussed in FASB Interpretation No. 28. We are in the process of evaluating SFAS 123(R)'s impact on our Consolidated Financial Statements.

In September 2005, the FASB issued FSP No. FAS 123(R)−1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)," to defer the requirement of SFAS No. 123(R) that a freestanding financial instrument, originally subject to SFAS No. 123(R), becomes subject to the recognition and measurement requirements of other applicable GAAP when the rights conveyed by the instrument to the holder are no longer dependent on the holder being an employee of the entity. The Company will apply the principles set forth in this FSP upon its adoption of SFAS No. 123(R). SFAS No. 123(R) is effective for the first quarter of the Company's 2006 fiscal year.

In October 2005, the FASB issued FSP No. FAS 123(R)−2, "Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)," to provide guidance on determining the grant date for an award as defined in SFAS No. 123(R). This FSP stipulates that, assuming all other criteria in the grant date definition are met, a mutual understanding of the key terms and conditions of an award to an individual employee is presumed to exist upon the award's approval in accordance with the relevant corporate governance

requirements. Further, the key terms and conditions of an award (a) cannot be negotiated by the recipient with the employer because the award is a unilateral grant, and (b) are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. The Company will apply the principles set forth in this FSP upon its adoption of SFAS No. 123(R). SFAS No. 123(R) is effective for the first quarter of the Company's 2006 fiscal year.

In November 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. FAS 123(R)−3, "Transition Election Related to Accounting for the Tax Effects of Share−Based Payment Awards," to provide an alternate transition method for the implementation of SFAS No. 123(R). Some entities do not have, and may not be able to re−create, information about the net excess tax benefits that would have qualified as such had those entities adopted SFAS No. 123(R) for recognition purposes. This method comprises (a) a computational component that establishes a beginning balance of the additional paid−in capital ("APIC") pool related to employee compensation and (b) a simplified method to determine the subsequent impact on the APIC pool of employee awards that are fully vested and outstanding upon the adoption of SFAS No. 123(R). The Company will apply the principles set forth in this FSP upon its adoption of SFAS No. 123(R). SFAS No. 123(R) is effective for the first quarter of the Company's 2006 fiscal year.

In October 2005, the FASB the issued FSP No. 13−1, "Accounting for Rental Costs Incurred during a Construction Period." The guidance requires the rental costs recognized for ground or building operating leases during the construction period be recognized as rental expense. The guidance permits either retroactive or prospective treatment for periods beginning after December 15, 2005. The Company's current accounting follows FSP 13−1 and therefore does not have an impact on the financial statements.

In December 2004, the FASB issued SFAS 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29" ("SFAS 153"). SFAS 153 was issued primarily to improve the comparability of accounting for exchanges of nonmonetary assets with the International Accounting Standards Board. SFAS 153 requires that exchanges of nonmonetary assets be measured based on the fair value of the assets exchanged. APB Opinion No. 29 included some exceptions to measuring exchanges at fair value. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005, though early adoption is encouraged. The application of SFAS 153 is not expected to have a material impact on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Interest on our senior secured revolving credit facility, which is entirely comprised of a revolving line of credit, is based on the London Inter−Bank Offered Rate ("LIBOR") plus a variable margin of 1.25 percent to 2.0 percent, or the base rate, as defined in the credit agreement. There are no outstanding borrowings on the revolving line of credit at January 28, 2006; however, if we were to borrow against our revolving line of credit, borrowing costs may fluctuate depending upon the volatility of LIBOR.

Foreign Currency Risk

We have retail operations in foreign countries; therefore, our cash flows in U.S. dollars are impacted by fluctuations in foreign currency exchange rates. We adjust our retail prices, when possible, to reflect changes in exchange rates to mitigate this risk. To further mitigate this risk, we may, from time to time, enter into forward contracts to purchase or sell foreign currencies. For the fiscal years ended January 28, 2006, January 29, 2005, and January 31, 2004, fluctuations in foreign currency exchange rates did not have a material impact on our operations or cash flows and we did not enter into any forward contracts to purchase or sell foreign currencies.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

In 2005, approximately 93 percent of our footwear, based on cost, was sourced from the People's Republic of China (the "PRC"). The national currency of the PRC, the yuan, is currently not a freely convertible currency. The value of the yuan depends to a large extent on the PRC government's policies and upon the PRC's domestic and international economic and political developments. Since 1994, the official exchange rate for the conversion of the PRC's currency was pegged to the U.S. dollar at a virtually fixed rate of approximately 8.28 yuan per U.S. dollar. However, on July 21, 2005, the PRC's government revalued the yuan by 2.1%, setting the exchange rate at 8.11 yuan per U.S. dollar, and adopted a more flexible system based on a trade–weighted basket of foreign currencies of the PRC's main trading partners. Under the new "managed float" policy, the exchange rate of the yuan may shift each day up to 0.3% in either direction from the previous day's close, and as a result, the valuation of the yuan may increase incrementally over time should the PRC central bank allow it to do so, which could significantly increase the cost of the products we source from the PRC. As of January 27, 2006, the last day of trading in our fiscal year, the exchange rate was 8.06 yuan per U.S. dollar.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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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 accounting principles generally accepted in the United States applied on a consistent basis.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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, and are prepared with the assistance of specialists within and outside the Company, actual results could differ from those estimates.

Management has established and maintains an internal control structure 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. Internal controls include 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 and loss prevention 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 registered public accounting firm and internal auditors.

Management believes that it is essential for the Company 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 the Company.

Audit and Finance Committee of the Board of Directors

The Board of Directors, through the activities of its Audit and Finance Committee (the "Committee"), participates in the reporting of financial information by the Company. The Committee meets regularly with management, the internal auditors and the independent registered public accounting firm. 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 registered public accounting firm, including the recommendations to improve certain internal controls and the follow−up reports prepared by management. The independent registered public accounting firm and internal auditors have free access to the Committee and the Board of Directors and attend each regularly scheduled Committee meeting.

The Committee consists of four outside directors all of whom have accounting or financial management expertise. The members of the Committee are Daniel Boggan Jr., Howard R. Fricke, Michael E. Murphy and John F. McGovern. The Audit and Finance Committee regularly reports the results of its activities to the full Board of Directors.

Management's Annual Report on Internal Control Over Financial Reporting

The management of Payless ShoeSource, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting for the company. With the participation of the Chief Executive Officer and the Chief Financial Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework and criteria established in *Internal Control — Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management has concluded that our internal control over financial reporting was effective as of January 28, 2006.

Payless ShoeSource, Inc.'s independent registered public accounting firm, Deloitte and Touche LLP, has issued an audit report dated March 31, 2006 on our management's assessment of our internal control over financial reporting.

/s/ Matthew E. Rubel	/s/ Ullrich E. Porzig
Chief Executive Officer	Senior Vice President — Chief
and President	Financial Officer and Treasurer

Report of Independent Registered Public Accounting Firm

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

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Payless ShoeSource, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of January 28, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of January 28, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 28, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and the financial statement schedule as of and for the year ended January 28, 2006 of the Company and our report dated March 31, 2006 expressed an unqualified opinion on those financial statements and financial statement schedule.

DELOITTE & TOUCHE LLP

Kansas City, Missouri
March 31, 2006

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Payless ShoeSource, Inc. and subsidiaries (the "Company") as of January 28, 2006 and January 29, 2005, and the related consolidated statements of earnings (loss), shareowners' equity, and cash flows for each of the three fiscal years in the period ended January 28, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of January 28, 2006 and January 29, 2005, and the results of their operations and their cash flows for each of the three years in the period ended January 28, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of January 28, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 29, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

As discussed in Note 22 to the consolidated financial statements, the Company changed its method of accounting for conditional asset retirement obligations in the fourth quarter of the fiscal year ended January 28, 2006.

DELOITTE & TOUCHE LLP

Kansas City, Missouri
March 31, 2006

PAYLESS SHOESOURCE, INC.
CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)

(dollars in millions, except per share)	2005	2004	2003
Net sales	**$2,667.3**	$2,656.5	$2,662.4
Cost of sales	**1,778.9**	1,836.9	1,920.9
Gross margin	**888.4**	819.6	741.5
Selling, general and administrative expenses	**770.8**	733.2	715.7
Restructuring charges (benefits)	**3.8**	24.9	(0.2)
Operating profit from continuing operations	**113.8**	61.5	26.0
Interest expense	**19.7**	22.1	20.7
Interest income	**(12.3)**	(5.3)	(3.9)
Earnings from continuing operations before income taxes and minority interest	**106.4**	44.7	9.2
Provision (benefit) for income taxes	**30.8**	13.2	(4.0)
Earnings from continuing operations before minority interest	**75.6**	31.5	13.2
Minority interest, net of income taxes	**(1.4)**	3.6	3.7
Net earnings from continuing operations	**74.2**	35.1	16.9
Loss from discontinued operations, net of income taxes and minority interest	**(3.7)**	(37.1)	(17.0)
Net earnings (loss) before cumulative effect of change in accounting principle	**$ 70.5**	$ (2.0)	$ (0.1)
Cumulative effect of change in accounting principle, net of income taxes and minority interest	**(4.1)**	—	—
Net earnings (loss)	**$ 66.4**	$ (2.0)	$ (0.1)
Basic earnings (loss) per share:			
Earnings from continuing operations	**$ 1.09**	$ 0.52	$ 0.25
Loss from discontinued operations	**(0.05)**	(0.55)	(0.25)
Earnings (loss) per share before cumulative effect of change in accounting principle	**$ 1.04**	$ (0.03)	$ (0.00)
Cumulative effect of change in accounting principle	**(0.06)**	—	—
Basic earnings (loss) per share	**$ 0.98**	$ (0.03)	$ (0.00)
Diluted earnings (loss) per share:			
Earnings from continuing operations	**$ 1.09**	$ 0.52	$ 0.25
Loss from discontinued operations	**(0.05)**	(0.55)	(0.25)
Earnings (loss) per share before cumulative effect of change in accounting principle	**$ 1.04**	$ (0.03)	$ (0.00)
Cumulative effect of change in accounting principle	**(0.06)**	—	—
Diluted earnings (loss) per share	**$ 0.98**	$ (0.03)	$ (0.00)

See Notes to Consolidated Financial Statements

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PAYLESS SHOESOURCE, INC.
CONSOLIDATED BALANCE SHEETS

(dollars in millions)	January 28, 2006	(as restated, see Note 2) January 29, 2005
Assets		
Current assets:		
Cash and cash equivalents	**$ 378.9**	$ 273.3
Short–term investments	**59.0**	21.3
Restricted cash	**2.0**	3.0
Inventories	**333.0**	345.3
Current deferred income taxes	**20.2**	21.9
Other current assets	**59.8**	56.6
Current assets of discontinued operations	**1.6**	8.5
Total current assets	**854.5**	729.9
Property and equipment:		
Land	**7.7**	8.0
Property, buildings and equipment	**1,186.3**	1,186.9
Accumulated depreciation and amortization	**(807.9)**	(772.6)
Property and equipment, net	**386.1**	422.3
Favorable leases, net	**18.2**	21.7
Deferred income taxes	**27.5**	36.4
Goodwill	**5.9**	5.9
Other assets	**22.3**	23.5
Non–current assets of discontinued operations	**—**	0.1
Total assets	**$1,314.5**	$ 1,239.8
Liabilities and Shareowners' Equity		
Current liabilities:		
Current maturities of long–term debt	**$ 0.4**	$ 0.3
Notes payable	**2.0**	3.0
Accounts payable	**168.9**	160.3
Accrued expenses	**163.8**	159.7
Current liabilities of discontinued operations	**3.4**	15.0
Total current liabilities	**338.5**	338.3
Long–term debt	**204.2**	204.3
Other liabilities	**109.3**	93.6
Minority interest	**10.5**	8.6
Commitments and contingencies (Notes 15 and 18)		
Shareowners' Equity:		
Preferred stock, $.01 par value; 25,000,000 shares authorized; none issued	**—**	—
Common stock, $.01 par value; 240,000,000 shares authorized; 88,130,874 issued; 67,305,608 and 67,191,515 shares outstanding in 2005 and 2004, respectively	**0.9**	0.9
Treasury stock, $.01 par value; 20,825,266 and 20,939,359 shares in 2005 and 2004, respectively	**(0.2)**	(0.2)
Additional paid–in capital	**15.3**	25.6
Unearned restricted stock	**(4.3)**	(0.8)
Retained earnings	**628.4**	562.0
Accumulated other comprehensive income, net of income taxes	**11.9**	7.5
Total shareowners' equity	**652.0**	595.0
Total liabilities and shareowners' equity	**$1,314.5**	$ 1,239.8

See Notes to Consolidated Financial Statements

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PAYLESS SHOESOURCE, INC.
CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY AND COMPREHENSIVE INCOME

(dollars in millions, shares in thousands)	Outstanding Common Stock Shares	Outstanding Common Stock Dollars	Additional Paid–in Capital	Unearned Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareowners' Equity	Comprehensive Income
Balance at February 1, 2003	67,946	$0.7	$ 35.9	$(0.6)	$564.1	$ (5.0)	$595.1	
Net loss		—	—	—	(0.1)	—	(0.1)	$ (0.1)
Translation adjustments		—	—	—	—	7.9	7.9	7.9
Cash flow hedge adjustments		—	—	—	—	1.8	1.8	1.8
Issuances of common stock under stock plans	179	—	1.7	(1.1)	—	—	0.6	
Purchases of common stock	(117)	—	(1.7)	—	—	—	(1.7)	
Amortization of unearned restricted stock		—	—	0.8	—	—	0.8	
Restricted stock cancellation	(16)	—	(0.2)	0.2	—	—	—	
Comprehensive income								9.6
Balance at January 31, 2004	67,992	0.7	35.7	(0.7)	564.0	4.7	604.4	
Net loss		—	—	—	(2.0)	—	(2.0)	(2.0)
Translation adjustments		—	—	—	—	2.8	2.8	2.8
Issuances of common stock under stock plans	228	—	2.8	(1.2)	—	—	1.6	
Purchases of common stock	(938)	—	(11.4)	—	—	—	(11.4)	
Amortization of unearned restricted stock		—	—	0.7	—	—	0.7	
Restricted stock cancellation	(90)	—	(1.5)	0.4	—	—	(1.1)	
Comprehensive income								0.8
Balance at January 29, 2005	67,192	0.7	25.6	(0.8)	562.0	7.5	595.0	
Net earnings		—	—	—	66.4	—	66.4	66.4
Translation adjustments		—	—	—	—	4.9	4.9	4.9
Change in unrecognized pension liability		—	—	—	—	(0.5)	(0.5)	(0.5)
Issuances of common stock under stock plans	3,408	—	54.7	(5.1)	—	—	49.6	
Purchases of common stock	(3,279)	—	(71.2)	—	—	—	(71.2)	
Amortization of unearned restricted stock		—	—	1.3	—	—	1.3	
Income tax benefit of stock option		—	6.5	—	—	—	6.5	

exercise								
Restricted stock cancellation	(15)	—	(0.3)	0.3	—	—	—	
Comprehensive income								$70.8
Balance at January 28, 2006	67,306	$0.7	$ 15.3	$(4.3)	$628.4	$11.9	$652.0	

Outstanding common stock is net of shares held in treasury and is presented net of $0.2 million of treasury stock in 2005, 2004 and 2003, respectively. Treasury stock is accounted for using the par value method. Treasury share activity for the last three years is summarized below (in thousands):

	2005	2004	2003
Balance, beginning of year	**20,939**	20,139	20,185
Issuances of common stock:			
Stock options and employee stock purchase plan	**(3,145)**	(147)	(76)
Deferred compensation plan	**(6)**	(5)	(7)
Net restricted stock (grants) cancellations	**(242)**	14	(80)
	(3,393)	(138)	(163)
Purchases of common stock	**3,279**	938	117
Balance, end of year	**20,825**	20,939	20,139

See Notes to Consolidated Financial Statements

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PAYLESS SHOESOURCE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)	2005	2004 (as restated, see Note 2)	2003 (as restated, see Note 2)
Operating activities:			
Net earnings (loss)	**$ 66.4**	$ (2.0)	$ (0.1)
Loss from discontinued operations, net of income taxes and minority interest	**3.7**	37.1	17.0
Adjustments for non–cash items:			
Cumulative effect of change in accounting principle, net of income taxes and minority interest	**4.1**	—	—
Restructuring charges	**—**	10.8	—
Loss on impairment and disposal of assets	**9.8**	7.0	10.9
Depreciation and amortization	**90.5**	94.6	96.2
Amortization of deferred financing costs	**1.2**	0.9	4.0
Amortization of unearned restricted stock	**1.3**	0.7	0.8
Deferred income taxes	**13.7**	(6.4)	1.3
Minority interest, net of income taxes	**1.4**	(3.6)	(3.7)
Income tax benefit of stock option exercises	**6.5**	—	—
Accretion of investments	**(1.3)**	—	—
Changes in working capital:			
Inventories	**13.4**	31.0	60.8
Other current assets	**(1.2)**	8.4	(8.7)
Accounts payable	**7.9**	30.0	25.5
Accrued expenses	**9.6**	34.1	(2.2)
Other assets and liabilities, net	**6.6**	6.1	14.5
Net cash (used in) provided by discontinued operations	**(8.3)**	9.1	(11.0)
Cash flow provided by operating activities	**225.3**	257.8	205.3
Investing activities:			
Payments for capital expenditures	**(64.4)**	(103.0)	(107.7)
Proceeds from the sale of property and equipment	**1.2**	3.0	1.0
Restricted cash	**1.0**	30.5	(5.0)
Purchases of investments	**(146.4)**	(34.3)	(10.0)
Sales and maturities of investments	**110.0**	23.0	—
Cash used in discontinued operations	**—**	(2.5)	(3.9)
Cash flow used in investing activities	**(98.6)**	(83.3)	(125.6)
Financing activities:			
Repayment (issuance) of notes payable	**(1.0)**	(30.5)	5.0
Issuance of debt	**1.2**	2.4	196.7
Repayment of debt	**(1.5)**	(1.5)	(216.9)
Payment of deferred financing costs	**—**	(0.2)	(7.1)
Issuances of common stock	**49.6**	1.6	0.6
Purchases of common stock	**(71.2)**	(11.4)	(1.7)
Contributions by minority owners	**0.9**	3.7	4.4
Cash flow used in financing activities	**(22.0)**	(35.9)	(19.0)
Effect of exchange rate changes on cash	**0.9**	(2.0)	4.3
Increase in cash and cash equivalents	**105.6**	136.6	65.0
Cash and cash equivalents, beginning of year	**273.3**	136.7	71.7
Cash and cash equivalents, end of year	**$378.9**	$ 273.3	$ 136.7
Supplemental cash flow information:			
Interest paid	**$ 20.8**	$ 23.3	$ 14.0
Income taxes paid (received)	**$ 14.9**	$ (11.0)	$ 7.2
Non–cash investing and operating activities			
Accrued capital additions	**$ 9.4**	$ 16.4	$ 14.5

See Notes to Consolidated Financial Statements

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PAYLESS SHOESOURCE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

Payless ShoeSource, Inc., a Delaware corporation, together with its subsidiaries (the "Company"), is the largest family footwear specialty retailer in the Western Hemisphere.

As of January 28, 2006, the Company operated 4,605 retail shoe stores offering quality footwear and accessories in all 50 of the United States, the District of Columbia, Puerto Rico, Guam, Saipan, the U.S. Virgin Islands, Canada, the Central and South American Regions and Japan. The Central American Region is composed of operations in Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama and Trinidad and Tobago. The South American Region is composed of operations in Ecuador. The Company's operations in the Central and South American Regions and Japan are operated as consolidated joint ventures in which the Company maintains a 60–percent ownership.

The Company utilizes a network of agents with factories in ten foreign countries and the United States to source its footwear products, which are manufactured to meet the Company's specifications and standards. During 2005, factories in the People's Republic of China were a direct source of approximately 93% of the Company's footwear, based on merchandise cost.

The Consolidated Financial Statements include the accounts of the Company, all wholly–owned subsidiaries and all subsidiaries and joint ventures in which the Company owns a controlling interest. During 2003, the Company changed the reporting period for its operations in the Central American and South American Regions to use a December 31 year–end, primarily to match the local countries' statutory reporting requirements. The effect of this one–month lag on the Company's financial position and results of operations is not significant. Start–up activities in Japan were initiated in 2003 using a December 31 year–end. Significant inter–company transactions and balances have been eliminated in consolidation.

As a result of the restructuring, as discussed in Note 3 below, the financial information of the Parade, Peru and Chile stores and 26 of the Payless closed stores has been classified as discontinued operations for all periods presented. These Notes to Consolidated Financial Statements, except where otherwise indicated, relate to continuing operations only.

Fiscal Year

The Company's fiscal year ends on the Saturday closest to January 31. Fiscal years 2005, 2004 and 2003 ended on January 28, 2006, January 29, 2005, and January 31, 2004, respectively. References to years in these financial statements and notes relate to fiscal years rather than calendar years. The Company's operations in the Central American and South American Regions and Japan are consolidated using a December 31 year–end.

Use of Estimates

Management makes estimates and assumptions that affect the amounts reported within the Consolidated Balance Sheets and the Statements of Earnings (Loss), Shareowners' Equity and Comprehensive Income and Cash Flows, and the Notes to Consolidated Financial Statements. Actual results could differ from these estimates.

Net Sales

Net sales ("sales") are recognized at the time the sale is made to the customer, are net of estimated returns and current promotional discounts and exclude sales tax. Third−party liquidation sales related to restructuring are recognized at the time the sale is made to the customer, are calculated based upon contractually guaranteed amounts pursuant to our agreements with liquidators and are net of associated fees. During fiscal year 2005, approximately 22% of the Company's net sales were obtained from externally licensed branded product.

Gift Cards

The Company records a liability in the period in which a gift card is issued and proceeds are received. As gift cards are redeemed, this liability is reduced and revenue is recognized as a sale. The estimated value of gift cards expected to go unused is recognized ratably in proportion to actual redemptions as gift cards are redeemed.

Cost of Sales

Cost of sales includes the cost of merchandise sold and the Company's buying and occupancy costs.

Rent Expense

Certain of the Company's lease agreements provide for scheduled rent increases during the lease term, as well as provisions for renewal options. Rent expense is recognized on a straight−line basis over the term of the lease from the time at which the Company takes possession of the property. In instances where failure to exercise renewal options would result in an economic penalty, the calculation of straight−line rent expense includes renewal option periods. Also, landlord−provided tenant improvement allowances are recorded in other liabilities and amortized as a credit to rent expense over the term of the lease.

Pre−Opening Expenses

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

Advertising Costs

Advertising costs and sales promotion costs are expensed at the time the advertising takes place. Selling, general and administrative expenses include advertising and sales promotion costs of $106.7 million, $107.3 million and $106.2 million in 2005, 2004 and 2003, respectively.

Income Taxes

Income taxes are accounted for using a balance sheet approach known as the liability method. The liability method accounts for deferred income taxes by applying enacted statutory tax rates to differences between the book basis and the tax basis of assets and liabilities.

Stock−based Compensation

The Company follows the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock−Based Compensation — Transition and Disclosure, an amendment of FASB Statement No. 123." The Statement requires prominent disclosures in both annual and interim financial statements regarding the method of accounting for stock−based employee compensation and the effect of the method used on reported results. The Company accounts for stock compensation awards under the intrinsic value method of Accounting Principles Board ("APB") Opinion No. 25. APB Opinion No. 25 requires compensation cost to be recognized based on the excess, if any, between the quoted market price of the stock at

the date of grant and the amount an employee must pay to acquire the stock. All options awarded under all of the Company's plans are granted with an exercise price equal to the fair market value on the date of the grant.

SFAS 123, "Accounting for Stock−Based Compensation," provides an alternative method of accounting for stock based compensation, which establishes a fair value based method of accounting for employee stock options or similar equity instruments. The Company uses the Black−Scholes option pricing model to estimate the grant date fair value of its 1996 and later option grants. The fair value is recognized over the option vesting period using tranche specific expense attribution as discussed in FASB Interpretation No. 28. The following table presents the effect on net earnings (loss) and earnings (loss) per share had the Company adopted the fair value based method of accounting for stock−based compensation under SFAS No. 123, "Accounting for Stock−Based Compensation."

(dollars in millions, except per share amounts)	**2005**	2004	2003
Net earnings (loss):			
As reported	**$ 66.4**	$ (2.0)	$ (0.1)
Add: Total stock−based employee compensation expense included in net earnings (loss) as reported, net of related income taxes	**3.2**	1.2	1.7
Less: Total stock−based employee compensation expense determined under fair value based method for all awards, net of related income taxes	**$ 6.8**	$ 3.0	$ 6.1
Pro forma	**$ 62.8**	$ (3.8)	$ (4.5)
Basic earnings (loss) per share:			
As reported	**$ 0.98**	$ (0.03)	$ (0.00)
Pro forma	**$ 0.93**	$ (0.06)	$ (0.06)
Diluted earnings (loss) per share:			
As reported	**$ 0.98**	$ (0.03)	$ (0.00)
Pro forma	**$ 0.93**	$ (0.06)	$ (0.06)

The average fair value of options granted (per option) was $7, $7 and $6 for 2005, 2004 and 2003, respectively, using the following assumptions:

	2005	2004	2003
Risk−free interest rate	**3.88%**	4.29%	3.40%
Expected dividend yield	**0%**	0%	0%
Expected option life	**5.33 yrs**	7.00 yrs	7.00 yrs
Expected volatility	**34%**	33%	31%

Stock Split

The Company completed a three−for−one stock split, effected in the form of a stock dividend, to shareholders of record on March 13, 2003, paid on March 27, 2003. The Company issued approximately 44.4 million shares of common stock as a result of the stock split. All references to the number of shares and per share amounts of common stock have been restated to reflect the stock split. The Company reclassified an amount equal to the par value of the number of shares issued to common stock from retained earnings.

Cash and Cash Equivalents

Cash equivalents consist of liquid investments with an original maturity of three months or less. Amounts due from banks and credit card companies of $14.4 million and $12.6 million for the settlement of credit card transactions are included in cash and cash equivalents as of January 28, 2006, and January 29, 2005, respectively, as they are generally collected within three business days. Cash equivalents are stated at cost, which approximates fair value.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Short–Term Investments

As of January 28, 2006, and January 29, 2005, short–term investments consisted of the following:

(dollars in millions)	2005	2004
Held–to–maturity securities:		
Commercial paper	**$ 58.5**	$ 6.5
Certificates of deposit	**0.5**	—
Corporate debt securities	—	6.5
Agency securities	—	3.3
Total held–to–maturity securities	**59.0**	16.3
Available–for–sale securities:		
Auction rate securities	—	5.0
Total	**$ 59.0**	$ 21.3

Held–to–maturity securities are carried at amortized cost. As of January 28, 2006, the maturities for all held–to–maturity securities were less than one year. As of January 28, 2006, and January 29, 2005, the estimated fair value of each investment approximated its amortized cost and, therefore, there were no significant unrecognized holding gains or losses.

As of January 29, 2005, short–term investments included $5.0 million of auction rate securities. These investments were classified as available–for–sale securities and were recorded at fair value with unrealized gains or losses reported in other comprehensive income (loss). As of January 29, 2005, the maturities for auction rate securities were in excess of ten years. However, due to the short time period between the reset dates of interest rates, there were no unrealized or realized gains or losses associated with these securities.

Inventories

Merchandise inventories in our stores 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. Prior to shipment to a specific store, inventories are valued at the lower of cost using the FIFO basis, or market. The retail method is widely used in the retail industry due to its practicality. Under the retail method, cost is determined by applying a calculated cost–to–retail ratio across groupings of similar items, known as departments. As a result, the retail method results in an averaging of inventory costs across similar items within a department. The cost–to–retail ratio is applied to ending inventory at its current owned retail valuation to determine the cost of ending inventory on a department basis. Current owned retail represents the retail price for which merchandise is offered for sale on a regular basis reduced for any permanent or clearance markdowns. As a result, the retail method normally results in an inventory valuation that is lower than a traditional FIFO cost basis.

Inherent in the retail method calculation are certain significant management judgments and estimates including initial mark–up, markdowns and shrinkage, which can significantly impact the owned retail and, therefore, the ending inventory valuation at cost. Specifically, the failure to take permanent or clearance markdowns on a timely basis can result in an overstatement of carrying cost under the retail method. Management believes that its application of the retail method reasonably states inventory at the lower of cost or market.

The Company takes ownership of certain raw materials as the materials enter the production process. These raw materials are included in inventories and accounted for under the FIFO basis. Raw materials of $20.1 million and $18.8 million are held by third parties and included in inventories in the consolidated balance sheet at January 28, 2006, and January 29, 2005, respectively.

Property and Equipment

Property and equipment are recorded at cost and are depreciated on a straight−line basis over their estimated useful lives. The costs of repairs and maintenance are expensed when incurred, while expenditures for store remodels, refurbishments and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Projects in progress are stated at cost, which includes the cost of construction and other direct costs attributable to the project. No provision for depreciation is made on projects in progress until such time as the relevant assets are completed and put to use. The estimated useful life for each major class of property and equipment is as follows:

Buildings	10 to 30 years
Leasehold improvements	the lesser of 10 years or the remaining expected lease term that is reasonably assured (which may exceed the current non−cancelable term)
Furniture, fixtures and equipment	3 to 8 years
Property under capital lease	10 to 30 years

The following is a summary of the components of property, buildings and equipment:

(dollars in millions)	**2005**	2004
Buildings and leasehold improvements	**$ 631.7**	$ 618.4
Furniture, fixtures and equipment	**524.5**	509.8
Property under capital leases	**0.9**	3.8
Projects in progress	**29.2**	54.9
	$ 1,186.3	$ 1,186.9

Depreciation expense for 2005, 2004, and 2003 was $87.1 million, $90.5 million, and $91.3 million, respectively.

Property and equipment are reviewed for recoverability on a store−by−store basis if an indicator of impairment exists to determine whether the carrying amount of the assets is recoverable. Estimated future cash flows are used to determine if impairment exists. The Company uses current operating results and historical performance to estimate future cash flows on a store−by−store basis. Excluding restructuring charges as discussed in Note 3, total impairment charges related to assets held and used for 2005, 2004 and 2003 were $2.4 million, $1.5 million, and $5.4 million, respectively. These charges are included in cost of sales.

Intangible Assets

Goodwill and indefinite−lived intangible assets are not amortized, but are tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. Favorable leases and other intangible assets with finite lives are amortized over their useful lives using the straight−line method. During 2005, the Company performed the required annual impairment testing and no impairment losses were necessary.

Insurance Programs

The Company retains its normal expected losses related primarily to workers' compensation, physical loss to property and business interruption resulting from such loss and comprehensive general, product, and vehicle liability. The Company purchases third−party coverage for losses in excess of the normal expected levels. Provisions for losses expected under these programs are recorded based upon estimates of the aggregate liability for claims incurred utilizing independent actuarial calculations based on historical results.

Foreign Currency Translation

Local currencies are the functional currencies for most foreign subsidiaries. Accordingly, assets and liabilities of these subsidiaries are translated at the rate of exchange at the balance sheet date. Adjustments from the translation process are accumulated as part of other comprehensive income and are included as a separate component of shareowners' equity. The changes in foreign currency translation adjustments were not adjusted for income taxes since they relate to indefinite term investments in non−United States subsidiaries. Income and expense items of these subsidiaries are translated at average rates of exchange. As of fiscal year−end 2005, 2004 and 2003, cumulative translation adjustments included in accumulated other comprehensive income (loss) were $12.4 million, $7.5 million and $4.7 million, respectively.

For those foreign subsidiaries operating in a highly inflationary economy or having the U.S. Dollar as their functional currency, net non−monetary assets are translated at historical rates and net monetary assets are translated at current rates. Translation adjustments are included in the determination of net earnings.

Financial Derivatives

The Company has used derivative financial instruments to reduce its exposure to fluctuations in interest rates and foreign currencies and to minimize the risk associated with investments in foreign operations. Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," requires that all derivatives be reflected as either assets or liabilities on the balance sheet based on their fair value. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in the fair value of the hedged asset, liability or firm commitment through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The change in a derivative's fair value related to the ineffective portion of a hedge, if any, will be immediately recognized in earnings. As of January 28, 2006 and January 29, 2005, the Company had no derivative instruments in place.

Asset Retirement Obligations

The Company follows FASB Interpretation No. 47 ("FIN 47"), "Accounting for Conditional Asset Retirement Obligations — An Interpretation of FASB Statement No. 143," which requires entities to record a liability equal to the fair value of the estimated future cost to retire an asset, if the liability's fair value can be reasonably estimated. The Company's asset retirement obligation ("ARO") liabilities are primarily associated with the disposal of personal property and trade fixtures which, at the end of a lease, the Company is contractually obligated to remove in order to restore the facility back to a condition specified in the lease agreement. The Company estimates the fair value of these liabilities based on current store closing costs and discounts the costs back as if they were to be performed at the inception of the lease. At the inception of such a lease, the Company records the ARO as a liability and also records a related asset in an amount equal to the estimated fair value of the liability. The capitalized asset is then depreciated on a straight−line basis over the useful life of the asset. Upon retirement of the asset, any difference between the actual retirement costs incurred and the previously recorded estimated ARO liability is recognized as a gain or loss in the consolidated statement of earnings (loss).

In future periods, the Company may make adjustments to the ARO liability as a result of the availability of new information, changes in labor costs and other factors. The estimate of the ARO liability is based on a number of assumptions requiring professional judgment, including average store closing costs, inflation rates and asset re−use rates.

Note 2 — Restatement of Financial Statements

Subsequent to the issuance of the Company's consolidated financial statements for the year ended January 29, 2005, the Company determined that certain investments with original maturities more than three months were misclassified as cash and cash equivalents as of the end of 2004. The investments should have been classified as short–term investments.

In addition, the Company has made the following corrections to its consolidated statements of cash flows:

- 2004 and 2003 payments for capital expenditures have been corrected to exclude non–cash accrued capital additions.
- 2004 and 2003 discontinued operations cash flow activity has been reclassified to identify cash flows from discontinued operations within each category.
- 2004 and 2003 changes in restricted cash were reclassified from financing activities to investing activities.

Also, corrections were made to the Company's segment and subsidiary guarantors of senior notes footnote disclosures. Please refer to Notes 19 and 25 for further discussion regarding these errors. The errors did not affect our consolidated statements of earnings (loss) or shareowners' equity for any period previously reported and did not affect compliance with debt covenants.

Following is a summary of the effects of the corrections to the Company's consolidated balance sheets as of January 29, 2005, and consolidated statements of cash flows for fiscal years 2004 and 2003:

	Consolidated Balance Sheets		
(dollars in millions)	As previously Reported	Adjustments	As restated
January 29, 2005			
Cash and cash equivalents	$289.6	$(16.3)	$273.3
Short–term investments	5.0	16.3	21.3

	Consolidated Statements of Cash Flows		
(dollars in millions)	As previously reported	Adjustments	As restated
Fiscal year ended January 29, 2005			
Changes in working capital — accounts payable	$ 30.7	$ (0.7)	$ 30.0
Changes in working capital — accrued expenses	35.3	(1.2)	34.1
Net cash provided by discontinued operations	—	9.1	9.1
Cash flow provided by operating activities	250.6	7.2	257.8
Cash flow provided by discontinued operations	6.6	(6.6)	—
Capital expenditures	(104.9)	1.9	(103.0)
Restricted cash	—	30.5	30.5
Purchases of investments	(13.0)	(21.3)	(34.3)
Sales and maturities of investments	18.0	5.0	23.0
Cash used in discontinued operations	—	(2.5)	(2.5)
Cash flow used in investing activities	(96.9)	13.6	(83.3)
Restricted cash	30.5	(30.5)	—
Cash flow used in financing activities	(5.4)	(30.5)	(35.9)
Increase (decrease) in cash and cash equivalents	152.9	(16.3)	136.6
Cash and cash equivalents, end of year	289.6	(16.3)	273.3
Non–cash investing and operating activities:			
Accrued capital additions	—	16.4	16.4

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

(dollars in millions)	Consolidated Statements of Cash Flows — As previously reported	Adjustments	As restated
Fiscal year ended January 31, 2004			
Changes in working capital — accounts payable	$ 27.7	$ (2.2)	$ 25.5
Changes in working capital — accrued expenses	4.2	(6.4)	(2.2)
Net cash used in discontinued operations	—	(11.0)	(11.0)
Cash flow provided by operating activities	224.9	(19.6)	205.3
Cash flow used in discontinued operations	(14.9)	14.9	—
Capital expenditures	(116.3)	8.6	(107.7)
Restricted cash	—	(5.0)	(5.0)
Cash used in discontinued operations	—	(3.9)	(3.9)
Cash flow used in investing activities	(125.3)	(0.3)	(125.6)
Restricted cash	(5.0)	5.0	—
Cash flow used in financing activities	(24.0)	5.0	(19.0)
Non–cash investing and operating activities:			
Accrued capital additions	—	14.5	14.5

Note 3 — Restructuring Charges

During 2004, the Company initiated a restructuring plan to build long–term shareowner value. The Company has substantially completed the restructuring, which included: 1) closing all Parade stores, 2) sale of Chile and Peru entities, 3) closing of 264 Payless ShoeSource stores, 4) ceasing all wholesale businesses with no significant growth opportunity and 5) eliminating approximately 200 management and administrative positions.

During 2005, the Company recorded $9.7 million in pre–tax restructuring charges primarily related to contract termination costs in excess of previous estimates and other exit costs associated with our strategic initiatives. The $9.7 million pre–tax charge was comprised of $3.8 million relating to continuing operations and $5.9 million relating to discontinued operations.

In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long–Lived Assets” (“SFAS 144”), the results of operations of Parade, Peru, Chile and 26 Payless ShoeSource stores have been classified as discontinued operations in the Company’s consolidated statements of earnings.

In accordance with SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities,” employee severance, contract termination and other exit costs are recorded at their estimated fair value when they are incurred. Employee severance costs include estimates regarding the amount of severance payments made to certain terminated associates, and contract termination costs include estimates regarding the length of time required to sublease vacant space and expected recovery rates. Actual results could vary from these estimates.

The significant components of the restructuring charge incurred as of January 28, 2006 are summarized as follows:

(dollars in millions)	Total Charges to Date	Accrual Balance as of January 29, 2005	2005 Charges — Costs Incurred	2005 Charges — Accrual Adjustments	Cash Payments	Accrual Balance as of January 28, 2006
Employee severance costs	$ 9.0	$ 4.2	$ —	$ (0.3)	$ (2.9)	$ 1.0
Contract termination costs	28.5	17.6	—	7.2	(19.3)	5.5
Other exit costs	5.1	—	2.5	—	(2.5)	—
	42.6	$ 21.8	2.5	$ 6.9	$ (24.7)	$ 6.5
Asset impairments and net disposal losses	35.0		0.3			
Total Charges	$ 77.6		$ 2.8			

The Company expects that the payments of employee severance costs will be substantially completed by June 2007. The remaining contract termination obligations primarily relate to lease obligations for vacant space (certain lease terms extend through November 2013) resulting from the store closings.

Note 4 — Discontinued Operations

In accordance with SFAS No. 144, the results of operations for Parade, Peru, Chile and 26 Payless closed stores are classified as discontinued operations. In the case of Parade, Peru and Chile, all stores were closed, and thus their operations and cash flows were eliminated from the Company's ongoing operations. Payless stores are considered for discontinued operations disclosure if the nearest store is greater than 10 miles from the closed store. If the nearest store is greater than 10 miles from the store to be closed, the store is generally not expected to realize a migration of significant direct cash inflows as a result of the closure and, consequently, these stores are considered to be discontinued operations. If the nearest store is less than 10 miles from the closed store, the Company generally expects to realize a migration of significant direct cash inflows as a result of the closure and those stores are not reported as discontinued operations.

The following is a summary of these results by segment:

Fiscal Year Ended January 28, 2006

(dollars in millions)	Payless Domestic	Payless International	Payless Consolidated
Loss on disposal of discontinued operations before income taxes	$(5.9)	$ —	$ (5.9)
Benefit for income taxes	(2.2)	—	(2.2)
Loss from discontinued operations, net of income taxes	$(3.7)	$ —	$(3.7)

Fiscal Year Ended January 29, 2005

(dollars in millions)	Payless Domestic	Payless International	Payless Consolidated
Net sales	$100.8	$ 9.0	$109.8
Loss from discontinued operations before income taxes and minority interest	(11.5)	(6.1)	(17.6)
(Benefit) provision for income taxes	(4.5)	0.4	(4.1)
Loss from discontinued operations before minority interest	(7.0)	(6.5)	(13.5)
Minority interest, net of income taxes	—	2.6	2.6
Loss before disposal	(7.0)	(3.9)	(10.9)
Loss on disposal of discontinued operations, net of income taxes of $12.9 and $0.0, respectively, and minority interest of $0.0 and $3.9, respectively	(20.4)	(5.8)	(26.2)
Loss from discontinued operations, net of income taxes and minority interest	$ (27.4)	$(9.7)	$ (37.1)

Fiscal Year Ended January 31, 2004

(dollars in millions)	Payless Domestic	Payless International	Payless Consolidated
Net sales	$109.8	$11.1	$120.9
Loss from discontinued operations before income taxes and minority interest	(18.7)	(6.7)	(25.4)
(Benefit) provision for income taxes	(6.7)	1.7	(5.0)
Loss from discontinued operations before minority interest	(12.0)	(8.4)	(20.4)
Minority interest, net of income taxes	—	3.4	3.4
Loss from discontinued operations, net of income taxes and minority interest	$ (12.0)	$ (5.0)	$ (17.0)

As of January 28, 2006, and January 29, 2005, the current and non−current assets and liabilities of discontinued operations by financial reporting segment were as follows:

Fiscal Year Ended January 28, 2006

(dollars in millions)	Payless Domestic	Payless International	Payless Consolidated
Assets			
Current assets:			
Current deferred income taxes	$1.3	$ —	$1.3
Other current assets	0.3	—	0.3
Total current assets of discontinued operations	$1.6	$ —	$1.6
Liabilities			
Current liabilities:			
Accrued expenses	$3.4	$ —	$3.4
Total current liabilities of discontinued operations	$3.4	$ —	$3.4

Fiscal Year Ended January 29, 2005

(dollars in millions)	Payless Domestic	Payless International	Payless Consolidated
Assets			
Current assets:			
Current deferred income taxes	$ 5.6	—	$ 5.6
Other current assets	2.9	—	2.9
Total current assets of discontinued operations	$ 8.5	$ —	$ 8.5
Other assets	0.1	—	$ 0.1
Total non−current assets of discontinued operations	$ 0.1	$ —	$ 0.1
Liabilities			
Current liabilities:			
Accounts payable	$ 0.2	$ —	$ 0.2
Accrued expenses	14.8	—	14.8
Total current liabilities of discontinued operations	$15.0	$ —	$15.0

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Note 5 — Quarterly Results (Unaudited)

The tables below summarize quarterly results for the last two years. Quarterly results are determined in accordance with annual accounting policies and all adjustments (consisting only of normal recurring adjustments, except as noted below) necessary for a fair statement of the results for the interim periods have been included; however, certain items are based upon estimates for the entire year.

(dollars in millions, except per share)			2005		
Quarter	First	Second	Third	Fourth	Year
Net sales	**$695.2**	**$693.9**	**$666.9**	**$611.3**	**$2,667.3**
Gross margin	**244.4**	**235.1**	**218.5**	**190.4**	**888.4**
Net earnings (loss) from continuing operations	**31.7**	**21.8**	**21.9**	**(1.2)**	**74.2**
Loss from discontinued operations, net of income taxes and minority interest	**(1.5)**	**(1.9)**	**—**	**(0.3)**	**(3.7)**
Cumulative effect of change in accounting principle, net(2)	**—**	**—**	**—**	**(4.1)**	**(4.1)**
Net earnings (loss)	**$ 30.2**	**$ 19.9**	**$ 21.9**	**$ (5.6)**	**$ 66.4**
Basic (loss) earnings per share:					
Earnings from continuing operations	$ **0.47**	**$ 0.32**	**$ 0.32**	**$ (0.02)**	**$ 1.09**
Loss from discontinued operations	**(0.02)**	**(0.03)**	**—**	**(0.00)**	**(0.05)**
Earnings per share before cumulative effect of change in accounting principle	$ **0.45**	**$ 0.29**	**$ 0.32**	**$ (0.02)**	**$ 1.04**
Cumulative effect of change in accounting principle(2)	**—**	**—**	**—**	**(0.06)**	**(0.06)**
Basic earnings (loss) per share:(1)	**$ 0.45**	**$ 0.29**	**$ 0.32**	**$ (0.08)**	**$ 0.98**
Diluted earnings (loss) per share:					
Earnings (loss) from continuing operations	$ **0.47**	**$ 0.32**	**$ 0.32**	**$ (0.02)**	**$ 1.09**
Loss from discontinued operations	**(0.02)**	**(0.03)**	**—**	**(0.00)**	**(0.05)**
Earnings (loss) per share before cumulative effect of change in accounting principle	$ **0.45**	**$ 0.29**	**$ 0.32**	**$ (0.02)**	**$ 1.04**
Cumulative effect of change in accounting principle(2)	**—**	**—**	**—**	**(0.06)**	**(0.06)**
Diluted earnings (loss) per share:(1)	**$ 0.45**	**$ 0.29**	**$ 0.32**	**$ (0.08)**	**$ 0.98**

(dollars in millions, except per share)			2004		
Quarter	First	Second	Third	Fourth	Year
Net sales	$692.3	$695.6	$661.4	$607.2	$2,656.5
Gross margin	216.8	219.5	201.1	182.2	819.6
Net earnings (loss) from continuing operations	17.9	19.8	12.5	(15.1)	35.1
Loss from discontinued operations, net of income taxes and minority interest	(3.8)	(16.0)	(5.9)	(11.4)	(37.1)
Net earnings (loss)	$ 14.1	$ 3.8	$ 6.6	$ (26.5)	$ (2.0)
Basic (loss) earnings per share:					
Earnings from continuing operations	$ 0.26	$ 0.29	$ 0.19	$ (0.22)	$ 0.52
Loss from discontinued operations	(0.05)	(0.24)	(0.09)	(0.17)	(0.55)
Basic earnings (loss) per share(1)	$ 0.21	$ 0.05	$ 0.10	$ (0.39)	$ (0.03)
Diluted (loss) earnings per share:					
Earnings from continuing operations	$ 0.26	$ 0.29	$ 0.19	$ (0.22)	$ 0.52
Loss from discontinued operations	(0.05)	(0.24)	(0.09)	(0.17)	(0.55)
Diluted earnings (loss) per share(1)	$ 0.21	$ 0.05	$ 0.10	$ (0.39)	$ (0.03)

(1) Earnings (loss) per share were computed independently for each of the quarters presented. The sum of the quarters may not equal the total year amount due to the impact of changes in average quarterly shares outstanding.

(2) As discussed in Note 22, during the fourth quarter of 2005 the Company adopted FASB Interpretation No. 47, “Accounting for Conditional Asset Retirement Obligations – An Interpretation of FASB Statement No. 143.”

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Note 6 — Profit Sharing Plan

The Company has two qualified profit sharing plans (“Payless Profit Sharing Plans”) that cover full−time associates who have worked for the Company for 60 days and have attained age 21 or part−time associates who work 1,000 hours or more in a year and have attained age 21. The Payless Profit Sharing Plans are defined contribution plans that provide for Company contributions related to the Company’s annual performance and are at the discretion of the Board of Directors. Beginning with the 2005 plan year, the Company will fund a minimum guaranteed Company matching contribution of $0.20 per $1.00 contributed by associates, up to 5% of their pay. The Company has historically contributed 2.5% of net profits as defined by the plans. At the discretion of the Board of Directors, the 2005 contribution was determined to be 2.5% of pre−tax earnings from continuing operations. Associates may voluntarily contribute to the Company’s profit sharing plans on both a pre−tax and after−tax basis. For 2005, the Company’s contribution is allocated to all associates participating in the Payless Profit Sharing Plans who have worked for the Company for at least one year as of December 31 before the match is paid. Total profit sharing contributions for 2005 and 2004 were $2.7 million and $1.3 million, respectively. There were no contributions for 2003.

Note 7 — Pension Plan

The Company has a nonqualified, supplementary defined benefit plan for a select group of management employees. The plan is an unfunded, noncontributory plan and provides for benefits based upon years of service and cash compensation during employment.

Pension expense is based on information provided to an outside actuarial firm that uses assumptions to estimate the total benefits ultimately payable to each management employee and allocates this cost to service periods. The actuarial assumptions used to calculate pension expense are reviewed annually for reasonableness.

The components of net periodic benefit costs and actuarial assumptions for the plan were:

(dollars in millions)	**2005**	2004	2003
Components of pension expense:			
Service cost	**$0.7**	$0.8	$0.8
Interest cost	**1.1**	1.1	1.2
Amortization of prior service cost	**0.2**	0.2	0.1
Amortization of actuarial loss	**0.1**	0.2	0.2
Total	**$2.1**	$2.3	$2.3

The change in projected benefit obligation (PBO), accumulated benefit obligation (ABO), funded status of the plan and the actuarial assumptions used were:

(dollars in millions)	**2005**	2004
Change in PBO:		
PBO at beginning of year	**$20.8**	$20.7
Service cost	**0.7**	0.8
Interest cost	**1.1**	1.1
Plan amendments	**0.4**	—
Actuarial gain	**(0.7)**	(1.1)
Benefits paid	**(0.8)**	(0.7)
PBO at end of year	**$21.5**	$20.8
Unrecognized net actuarial loss	**(4.0)**	(4.8)
Unrecognized prior service cost	**(1.4)**	(1.2)
Accrued benefit cost	**$16.1**	$14.8
Amounts recognized in the balance sheet:		
Accrued benefit liability and ABO	**$18.0**	$15.5
Intangible asset	**(1.4)**	(0.7)
Accumulated other comprehensive loss	**(0.5)**	—
Net amount recognized	**$16.1**	$14.8
Actuarial assumptions:		
Discount rate	**5.5%**	5.5%
Salary increases	**3.0%**	3.0%

Estimated future benefit payments for the next five years and the aggregate amount for the following five years are:

(dollars in millions)	
2006	$1.2
2007	1.2
2008	1.3
2009	1.3
2010	6.4
2011– 2015	5.3

The expected contribution to be paid to the plan during fiscal year 2006 is $1.2 million.

Note 8 — Income Taxes

The provision (benefit) for income taxes from continuing operations consisted of the following:

(dollars in millions)	2005	2004	2003
Federal	$ 6.7	$15.9	$(9.2)
State and local	0.7	0.7	2.1
Foreign	9.7	3.0	1.8
Current tax provision (benefit)	17.1	19.6	(5.3)
Federal	10.2	(4.7)	0.2
State and local	0.8	(0.6)	0.4
Foreign	2.7	(1.1)	0.7
Deferred tax provision (benefit)	13.7	(6.4)	1.3
Total provision (benefit)	$30.8	$13.2	$(4.0)

The reconciliation between the statutory federal income tax rate and the effective income tax rate as applied to continuing operations was as follows:

		Percentage			Amount	
(dollars in millions)	**2005**	2004	2003	**2005**	2004	2003
Statutory federal income tax rate	35.0%	35.0%	35.0%	$37.2	$15.6	$ 3.2
State and local income taxes, net of federal tax benefit	1.4	0.3	8.7	1.5	0.2	0.8
Rate differential on foreign earnings, net of valuation allowance	(1.3)	(6.5)	(78.3)	(1.4)	(2.9)	(7.2)
Canada statutory rate change	—	0.4	2.2	—	0.2	0.2
Repatriation of foreign earnings	1.3	5.1	—	1.4	2.3	—
Decrease in excess tax reserves	(5.5)	(4.0)	(12.0)	(5.9)	(1.8)	(1.1)
Federal employment tax credits	(1.0)	(1.8)	(10.9)	(1.1)	(0.8)	(1.0)
Other, net	(1.0)	1.0	11.8	(0.9)	0.4	1.1
Effective income tax rate	28.9%	29.5%	(43.5)%	$30.8	$13.2	$(4.0)

The amount of income taxes the Company pays is subject to ongoing audits by federal, state and foreign tax authorities, which often result in proposed assessments. The Company's estimate for the potential outcome for any uncertain tax issue is highly judgmental. The Company believes it has adequately provided for any reasonable foreseeable outcome related to these matters. However, future results may include favorable or unfavorable adjustments to estimated tax liabilities in the period the assessments are made or resolved or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which the Company's earnings or deductions are realized may differ from current estimates. As a result, the Company's effective tax rate may fluctuate significantly on a quarterly basis due to discrete events.

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Because of the relatively low earnings from continuing operations in 2003, the impact of relatively modest amounts of tax benefits had a large percentage impact on the Company's worldwide tax rate.

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

(dollars in millions)	2005	2004
Deferred Tax Assets:		
Accrued expenses and reserves	$ 42.9	$ 40.1
Tax net operating losses and tax credits	23.5	29.8
Other deferred income taxes, net	1.2	4.2
Gross deferred income tax assets	67.6	74.1
Depreciation/amortization and basis differences	(9.4)	(8.2)
Valuation allowance	(10.5)	(7.6)
Net deferred income tax assets	47.7	58.3
Less: Net current deferred income tax assets	(20.2)	(21.9)
Net noncurrent deferred income tax assets	27.5	36.4
Deferred Tax Liabilities:		
Depreciation/amortization and basis differences	(0.8)	(0.9)
Less: Net current deferred income tax liabilities (included in accrued expenses on the consolidated balance sheets)	—	0.3
Net noncurrent deferred tax liabilities (included in other liabilities on the consolidated balance sheets)	$ (0.8)	$ (0.6)

The Company provides a valuation allowance against net deferred tax assets if, based on management's assessment of historical and projected future operating results and other available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company carries valuation allowances related primarily to realization of foreign net operating loss carryforwards and state income tax credits.

At January 28, 2006, deferred tax assets for state and foreign net operating loss carryforwards are $11.9 million, less a valuation allowance of $6.6 million. The net operating losses related to recorded assets will expire as follows: $0.2 million in 2007, $2.3 million in 2010 through 2011, and $2.8 million by 2024. In addition, federal and state income tax credit carryforwards are $11.6 million, less a valuation allowance of $3.3 million. The remaining valuation allowance relates to other deferred tax assets in Latin American countries that do not have a history of earnings. The tax credit carryforwards related to the recorded assets expire as follows: $6.3 million by 2014, and $2.0 million may be carried forward indefinitely.

The American Jobs Creation Act of 2004, enacted on October 22, 2004 (the "Jobs Act"), provides for a temporary 85% dividends received deduction on certain foreign earnings repatriated during a one−year period. To qualify for the deduction, the earnings must be reinvested in the U.S. pursuant to a domestic reinvestment plan established by a company's chief executive officer and approved by its board of directors. Certain other criteria in the Jobs Act must be satisfied as well. During 2005, the Company's Chief Executive Officer established domestic reinvestment plans which were approved by the Board of Directors. Pursuant to the plans, the Company repatriated $85.0 million from foreign subsidiaries during 2005. The repatriation resulted in recognition of income tax expense of $3.7 million, for which the Company provided $2.3 million in 2004 and $1.4 million in 2005. At the close of 2005, the Company has not provided tax on cumulative undistributed earnings of foreign subsidiaries, other than for Puerto Rico operations, because it is the Company's intention to reinvest these earnings indefinitely. The calculation of the unrecognized deferred tax liability related to these earnings is complex and is not practicable. If earnings were distributed, the Company would be subject to U.S. taxes and withholding taxes payable to various foreign governments. Based on the facts and circumstances at that time, the Company would determine whether a credit for foreign taxes already paid would be available to reduce or offset the U.S. tax liability. The Company anticipates that earnings would not be repatriated unless it was tax efficient to do so.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Note 9 — Earnings (Loss) Per Share

Basic earnings per share from continuing operations were $1.09, $0.52 and $0.25 in 2005, 2004 and 2003, respectively. The per share amounts have been computed on the basis of the weighted average number of shares outstanding.

The calculation of diluted earnings per share from continuing operations for 2005, 2004 and 2003 excludes the impact of 1.4 million, 7.3 million and 7.8 million stock options, respectively, because to include them would be antidilutive. Diluted earnings per share have been computed as follows:

(dollars in millions, except per share; shares in thousands)	**2005**	2004	2003
Net earnings from continuing operations	**$ 74.2**	$ 35.1	$ 16.9
Weighted average shares outstanding — basic	**67,520**	67,947	67,852
Stock options and unvested restricted stock	**334**	73	179
Weighted average shares outstanding — diluted	**67,854**	68,020	68,031
Diluted earnings per share from continuing operations	**$ 1.09**	$ 0.52	$ 0.25

Note 10 — Favorable Leases

Favorable lease rights subject to amortization pursuant to SFAS 142 are as follows:

(dollars in millions)	**2005**	2004
Gross carrying amount	**$ 75.6**	$ 78.2
Less: accumulated amortization	**(57.4)**	(56.5)
Carrying amount, end of year	**$ 18.2**	$ 21.7

Amortization expense on favorable lease rights was as follows:

(dollars in millions)	**2005**	2004	2003
Amortization expense on favorable lease rights	**$3.4**	$4.1	$4.9

The Company expects annual amortization expense for favorable lease rights for the next five years to be as follows (in millions):

Year	Amount
2006	$3.1
2007	2.7
2008	2.4
2009	2.1
2010	1.9

Note 11 — Notes Payable

The Company has entered into $2.0 million of demand notes payable to efficiently finance its subsidiaries in the Central American Region. The Company maintains balances of $2.0 million in certificates of deposit as compensating balances to collateralize these notes payable. The notes payable accrue interest at a weighted average rate of 6.75 percent. The certificates of deposit earn interest at a weighted average rate of 6.00 percent and are reflected as restricted cash in the accompanying consolidated balance sheet. During 2005, the Company repaid $1.0 million of the $3.0 million balance outstanding at the end of 2004.

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Note 12 — Accrued Expenses and Other Liabilities

Major components of accrued expenses included:

(dollars in millions)	2005	2004
Income taxes	**$ 23.9**	$ 35.0
Profit sharing, bonus, retention and salaries	**56.3**	32.1
Sales, use and other taxes	**30.2**	28.1
Accrued restructuring costs	**3.2**	7.4
Other accrued expenses	**50.2**	57.1
Total	**$163.8**	$159.7

Major components of other liabilities included:

(dollars in millions)	2005	2004
Deferred tenant improvement allowances (net)	**$ 25.0**	$24.2
Accrued step rent	**21.7**	22.0
Workers' compensation and general liability insurance reserves	**18.9**	15.9
Other	**43.7**	31.5
Total	**$109.3**	$93.6

Note 13 — Long−term Debt

Long−term debt and capital−lease obligations were:

(dollars in millions)	2005	2004
Senior Subordinated Notes	**$197.3***	$197.0*
Capital−lease obligations	**0.9**	1.2
Other	**6.4**	6.4
Total debt	**204.6**	204.6
Less: current maturities of long−term debt	**0.4**	0.3
Long−term debt	$**204.2**	$204.3

Future debt maturities as of January 28, 2006, are as follows:

(dollars in millions)

Year	Senior Subordinated Notes	Capital Lease Obligations	Other	Total
2006	$ —	$ 0.4	$ —	$ 0.4
2007	—	0.4	2.4	2.8
2008	—	0.1	—	0.1
2009	—	—	—	—
2010	—	—	—	—
Thereafter	200.0*	—	4.0	204.0
Total	$ 200.0	$ 0.9	$6.4	$207.3

* At January 28, 2006, the $200 million of 8.25% Senior Subordinated Notes are recorded at $197.3 million (net of $2.7 million discount). At January 29, 2005, the notes were recorded at $197.0 million (net of $3.0 million discount).

In January 2004, the Company replaced its $150 million senior secured revolving credit facility with a new senior secured revolving credit facility (the "Facility"). Funds borrowed under the Facility are secured by domestic merchandise inventory and receivables. The Company may borrow up to $200 million through the Facility, subject to a sufficient borrowing base. The Facility bears interest at the LIBOR rate, plus a variable margin of 1.25 percent to 2.0 percent, or the base rate defined in the Facility. The margin on the Facility varies based upon certain borrowing levels specified in the Facility. The variable interest rate at January 28, 2006, was 4.67 percent. A quarterly commitment fee of 0.30 percent per annum is payable on the unborrowed balance. The Facility is scheduled to expire in January 2008, with a one−year extension to January 2009 at the Company's option. No amounts were drawn on the revolving credit facility as of January 28, 2006. As of January 28, 2006, our borrowing base permits us to borrow up to $192.2 million under the Facility, less $25.2 million in outstanding letters of credit.

In July 2003, the Company sold $200.0 million of 8.25% Senior Subordinated Notes (the "Notes") for $196.7 million, due 2013. The discount of $3.3 million is being amortized to interest expense over the life of the Notes. The Notes are guaranteed by all of the Company's domestic subsidiaries. Interest on the Notes is payable semi−annually, beginning February 1, 2004. The Notes contain various covenants including those that may limit the Company's ability to pay dividends, repurchase stock, accelerate the retirement of other subordinated debt or make certain investments. As of January 28, 2006, the Company is in compliance with all covenants. The proceeds of the Notes and additional general funds were used to repay the entire $200.0 million term loan portion of the Company's previous credit facility. As of January 28, 2006, the fair value of the Notes is $210.3 million based on recent trading activity of the Notes. On or after August 1, 2008, the Company may, on any one or more occasions, redeem all or a part of the Notes at the redemption prices set forth below, plus accrued and unpaid interest, if any, on the Notes redeemed, to the applicable redemption date:

Year	Percentage
2008	104.125%
2009	102.750%
2010	101.375%
2011 and thereafter	100.000%

Note 14 — Derivative Instruments

In order to mitigate the Company's exposure to fluctuations in interest rates on the term loan portion of the prior credit facility, during 2003 the Company entered into a series of interest rate swap agreements whereby the Company received interest at the three−month LIBOR rate and paid a weighted average rate of 6.9 percent. The Company's interest rate swap agreements were designated as cash flow hedging instruments under Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). Such instruments are those that effectively convert variable interest payments on debt instruments into fixed payments. As the critical terms of the Company's interest rate swap agreements match those of the related hedged obligations, the Company has concluded that there was virtually no ineffectiveness in its hedges.

During 2003, the Company recorded an after−tax gain of $0.1 million ($0.1 million pre−tax) to other accumulated comprehensive income, representing the increase in fair value of its interest rate swap agreements. During 2003, $1.7 million of after−tax losses ($2.7 million pre−tax) included in accumulated other comprehensive income related to interest rate swap agreements was reclassified to interest expense. As of January 31, 2004, the interest rate swap agreements had expired.

The Company did not have any outstanding derivative instruments as of January 28, 2006 or January 29, 2005.

Note 15 — Lease Obligations

The Company leases substantially all of its stores. Rental expense for the Company's operating leases consisted of:

(dollars in millions)	**2005**	2004	2003
Minimum rentals	**$ 264.2**	$ 266.5	$ 258.8
Contingent rentals based on sales	**7.0**	7.0	7.4
Real property rentals	**271.2**	273.5	266.2
Equipment rentals	**0.3**	0.7	0.6
Total	**$ 271.5**	$ 274.2	$ 266.8

Most lease agreements contain renewal options and include escalating rents over the lease terms. Certain leases provide for contingent rentals based upon gross sales. Cumulative expense recognized on the straight−line basis in excess of cumulative payments is included in accrued expenses and other liabilities on the accompanying consolidated balance sheets. Certain of the Company's lease agreements provide for scheduled rent increases

during the lease term, as well as provisions for renewal options. Rent expense is recognized on a straight−line basis over the term of the lease from the time at which the Company takes possession of the property. In instances where failure to exercise renewal options would result in an economic penalty, the calculation of straight−line rent expense includes renewal option periods. Also, landlord−provided tenant improvement allowances are recorded as a liability and amortized as a credit to rent expense.

Future minimum lease payments under non−cancelable lease obligations as of January 28, 2006, were as follows:

(dollars in millions)	Capital Leases	Operating Leases	Total
2006	0.5	246.1	**246.6**
2007	0.4	215.8	**216.2**
2008	0.1	185.4	**185.5**
2009	—	154.3	**154.3**
2010	—	118.9	**118.9**
After 2010	—	233.7	**233.7**
Minimum lease payments	$ 1.0	$ 1,154.2	**$ 1,155.2**
Less imputed interest component	0.1		
Present value of net minimum lease payments of which $0.4 million is included in current liabilities	$ 0.9		

At January 28, 2006, the present value of future operating lease payments was $945.7 million, and the total amount of minimum rentals to be received in the future under non−cancelable subleases was $2.7 million.

Note 16 — Common Stock Repurchases

The Company repurchased $70.4 million (3.2 million shares) and $10.1 million (839 thousand shares) of common stock under its stock repurchase program during 2005 and 2004, respectively. The Company did not repurchase any common stock under stock repurchase programs during 2003. In addition, the Company repurchased $0.8 million (45 thousand shares), $1.3 million (99 thousand shares), and $1.7 million (117 thousand shares) during 2005, 2004 and 2003, respectively, of common stock in connection with its employee stock purchase, deferred compensation and stock incentive plans. Under the indenture governing the Company’s 8.25% Senior Subordinated Notes, the Company may repurchase approximately $32.4 million of common stock. This limit may increase or decrease based upon the Company’s earnings. As of January 28, 2006, the Company has approximately $167.7 million of remaining common stock repurchase authorization from its Board of Directors.

Note 17 — Stock Option and Stock−related Compensation Plans

Under the Company’s common stock option plans, options are granted at the average of the high and low trading price on the date of grant. Options to purchase may extend for up to ten years, may be exercised in installments only after stated intervals of time, and are conditional upon continued employment with the Company. The options may be exercised during certain periods following retirement, disability or death.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

A summary of the status of the various stock option plans at the end of 2005, 2004, and 2003, and the changes within years are presented below:

2005

(shares in thousands)	**Options**	**Weighted Average Exercise Price**
Outstanding at beginning of year	**7,383**	**$17**
Granted	**2,034**	**18**
Exercised	**(3,109)**	**16**
Forfeited or expired	**(570)**	**17**
Outstanding at end of year	**5,738**	**$18**
Exercisable at end of year	**3,460**	**$18**
Average fair value of options granted (per option)	**$ 7**	

2004

(shares in thousands)	Options	Weighted Average Exercise Price
Outstanding at beginning of year	8,026	$17
Granted	517	16
Exercised	(91)	12
Forfeited or expired	(1,069)	17
Outstanding at end of year	7,383	$17
Exercisable at end of year	6,410	$17
Average fair value of options granted (per option)	$ 7	

2003

(shares in thousands)	Options	Weighted Average Exercise Price
Outstanding at beginning of year	8,376	$17
Granted	414	15
Exercised	(18)	16
Forfeited or expired	(746)	17
Outstanding at end of year	8,026	$17
Exercisable at end of year	5,956	$17
Average fair value of options granted (per option)	$ 6	

The following table summarizes information about stock options outstanding and exercisable at January 28, 2006:

(shares in thousands)

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Years of Average Remaining Contractual Life	Weighted Average Exercise Price	Average Exercise Price	Number Exercisable
$ 9–11	11	<1	$ 9	$ 9	11
12–15	651	3	15	15	570
16–18	3,312	6	17	17	1,920
19–25	1,764	7	22	22	959

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Under the 1996 Stock Incentive Plan, the Company is authorized to grant a maximum of 1,200,000 shares of restricted stock to management associates. Associates who receive restricted stock pay no monetary consideration. Restricted stock can be granted with or without performance restrictions. Restrictions, including performance restrictions, lapse over periods of up to ten years, as determined at the date of grant. Under the 1996 Stock Incentive Plan, the Company granted 39,106 shares of restricted stock in 2005. Separately, the Company granted 214,250 shares of restricted stock in connection with the management transition in 2005.

The Company's plans are accounted for as provided by APB Opinion No. 25. For stock options, no compensation cost has been recognized because the option exercise price is fixed at the average market price on the date of grant. For restricted stock grants, compensation expense is based upon the grant date average market price; it is recorded over the vesting period. For performance−based restricted stock, compensation expense is recorded over the performance period based on estimates of performance levels.

Note 18 — Commitments and Contingencies

As of January 28, 2006, the Company has $30.7 million of royalty obligations consisting of minimum royalty payments for the purchase of branded merchandise, $14.4 million of service agreement obligations relating to minimum payments for services that the Company cannot avoid without penalty and $8.1 million of employment agreement obligations related to minimum payments to certain of the Company's executives. The Company has also committed to making capital contributions to our Japanese joint venture in the amount of 356 million yen in 2006. Additionally, if the Japanese joint venture achieves certain performance targets, the Company will be committed to contribute an additional 57 million yen in 2007. In U.S. dollars, based on the exchange rate of 116.5 yen to 1 U.S. dollar as of January 28, 2006, the committed contributions are $3.1 million and $0.5 million for 2006 and 2007, respectively.

Other than as described below, there are no material pending legal proceedings other than ordinary, routine litigation incidental to the business to which the Company is a party or of which any of its property is subject. Legal fees associated with pending legal proceedings are expensed when incurred.

On or about February 5, 2004, a complaint was filed against the Company in the U.S. District Court for the Central District of California, captioned K−Swiss, Inc. v. Payless ShoeSource, Inc. The Complaint seeks injunctive relief and unspecified monetary damages for trademark and trade dress infringement, trademark dilution and unfair competition. On May 14, 2005, a First Amended Complaint was filed, to include a breach of contract claim. The Company believes it has meritorious defenses to the claims asserted in the lawsuit and has filed an answer. An estimate of the possible loss, if any, or the range of the loss cannot be made. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position and results of operations.

On or about December 20, 2001, a First Amended Complaint was filed against the Company in the U.S. District Court for the District of Oregon, captioned Adidas America, Inc. and Adidas−Salomon AG v. Payless ShoeSource, Inc. The First Amended Complaint seeks injunctive relief and unspecified monetary damages for trademark and trade dress infringement, unfair competition, deceptive trade practices and breach of contract. The Company believes it has meritorious defenses to claims asserted in the lawsuit and has filed an answer and a motion for summary judgment which the court granted in part. An estimate of the possible loss, if any, or the range of loss cannot be made. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position and results of operations.

On or about January 20, 2000, a complaint was filed against the Company in the U.S. District Court for the District of New Hampshire, captioned Howard J. Dananberg, D.P.M. v. Payless ShoeSource, Inc. The Complaint sought injunctive relief, unspecified treble monetary damages, attorneys' fees, interest and costs for patent infringement. On March 30, 2006, the Court granted the Company's motion for summary judgment of non–infringement and judgment favorable to the Company was entered by the Clerk that same day. Plaintiff is expected to appeal the judgment. An estimate of the possible loss, if any, or the range of loss cannot be made. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position and results of operations.

Note 19 — Segment Reporting (Restated)

The Company and its subsidiaries are principally engaged in the operation of retail locations offering family footwear and accessories. The Company operates its business in two reportable business segments: Payless Domestic and Payless International. These segments have been determined based on internal management reporting and management responsibilities. The Payless Domestic segment includes retail operations in the United States, Guam and Saipan. The Payless International segment includes retail operations in Canada, the South American Region, the Central American Region, Puerto Rico, the U.S. Virgin Islands, and Japan. The Company's operations in its Central American and South American Regions and Japan are operated as joint ventures in which the Company maintains a 60–percent ownership interest. Certain management costs for services performed by Payless Domestic and certain royalty fees and sourcing fees charged by Payless Domestic are allocated to the Payless International segment. These total costs and fees amounted to $18.1 million, $18.0 million and $16.7 million during 2005, 2004 and 2003, respectively.

During 2003, the Company changed the reporting period for its operations in the South American and Central American Regions to use a December 31 year–end. The effect of this one–month lag on the Company's financial position and results of operations is not significant.

Subsequent to the issuance of the consolidated financial statements for the year ended January 29, 2005, the Company determined that certain 2004 eliminating journal entries were not recorded in the correct segment. The effect of these errors on previously reported segment information is as follows:

	Operating Profit from Continuing Operations		
(dollars in millions)	As previously reported	Adjustment	As restated
Fiscal year ended January 29, 2005:			
Payless Domestic	$ 44.9	$ 8.6	$ 53.5
Payless International	16.6	(8.6)	8.0
	$ 61.5	$ —	$ 61.5

	Net Earnings from Continuing Operations before Income Taxes and Minority Interest		
(dollars in millions)	As previously reported	Adjustment	As restated
Fiscal year ended January 29, 2005:			
Payless Domestic	$ 29.2	$ 8.6	$ 37.8
Payless International	15.5	(8.6)	6.9
	$ 44.7	$ —	$ 44.7

Information on the segments is as follows:

(dollars in millions)	Payless Domestic	Payless International	Payless Consolidated
Fiscal year ended January 28, 2006			
Revenues from external customers	**$2,306.0**	**$361.3**	**$2,667.3**
Operating profit from continuing operations	**83.4**	**30.4**	**113.8**
Interest expense	**18.6**	**1.1**	**19.7**
Interest income	**(10.9)**	**(1.4)**	**(12.3)**
Net earnings from continuing operations before income taxes and minority interest	**75.7**	**30.7**	**106.4**
Depreciation and amortization	**76.4**	**14.1**	**90.5**
Total assets	**1,157.5**	**157.0**	**1,314.5**
Long–lived assets	**368.0**	**64.5**	**432.5**
Additions to long–lived assets	**54.3**	**5.3**	**59.6**
Fiscal year ended January 29, 2005 (Restated)			
Revenues from external customers	$2,326.5	$330.0	$2,656.5
Operating profit from continuing operations	53.5	8.0	61.5
Interest expense	18.0	4.1	22.1
Interest income	(2.3)	(3.0)	(5.3)
Net earnings from continuing operations before income taxes and minority interest	37.8	6.9	44.7
Depreciation and amortization	80.3	14.3	94.6
Total assets	1,076.2	163.6	1,239.8
Long–lived assets	402.2	71.3	473.5
Additions to long–lived assets	98.6	12.0	110.6
Fiscal year ended January 31, 2004			
Revenues from external customers	$2,367.1	$295.3	$2,662.4
Operating profit from continuing operations	24.1	1.9	26.0
Interest expense	16.9	3.8	20.7
Interest income	(0.8)	(3.1)	(3.9)
Net earnings from continuing operations before income taxes and minority interest	8.1	1.1	9.2
Depreciation and amortization	83.8	12.4	96.2
Total assets	999.7	204.6	1,204.3
Long–lived assets	423.5	82.4	505.9
Additions to long–lived assets	108.8	18.5	127.3

Note 20 — Shareowner Protection Rights Agreement

The Company has adopted a Stockholder Protection Rights Agreement (the "Plan") which provides for a dividend of one right ("Right") for each outstanding share of the Company's common stock. The Rights are separated by and traded with the Company's common stock. There are no separate certificates or markets for the Rights, and the Rights will expire on or before May 21, 2008. No Rights were exercised under the Plan in fiscal 2005.

The Rights do not become exercisable or trade separately from the common stock unless 15% or more of the common stock of the Company has been acquired, or after a tender or exchange offer is made for 15% or greater ownership of the Company's common stock. Should the Rights become exercisable, each Right will entitle the holder thereof to buy 1/100th of a share of the Company's Series A Preferred Stock at an exercise price of $83.33, as adjusted for the 3–for–1 split which occurred in March 2003.

Under certain circumstances, each Right "flips–in" and becomes a right to buy, for the exercise price, the Company's common stock at a 50% discount. Under certain other circumstances, each Right "flips–over" and becomes a right to buy, for the exercise price, an acquirer's common stock at a 50% discount.

The Rights may be redeemed by the Company for $0.01 per Right at any time on or prior to the first public announcement by the Company of the acquisition by any person of beneficial ownership of 15% or more of the Company's stock (or a later date as determined by the Board of Directors).

Note 21 — Hurricanes Katrina, Rita, and Wilma

Hurricanes Katrina and Rita struck the Gulf Coast on August 29, 2005, and September 24, 2005, respectively. The Company closed approximately 130 stores in areas impacted by Hurricane Katrina. As of the end of the year, 14 of those stores were not open for operations. Store closings related to Hurricane Rita peaked at approximately 139 stores and as of the end of the year, five stores impacted by Rita were not open for operations. Hurricane Wilma struck Florida on October 24, 2005. The Company closed approximately 120 stores in areas impacted by Hurricane Wilma, and as of the end of the year, three of those stores have not been reopened for operations. The Company maintains business interruption insurance. As a result of these Hurricanes, certain merchandise inventory was destroyed and written off. The Company is insured at the selling price of the inventory less a deductible and believes it will be reimbursed in excess of the net book value of the merchandise inventory. The Company also recorded asset impairments related to long−lived assets that were damaged by the Hurricanes. These assets were insured at replacement cost less a deductible. Based on an analysis of the Company's losses incurred and related insurance coverage, the Company recorded a net loss of $0.3 million in its 2005 consolidated statement of earnings. The Company also recorded a $4.3 million receivable in other current assets on the January 28, 2006 consolidated balance sheet for insurance recoveries related to the hurricane losses based on the determination that the realization of insurance claims sufficient to cover these losses is probable. The Company is unable to determine the amount and timing of any future insurance recoveries in excess of the receivable currently recorded.

Note 22 — Change in Accounting Principle

During the fourth quarter of 2005, the Company adopted FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations – An Interpretation of FASB Statement No. 143" ("FIN 47"). FIN 47 clarified the timing of liability recognition for legal obligations associated with the retirement of a tangible long−lived asset when the timing and (or) method of settlement of the obligation are conditional on a future event. FIN 47 also clarified that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when a tangible long−lived asset is obtained, if the liability's fair value can be reasonably estimated. Please refer to Note 1 for further discussion regarding the Company's accounting for asset retirement obligations. Prior to this change, the Company expensed such asset retirement costs when incurred. The initial adoption resulted in a charge of $4.1 million (net of income taxes and minority interest), which was recorded as a cumulative effect of a change in accounting principle. The adoption increased net property and equipment by $1.7 million, increased asset retirement obligations by $8.5 million, and increased deferred tax assets by $2.7 million.

As of the end of 2005, the ARO liability was $8.5 million, and had FIN 47 been applied during 2004 and 2003, the pro forma ARO liabilities would have been $8.5 million and $9.1 million, respectively.

Pro forma results of operations for 2004 and 2003 had the Company applied the provisions of FIN 47 in those periods are as follows (in millions, except per share amounts):

	2004	2003
Net earnings (loss) before cumulative effect of change in accounting principle:		
As reported	$ (2.0)	$ (0.1)
Add: Total asset retirement expenses included in net earnings (loss) as reported, net of related income taxes and minority interest	0.8	0.4
Less: Total asset retirement expenses determined under FIN 47, net of related income taxes and minority interest	(0.4)	(0.4)
Pro form net loss	$ (1.6)	$ (0.1)
Diluted earnings (loss) per share:		
As reported	$ (0.03)	$ (0.00)
Pro forma	$ (0.02)	$ (0.00)

Note 23 — New Accounting Standards

In December 2004, the FASB issued SFAS 123(R), "Share−Based Payment" ("SFAS 123(R)"). SFAS 123(R) provides accounting guidance for stock−based payments to employees. SFAS 123(R) revises SFAS 123 by eliminating the choice of using the recognition and measurement provisions of APB No. 25 and requiring all companies to use the fair value method of measuring stock compensation expense. SFAS 123(R) clarifies and expands SFAS 123's guidance in several areas, including measuring fair value, classifying an award as equity or liability, attributing compensation cost to reporting periods as well as adding several new disclosure requirements. SFAS 123(R) also changes the accounting for the tax effects of options, including the presentation of the tax effects on the consolidated statements of cash flows. SFAS 123(R) is effective for public companies with the first interim or annual period that begins after June 15, 2005. The Company plans to adopt SFAS 123(R) effective January 29, 2006, using the modified prospective application method. This method requires the recognition of compensation expense for previously granted awards that have not yet been vested and all future awards that are granted or modified after adoption of the standard. Upon adoption of SFAS 123(R), the Company plans to value future grants using a binomial option pricing model and amortize compensation expense over the applicable service period using the straight−line method. Previous grants were valued using the Black−Scholes option pricing model and amortized using tranche specific expense attribution as discussed in FASB Interpretation No. 28. The Company is in the process of evaluating SFAS 123(R)'s impact on the Company's consolidated financial statements.

In September 2005, the FASB issued FSP No. FAS 123(R)−1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)," to defer the requirement of SFAS No. 123(R) that a freestanding financial instrument, originally subject to SFAS No. 123(R), becomes subject to the recognition and measurement requirements of other applicable GAAP when the rights conveyed by the instrument to the holder are no longer dependent on the holder being an employee of the entity. The Company will apply the principles set forth in this FSP upon its adoption of SFAS No. 123(R). SFAS No. 123(R) is effective for the first quarter of the Company's 2006 fiscal year.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

In October 2005, the FASB issued FSP No. FAS 123(R)−2, “Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R),” to provide guidance on determining the grant date for an award as defined in SFAS No. 123(R). This FSP stipulates that, assuming all other criteria in the grant date definition are met, a mutual understanding of the key terms and conditions of an award to an individual employee is presumed to exist upon the award’s approval in accordance with the relevant corporate governance requirements. Further, the key terms and conditions of an award (a) cannot be negotiated by the recipient with the employer because the award is a unilateral grant, and (b) are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. The Company will apply the principles set forth in this FSP upon its adoption of SFAS No. 123(R). SFAS No. 123(R) is effective for the first quarter of the Company’s 2006 fiscal year.

In November 2005, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position (“FSP”) No. FAS 123(R)−3, “Transition Election Related to Accounting for the Tax Effects of Share−Based Payment Awards,” to provide an alternate transition method for the implementation of SFAS No. 123(R). Some entities do not have, and may not be able to re−create, information about the net excess tax benefits that would have qualified as such had those entities adopted SFAS No. 123(R) for recognition purposes. This method comprises (a) a computational component that establishes a beginning balance of the additional paid−in capital (“APIC”) pool related to employee compensation and (b) a simplified method to determine the subsequent impact on the APIC pool of employee awards that are fully vested and outstanding upon the adoption of SFAS No. 123(R). The Company will apply the principles set forth in this FSP upon its adoption of SFAS No. 123(R). SFAS No. 123(R) is effective for the first quarter of the Company’s 2006 fiscal year.

In October 2005, the FASB the issued FSP No. 13−1, “Accounting for Rental Costs Incurred during a Construction Period.” The guidance requires the rental costs recognized for ground or building operating leases during the construction period be recognized as rental expense. The guidance permits either retroactive or prospective treatment for periods beginning after December 15, 2005. The Company’s current accounting follows FSP 13−1 and therefore does not have an impact on the financial statements.

In December 2004, the FASB issued SFAS 153, “Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29” (“SFAS 153”). SFAS 153 was issued primarily to improve the comparability of accounting for exchanges of nonmonetary assets with the International Accounting Standards Board. SFAS 153 requires that exchanges of nonmonetary assets be measured based on the fair value of the assets exchanged. APB Opinion No. 29 included some exceptions to measuring exchanges at fair value. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005, though early adoption is encouraged. The application of SFAS 153 is not expected to have a material impact on the Company’s consolidated financial statements.

Note 24 — Related Party Transactions

The Company maintains banking relationships with certain financial institutions that are affiliated with some of the Company’s Latin America joint venture partners. Total deposits in these financial institutions at end of 2005, 2004 and 2003 were $9.3 million, $5.6 million and $7.4 million, respectively. Total borrowings from the Company’s Latin American partners were $6.4 million, $6.4 million and $4.0 million as of the end of 2005, 2004 and 2003, respectively. In addition, the Company recorded interest expense of $0.3 million, $0.2 million and $0.1 million during 2005, 2004 and 2003, respectively, related to these borrowings.

Note 25 — Subsidiary Guarantors of Senior Notes — Consolidating Financial Information (Restated)

The Company has issued Notes guaranteed by certain of its subsidiaries (the "Guarantor Subsidiaries"). The Guarantor Subsidiaries are direct or indirect wholly owned domestic subsidiaries of the Company. The guarantees are full and unconditional, to the extent allowed by law, and joint and several.

Subsequent to the issuance of the 2004 consolidated financial statements, the Company determined that certain 2004 eliminating journal entries were not recorded in the correct subsidiary. The errors overstated net earnings of the non−guarantor Subsidiaries by $8.6 million for the fiscal year ended January 29, 2005. The errors did not impact the net earnings of the Guarantor Subsidiaries for any period. The errors also overstated total shareowners' equity and understated total current liabilities of the Non−guarantor Subsidiaries, and overstated total assets and total current liabilities of the Guarantor Subsidiaries by $8.6 million as of January 29, 2005. The errors did not impact the total shareowners' equity of the Guarantor Subsidiaries for any period. The Company made additional corrections that impacted this footnote. Please refer to Notes 2 and 19 for further discussion of these restatements.

The following supplemental financial information sets forth, on a consolidating basis, the statements of earnings (loss) and cash flows for the Company (the "Parent Company"), for the Guarantor Subsidiaries and for the Company's non−guarantor subsidiaries (the "Non−guarantor Subsidiaries") and total consolidated Payless ShoeSource, Inc. and subsidiaries for the fifty−two week periods ended January 28, 2006, January 29, 2005 (restated) and January 31, 2004, and the related condensed consolidating balanced sheets as of January 28, 2006, and January 29, 2005 (restated). With the exception of operations in the Central American and South American Regions and Japan in which the Company has a 60% ownership interest, the Non−guarantor Subsidiaries are direct or indirect wholly−owned subsidiaries of the Guarantor Subsidiaries. The intercompany investment for each subsidiary is recorded by its parent in Other Assets.

The Non−guarantor Subsidiaries are made up of the Company's retail operations in the Central American and South American Regions, Canada, Saipan, Puerto Rico and Japan and the Company's sourcing organization in Hong Kong, Taiwan, China, Indonesia and Brazil. During 2003, the Company changed the reporting period for its operations in the Central American and South American Regions to use a December 31 year−end. Operations in the Central American Region, the South American Region and Japan are included in our results on a one−month lag relative to results from other regions. The effect of this one−month lag on our financial position and results of operations is not significant.

Under the indenture governing the Notes, the Company's subsidiaries in Singapore and Japan are designated as unrestricted. The effect of these subsidiaries on the Company's financial position and results of operations and cash flows for fiscal years 2005, 2004 and 2003 is not significant.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Condensed Consolidated Statement of Earnings
For the year ended January 28, 2006

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non−guarantor Subsidiaries	Eliminations	Consolidation
Net sales	$ —	$2,424.0	$724.1	$(480.8)	$2,667.3
Cost of sales	—	1,687.4	562.2	(470.7)	1,778.9
Gross margin	—	736.6	161.9	(10.1)	888.4
Selling, general and administrative expenses	4.6	673.5	102.8	(10.1)	770.8
Restructuring charges	—	4.1	(0.3)	—	3.8
Operating (loss) profit from continuing operations	(4.6)	59.0	59.4	—	113.8
Interest expense	32.0	1.5	1.1	(14.9)	19.7
Interest income	—	(24.7)	(2.5)	14.9	(12.3)
Equity in earnings of subsidiaries	(91.1)	(44.4)	—	135.5	—
Earnings from continuing operations before income taxes and minority interest	54.5	126.6	60.8	(135.5)	106.4
Benefit (provision) for income taxes	(11.9)	28.0	14.7	—	30.8
Earnings from continuing operations before minority interest	66.4	98.6	46.1	(135.5)	75.6
Minority interest, net of income taxes	—	—	(1.4)	—	(1.4)
Net earnings from continuing operations	$ 66.4	$ 98.6	$ 44.7	$(135.5)	$ 74.2
Loss from discontinued operations, net of income taxes and minority interest	—	(3.7)	—	—	(3.7)
Net earnings before cumulative effect of accounting change	$ 66.4	$ 94.9	$ 44.7	$(135.5)	$ 70.5
Cumulative effect of change in accounting principle, net of income taxes and minority interest	—	(3.8)	(0.3)	—	(4.1)
Net earnings	$ 66.4	$ 91.1	$ 44.4	$(135.5)	$ 66.4

Condensed Consolidated Statement of Earnings (Loss)
For the year ended January 29, 2005 (Restated)

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non–guarantor Subsidiaries	Eliminations	Consolidation
Net sales	$ —	$2,457.0	$652.5	$(453.0)	$2,656.5
Cost of sales	—	1,752.3	530.6	(446.0)	1,836.9
Gross margin	—	704.7	121.9	(7.0)	819.6
Selling, general and administrative expenses	2.4	639.0	98.8	(7.0)	733.2
Restructuring charges	—	24.4	0.5	—	24.9
Operating (loss) profit from continuing operations	(2.4)	41.3	22.6	—	61.5
Interest expense	26.9	0.6	4.1	(9.5)	22.1
Interest income	—	(11.8)	(3.0)	9.5	(5.3)
Equity in earnings of subsidiaries	(17.0)	(16.5)	—	33.5	—
(Loss) earnings from continuing operations before income taxes and minority interest	(12.3)	69.0	21.5	(33.5)	44.7
(Benefit) provision for income taxes	(10.3)	24.6	(1.1)	—	13.2
(Loss) earnings from continuing operations before minority interest	(2.0)	44.4	22.6	(33.5)	31.5
Minority interest, net of income taxes	—	—	3.6	—	3.6
Net (loss) earnings from continuing operations	$ (2.0)	$ 44.4	$ 26.2	$ (33.5)	$ 35.1
Loss from discontinued operations, net of income taxes and minority interest	—	(27.4)	(9.7)	—	(37.1)
Net (loss) earnings	$ (2.0)	$ 17.0	$ 16.5	$ (33.5)	$ (2.0)

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Condensed Consolidated Statement of Earnings (Loss)
For the year ended January 31, 2004

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non−guarantor Subsidiaries	Eliminations	Consolidation
Net sales	$ —	$2,493.4	$689.4	$(520.4)	$2,662.4
Cost of sales	—	1,858.3	574.6	(512.0)	1,920.9
Gross margin	—	635.1	114.8	(8.4)	741.5
Selling, general and administrative expenses	1.7	634.7	87.7	(8.4)	715.7
Restructuring benefit	—	(0.2)	—	—	(0.2)
Operating (loss) profit from continuing operations	(1.7)	0.6	27.1	—	26.0
Interest expense	15.6	9.3	4.2	(8.4)	20.7
Interest income	—	(9.2)	(3.1)	8.4	(3.9)
Equity in earnings of subsidiaries	(10.9)	(22.1)	—	33.0	—
(Loss) earnings from continuing operations before income taxes and minority interest	(6.4)	22.6	26.0	(33.0)	9.2
(Benefit) provision for income taxes	(6.3)	(0.3)	2.6	—	(4.0)
(Loss) earnings from continuing operations before minority interest	(0.1)	22.9	23.4	(33.0)	13.2
Minority interest, net of income taxes	—	—	3.7	—	3.7
Net (loss) earnings from continuing operations	$ (0.1)	$ 22.9	$ 27.1	$ (33.0)	$ 16.9
Loss from discontinued operations, net of income taxes and minority interest	—	(12.0)	(5.0)	—	(17.0)
Net (loss) earnings	$ (0.1)	$ 10.9	$ 22.1	$ (33.0)	$ (0.1)

Condensed Consolidated Balance Sheet
As of January 28, 2006

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non–guarantor Subsidiaries	Eliminations	Consolidation
Assets					
Current assets:					
Cash and cash equivalents	$ —	$ 310.5	$ 68.4	$ —	$ 378.9
Short–term investments	—	58.5	0.5	—	59.0
Restricted cash	—	—	2.0	—	2.0
Inventories	—	271.3	64.3	(2.6)	333.0
Current deferred income taxes	—	19.3	0.9	—	20.2
Other current assets	28.7	82.7	31.7	(83.3)	59.8
Current assets of discontinued operations	—	1.6	—	—	1.6
Total current assets	28.7	743.9	167.8	(85.9)	854.5
Property and equipment:					
Land	—	7.7	—	—	7.7
Property, buildings and equipment	—	1,044.3	142.0	—	1,186.3
Accumulated depreciation and amortization	—	(728.8)	(79.1)	—	(807.9)
Property and equipment, net	—	323.2	62.9	—	386.1
Favorable leases, net	—	18.2	—	—	18.2
Deferred income taxes	—	18.5	9.0	—	27.5
Goodwill	—	5.9	—	—	5.9
Other assets	1,157.1	405.5	1.7	(1,542.0)	22.3
Non–current assets of discontinued operations	—	—	—	—	—
Total assets	$1,185.8	$1,515.2	$241.4	$(1,627.9)	$1,314.5
Liabilities and Shareowners’ Equity					
Current liabilities:					
Current maturities of long–term debt	$ —	$ 0.4	$ —	$ —	$ 0.4
Notes payable	—	—	2.0	—	2.0
Accounts payable	—	159.4	66.3	(56.8)	168.9
Accrued expenses	51.5	127.4	14.0	(29.1)	163.8
Current liabilities of discontinued operations	—	3.4	—	—	3.4
Total current liabilities	51.5	290.6	82.3	(85.9)	338.5
Long–term debt	480.4	0.6	6.4	(283.2)	204.2
Other liabilities	1.9	94.9	12.5	—	109.3
Minority interest	—	—	10.5	—	10.5
Commitments and contingencies					
Total shareowners’ equity	652.0	1,129.1	129.7	(1,258.8)	652.0
Total liabilities and shareowners’ equity	$1,185.8	$1,515.2	$241.4	$(1,627.9)	$1,314.5

Condensed Consolidated Balance Sheet
As of January 29, 2005 (Restated)

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non–guarantor Subsidiaries	Eliminations	Consolidation
Assets					
Current assets:					
Cash and cash equivalents	$ —	$ 194.5	$ 78.8	$ —	$ 273.3
Short–term investments	—	21.3	—	—	21.3
Restricted cash	—	—	3.0	—	3.0
Inventories	—	277.1	71.0	(2.8)	345.3
Current deferred income taxes	—	21.9	—	—	21.9
Other current assets	16.8	50.6	50.1	(60.9)	56.6
Current assets of discontinued operations	—	8.5	—	—	8.5
Total current assets	16.8	573.9	202.9	(63.7)	729.9
Property and equipment:					
Land	—	8.0	—	—	8.0
Property, buildings and equipment	—	1,051.3	135.6	—	1,186.9
Accumulated depreciation and amortization	—	(705.7)	(66.9)	—	(772.6)
Property and equipment, net	—	353.6	68.7	—	422.3
Favorable leases, net	—	21.7	—	—	21.7
Deferred income taxes	—	25.1	11.3	—	36.4
Goodwill	—	5.9	—	—	5.9
Other assets	1,067.1	439.9	1.9	(1,485.4)	23.5
Non–current assets of discontinued operations	—	0.1	—	—	0.1
Total assets	$1,083.9	$1,420.2	$284.8	$(1,549.1)	$1,239.8
Liabilities and Shareowners' Equity					
Current liabilities					
Current maturities of long–term debt	$ —	$ 0.3	$ —	$ —	$ 0.3
Notes payable	—	—	3.0	—	3.0
Accounts payable	—	122.0	77.4	(39.1)	160.3
Accrued expenses	7.2	156.9	20.2	(24.6)	159.7
Current liabilities of discontinued operations	—	15.0	—	—	15.0
Total current liabilities	7.2	294.2	100.6	(63.7)	338.3
Long–term debt	480.2	0.9	6.4	(283.2)	204.3
Other liabilities	1.5	82.8	13.7	(4.4)	93.6
Minority interest	—	—	8.6	—	8.6
Commitments and contingencies					
Total shareowners' equity	595.0	1,042.3	155.5	(1,197.8)	595.0
Total liabilities and shareowners' equity	$1,083.9	$1,420.2	$284.8	$(1,549.1)	$1,239.8

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Condensed Consolidated Statement of Cash Flows
For the year ended January 28, 2006

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non–guarantor Subsidiaries	Eliminations	Consolidation
Operating activities:					
Net earnings	$ 66.4	$ 91.1	$ 44.4	$(135.5)	$ 66.4
Loss from discontinued operations, net of tax and minority interest	—	3.7	—	—	3.7
Adjustments for non–cash items included in net earnings:					
Cumulative effect of change in accounting principle, net of income taxes and minority interest	—	3.8	0.3	—	4.1
Loss on impairment and disposal of assets	—	7.9	1.9	—	9.8
Depreciation and amortization	—	80.7	9.8	—	90.5
Amortization of deferred financing costs	0.2	1.0	—	—	1.2
Amortization of unearned restricted stock	1.3	—	—	—	1.3
Deferred income taxes	—	11.7	2.0	—	13.7
Minority interest, net of income tax	—	—	1.4	—	1.4
Income tax benefit of stock option exercises	6.5	—	—	—	6.5
Accretion of investments	—	(1.3)	—	—	(1.3)
Changes in working capital:					
Inventories	—	5.8	7.8	(0.2)	13.4
Other current assets	(11.9)	(32.1)	20.4	22.4	(1.2)
Accounts payable	—	29.4	(3.8)	(17.7)	7.9
Accrued expenses	44.3	(23.3)	(6.9)	(4.5)	9.6
Other assets and liabilities, net	(85.2)	(42.7)	(1.0)	135.5	6.6
Net cash used in discontinued operations	—	(8.3)	—	—	(8.3)
Cash flow provided by operating activities	21.6	127.4	76.3	—	225.3
Investing activities:					
Payments for capital expenditures	—	(59.8)	(4.6)	—	(64.4)
Proceeds from the sale of property and equipment	—	1.2	—	—	1.2
Restricted cash	—	—	1.0	—	1.0
Purchases of investments	—	(145.9)	(0.5)	—	(146.4)
Sales and maturities of investments	—	110.0	—	—	110.0
Investment in subsidiaries	—	(1.7)	—	1.7	—
Dividends from subsidiaries	—	85.1	—	(85.1)	—
Cash flow used in investing activities	—	(11.1)	(4.1)	(83.4)	(98.6)
Financing activities:					
Repayment of notes payable	—	—	(1.0)	—	(1.0)
Issuance of debt	—	—	1.2	—	1.2
Repayments of debt	—	(0.3)	(1.2)	—	(1.5)
Issuances of common stock	49.6	—	—	—	49.6
Purchases of common stock	(71.2)	—	—	—	(71.2)
Contributions by parent	—	—	1.7	(1.7)	—
Dividends to parent	—	—	(85.1)	85.1	—
Contributions by minority owners	—	—	0.9	—	0.9
Cash flow used in financing activities	(21.6)	(0.3)	(83.5)	83.4	(22.0)
Effect of exchange rate changes on cash	—	—	0.9	—	0.9
Increase in cash and cash equivalents	—	116.0	(10.4)	—	105.6
Cash and cash equivalents, beginning of year	—	194.5	78.8	—	273.3
Cash and cash equivalents, end of year	$ —	$ 310.5	$ 68.4	$ —	$ 378.9

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Condensed Consolidated Statement of Cash Flows
For the year ended January 29, 2005 (Restated)

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non–guarantor Subsidiaries	Eliminations	Consolidation
Operating activities:					
Net (loss) earnings	$ (2.0)	$ 17.0	$ 16.5	$(33.5)	$ (2.0)
Loss from discontinued operations, net of tax and minority interest	—	27.4	9.7	—	37.1
Adjustments for non–cash items included in net (loss) earnings:					
Restructuring charges	—	10.8	—	—	10.8
Loss on impairment and disposal of assets	—	4.6	2.4	—	7.0
Depreciation and amortization	—	82.3	12.3	—	94.6
Amortization of deferred financing costs	0.6	0.3	—	—	0.9
Amortization of unearned restricted stock	—	0.7	—	—	0.7
Deferred income taxes	—	(2.3)	(4.1)	—	(6.4)
Minority interest, net of income taxes	—	—	(3.6)	—	(3.6)
Changes in working capital:					
Inventories	—	31.4	1.0	(1.4)	31.0
Other current assets	(10.2)	21.3	(8.3)	5.6	8.4
Accounts payable	—	37.0	(19.9)	12.9	30.0
Accrued expenses	(0.3)	47.4	4.1	(17.1)	34.1
Other assets and liabilities, net	21.7	(60.0)	(0.1)	44.5	6.1
Net cash provided by (used in) discontinued operations	—	9.9	(0.8)	—	9.1
Cash flow provided by operating activities	9.8	227.8	9.2	11.0	257.8
Investing activities:					
Capital expenditures	—	(93.9)	(9.1)	—	(103.0)
Dispositions of property and equipment	—	3.0	—	—	3.0
Restricted cash	—	—	30.5	—	30.5
Purchases of investments	—	(34.3)	—	—	(34.3)
Sales and maturities of investments	—	23.0	—	—	23.0
Investment in subsidiaries	—	5.5	—	(5.5)	—
Cash used in discontinued operations	—	(2.3)	(0.2)	—	(2.5)
Cash flow used in investing activities	—	(99.0)	21.2	(5.5)	(83.3)
Financing activities:					
Issuance of notes payable	—	—	(30.5)	—	(30.5)
Issuance of debt	—	—	2.4	—	2.4
Payment of deferred financing costs	—	(0.2)	—	—	(0.2)
Repayments of debt	—	(1.5)	—	—	(1.5)
Issuances of common stock	1.6	—	—	—	1.6
Purchases of common stock	(11.4)	—	—	—	(11.4)
Contributions by parent	—	—	5.5	(5.5)	—
Contributions by minority owners	—	—	3.7	—	3.7
Cash flow used in financing activities	(9.8)	(1.7)	(18.9)	(5.5)	(35.9)
Effect of exchange rate changes on cash	—	—	(2.0)	—	(2.0)
Increase in cash	—	127.1	9.5	—	136.6
Cash and cash equivalents, beginning of year	—	67.4	69.3	—	136.7
Cash and cash equivalents, end of year	$ —	$194.5	$ 78.8	$ —	$ 273.3

Condensed Consolidated Statement of Cash Flows
For the year ended January 31, 2004 (Restated)

(dollars in thousands)	Parent Company	Guarantor Subsidiaries	Non–guarantor Subsidiaries	Eliminations	Consolidation
Operating activities:					
Net (loss) earnings	$ (0.1)	$ 10.9	$ 22.1	$ (33.0)	$ (0.1)
Loss from discontinued operations, net of tax and minority interest	—	12.0	5.0	—	17.0
Adjustments for non–cash items included in net (loss) earnings:					
Loss on impairment and disposal of assets	—	9.9	1.0	—	10.9
Depreciation and amortization	—	83.5	12.7	—	96.2
Amortization of deferred financing costs	—	4.0	—	—	4.0
Amortization of unearned restricted stock	—	0.8	—	—	0.8
Deferred income taxes	—	0.4	0.9	—	1.3
Minority interest, net of tax	—	—	(3.7)	—	(3.7)
Changes in working capital:					
Inventories	—	44.0	18.3	(1.5)	60.8
Other current assets	—	94.2	(24.4)	(78.5)	(8.7)
Accounts payable	—	17.5	26.1	(18.1)	25.5
Accrued expenses	(62.5)	(3.9)	(3.9)	68.1	(2.2)
Other assets and liabilities, net	(9.0)	(60.3)	20.8	63.0	14.5
Net cash used in discontinued operations	—	(2.5)	(8.5)	—	(11.0)
Cash flow (used in) provided by operating activities	(71.6)	210.5	66.4	—	205.3
Investing activities:					
Capital expenditures	—	(88.8)	(18.9)	—	(107.7)
Dispositions of property and equipment	—	1.0	—	—	1.0
Restricted cash	—	—	(5.0)	—	(5.0)
Purchases of investments	—	(10.0)	—	—	(10.0)
Investment in subsidiaries	—	(6.6)	—	6.6	—
Repayment of loan to parent/subsidiary	—	146.9	—	(146.9)	—
Cash used in discontinued operations	—	(1.3)	(2.6)	—	(3.9)
Cash flow provided (used in) by investing activities	—	41.2	(26.5)	(140.3)	(125.6)
Financing activities:					
Issuance of notes payable	—	—	5.0	—	5.0
Issuance of debt	196.7	—	—	—	196.7
Payment of deferred financing costs	(7.1)	—	—	—	(7.1)
Repayments of debt	—	(216.9)	—	—	(216.9)
Loan from parent/subsidiary	(116.9)	—	(30.0)	146.9	—
Issuances of common stock	0.6	—	—	—	0.6
Purchases of common stock	(1.7)	—	—	—	(1.7)
Contributions by parent	—	—	6.6	(6.6)	—
Contributions by minority owners	—	—	4.4	—	4.4
Cash flow provided by (used in) financing activities	71.6	(216.9)	(14.0)	140.3	(19.0)
Effect of exchange rate changes on cash	—	—	4.3	—	4.3
Increase in cash	—	34.8	30.2	—	65.0
Cash and cash equivalents, beginning of year	—	32.6	39.1	—	71.7
Cash and cash equivalents, end of year	$ —	$ 67.4	$ 69.3	$ —	$ 136.7

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this Form 10–K for fiscal 2005, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures (as defined in Rules 13a–14(c) and 15d–14(c) under the Securities Exchange Act of 1934) are effective and designed to ensure that information required to be disclosed in periodic reports filed with the SEC is recorded, processed, summarized and reported within the time period specified. Our principal executive officer and principal financial officer also concluded that our controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Act is accumulated and communicated to management including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management’s Annual Report on Internal Control over Financial Reporting and the Report of Independent Registered Public Accounting Firm

Management’s annual report on internal control over financial reporting and the report of independent registered public accounting firm are incorporated by reference to pages 37 and 38 of Item 8 of this Form 10–K.

Changes in Internal Control over Financial Reporting

The following changes in the Company’s internal control over financial reporting during the fourth quarter of fiscal year 2005 have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

The management of the Company, including the Chief Executive Officer and Chief Financial Officer, believe that the material weakness in the Company’s internal controls over financial reporting with respect to classification of investments, discussed in the Company’s Form 10–Q/A’s for the periods ended April 30, 2005, July 29, 2005 and October 28, 2005, was remediated during the fourth quarter ended January 28, 2006. The remediation actions included:

- Requiring the Accounting and Financial Reporting Department to review the investment portfolio on a quarterly basis for proper balance sheet classification.
- Improving the understanding of relevant personnel in the Treasury Department of the requirements of FASB Statement No. 95, *“Statement of Cash Flows”* and No. 115, *“Accounting for Certain Investments in Debt and Equity Securities.”*
- Developing a comprehensive listing of accounting and disclosure considerations for all investment–related transactions that will be reviewed on a quarterly basis with relevant personnel in the Treasury Department who regularly record general ledger transactions to ensure all transactions are properly accounted for and reported.

ITEM 9B. OTHER INFORMATION

None.

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

The Board of Directors has established a standing Audit and Finance Committee which currently consists of Mr. Michael E. Murphy — Chairman, Mr. Daniel Boggan Jr., Mr. Howard R. Fricke, and Mr. John F. McGovern. The Board has determined that each of the members of the Audit and Finance Committee are audit committee financial experts (as that term is defined under Item 401(h) of Regulation S−K) and are independent. In addition, because Mr. Murphy serves on the audit committees of more than three public companies, pursuant to the listing standards of the New York Stock Exchange, and after reviewing meeting attendance records and other matters it deemed relevant, the Board has determined that such simultaneous service on such audit committees would not impair Mr. Murphy's ability to serve effectively on the Company's Audit and Finance Committee.

Our policy on business conduct which includes our code of ethics which is applicable to all associates including our principal executive officer, principal financial officer, principal accounting officer, and persons performing similar functions is available on our website at *www.paylessinfo.com*. The charters for the Board of Directors, the Audit and Finance Committee, and the Compensation Nominating and Governance Committee are also available on our investor relations website.

a) Directors — The information set forth in the Company's definitive proxy statement to be filed in connection with its Annual Meeting to be held on May 25, 2006, under the captions "Election of Directors — Directors and Nominees for Director" and "Additional Information — Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated herein by reference.

b) Executive Officers — Information regarding the Executive Officers of the Company is as set forth in Item 1 of this report under the caption "Executive Officers of the Company." The information set forth in the Company's definitive proxy statement to be filed in connection with its Annual Meeting to be held on May 25, 2006, under the caption "Additional Information — Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information set forth in the Company's definitive proxy statement to be filed in connection with its Annual Meeting to be held on May 25, 2006, under the captions "Election of Directors — The Board and Committees of the Board — Compensation of Directors," and " — Annual Lump Sum Merit Awards," and "Executive Compensation" is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information set forth in the Company's definitive proxy statement to be filed in connection with its Annual Meeting to be held on May 25, 2006, under the caption "Beneficial Stock Ownership of Directors, Nominees, Executive Officers and Persons Owning More Than Five Percent of Common Stock" is incorporated herein by reference.

The following table summarizes information with respect to the Company's equity compensation plans at January 28, 2006:

(in thousands, except per share amounts)

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted–Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	5,018	$ 17.58	2,955(1)
Equity compensation plans not approved by security holders	720	20.65	—
Total	5,738	$ 17.97	2,955

(1) Includes up to 80 thousand shares of restricted stock that may be issued under the Company's 1996 Stock Incentive Plan, and up to 712 thousand shares that can be issued under the Company's Restricted Stock Plan for Non–Management Directors. The amount does not include up to 4,829 thousand shares that may be purchased under the Payless Stock Ownership Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information regarding principal accounting fees and services is incorporated herein by reference to the material under the heading "Principal Accounting Fees and Services" of the Company's definitive proxy statement to be filed in connection with its Annual Meeting to be held on May 25, 2006.

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules:

The financial statements are set forth under Item 8 of this Annual Report on Form 10–K. Other than as set forth below, financial statement schedules have been omitted since they are either not required, not applicable, or the information is otherwise included.

SCHEDULE II–VALUATION AND QUALIFYING ACCOUNTS

(dollars in millions)	Balance at beginning of period	Charged to costs and expenses	Deductions(1)	Balance at end of period
Year ended January 31, 2004				
Allowance for doubtful accounts	$ 1.4	$ 1.5	$ (0.9)	$ 2.0
Deferred tax valuation allowance	6.3	7.2	—	13.5
Sales return reserve	1.2	10.1	(10.0)	1.3
Year ended January 29, 2005				
Allowance for doubtful accounts	$ 2.0	$ 0.5	$ (1.6)	$ 0.9
Deferred tax valuation allowance	13.5	4.0	(9.9)	7.6
Sales return reserve	1.3	10.3	(10.4)	1.2
Year ended January 28, 2006				
Allowance for doubtful accounts	$ 0.9	$ 0.8	$ (0.8)	$ 0.9
Deferred tax valuation allowance	7.6	3.4	(0.5)	10.5
Sales return reserve	1.2	9.5	(9.3)	1.4

(1) With regard to allowances for doubtful accounts, deductions relate to uncollectible receivables that have been written off, net of recoveries. For the deferred tax valuation allowance, deductions relate to deferred tax assets that have been written off. For sales returns, deductions related to actual returns.

(b) **Exhibits**

Number	Description
3.1	Amended and Restated Certificate of Incorporation of Payless ShoeSource, Inc., a Delaware corporation (the "Company"). (1)
3.2	Amended and Restated Bylaws of the Company. (2)
4.1	Stockholder Protection Rights Agreement, dated as of April 20, 1998, between the Company and UMB Bank, N.A. (1)
4.2	Indenture, dated as of July 28, 2003, among Payless ShoeSource, Inc. and each of the Guarantors named therein and Wells–Fargo Bank Minnesota, National Association as Trustee, related to the 8.25% Senior Subordinated Notes Due 2013. (3)
4.3	Exchange and Registration Rights Agreement, Dated July 28, 2003, among Payless ShoeSource, Inc. and each of Guarantors named therein and Goldman Sachs & Co. as representative of the Several Purchasers. (3)
10.1	Amended and Restated Tax Sharing Agreement, dated as of April 2, 1996, by and between The May Department Stores Company and Payless ShoeSource, Inc. (4)
10.2	Sublease, dated as of April 2, 1996, by and between The May Department Stores Company and Payless ShoeSource, Inc. (5)
10.3	Payless ShoeSource, Inc., Stock 1996 Stock Incentive Plan, as amended September 18, 2003. (6)

Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

Number	Description
10.4	Spin−Off Stock Plan of Payless ShoeSource, Inc. (5)
10.5	Restricted Stock Plan for Non−Management Directors, as amended April 20, 1998. (1)
10.6	Form of Employment Agreement between Payless ShoeSource, Inc., and certain of its executives. (7)
10.7	Payless ShoeSource, Inc. Supplementary Retirement Plan, as amended September 18, 2003. (6)
10.8	Payless ShoeSource, Inc., 401(k) Profit Sharing Plan, as amended effective November 10, 2005.*
10.9	Executive Incentive Compensation Plan of Payless ShoeSource, Inc., as amended November 16, 2000. (8)
10.10	Form of Change of Control Agreement between Payless ShoeSource, Inc., and certain of its executives. (11)
10.11	Form of Directors' Indemnification Agreement. (7)
10.12	Form of Officers' Indemnification Agreement. (11)
10.13	Payless ShoeSource, Inc. Deferred Compensation Plan for Non−Management Directors, as amended September 18, 2003. (6)
10.14	The Stock Appreciation and Phantom Stock Unit Plan of Payless ShoeSource, Inc. and its Subsidiaries for Payless ShoeSource International Employees, as amended September 18, 2003. (6)
10.15	Payless ShoeSource, Inc. Stock Ownership Plan, as amended effective January 1, 2006.*
10.16	Assumption Agreement, dated as of May 22, 1998, by and between Payless ShoeSource, Inc. (Missouri) and Payless ShoeSource Holdings, Inc. (1)
10.17	Payless ShoeSource, Inc. Deferred Compensation 401(k) Mirror Plan, as amended September 18, 2003. (6)
10.18	Payless ShoeSource, Inc. Incentive Compensation Plan. (9)
10.19	Amended and Restated Employment Agreement, dated as of October 1, 2003, by and between Payless ShoeSource, Inc. and Steven J. Douglass. (6)
10.20	Amended and Restated Change of Control Agreement, dated as of October 1, 2003, by and between Payless ShoeSource, Inc. and Steven J. Douglass. (6)
10.21	Indemnification Agreement dated as of October 1, 2003, between Payless ShoeSource, Inc. and Steven J. Douglass. (6)
10.22	Loan, Guaranty and Security Agreement by and among Payless ShoeSource Finance, Inc., as Borrower, the Guarantors signatory thereto, the Lenders signatory thereto and Wells Fargo Retail Finance, as Arranger and Administrative Agent, dated as of January 15, 2004. (10)
10.23	Letter Agreement between Payless ShoeSource, Inc. and Steven J. Douglass dated May 26, 2005. (12)
10.24	Employment Agreement between Payless ShoeSource, Inc. and Matthew E. Rubel accepted and agreed to June 17, 2005. (13)
10.25	Mutual Waiver and Release executed August 1, 2005 between Steven J. Douglass and the Company. (14)
10.26	Settlement Agreement between and among Duane Cantrell, Mark Willoughby and Payless ShoeSource, Inc. dated October 20, 2005, executed November 7, 2005. (15)
11.1	Computation of Net Earnings Per Share.*
21.1	Subsidiaries of the Company.*
23.1	Consent of Deloitte & Touche LLP.*

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Number	Description
31.1	Certification Pursuant to Rules 13(a)−14(a) and 15(d)−14(a) under the Securities Exchange Act of 1934, as amended, of the Chief Executive Officer and President.*
31.2	Certification Pursuant to Rules 13(a)−14(a) and 15(d)−14(a) under the Securities Exchange Act of 1934, as amended, of the Senior Vice President, Chief Financial Officer and Treasurer.*
32.1	Certification Pursuant to 18 U.S.C. 1350 of the Chief Executive Officer and President.*
32.2	Certification Pursuant to 18 U.S.C. 1350 of the Senior Vice President, Chief Financial Officer and Treasurer.*

* Filed herewith

1. Incorporated by reference from the Company's Current Report on Form 8−K (File Number 1−14770) filed with the SEC on June 3, 1998.

2. Incorporated by reference from the Company's Annual Report on Form 10−K (File Number 1−14770) for the fiscal year ended January 30, 1999, filed with the SEC on April 12, 1999.

3. Incorporated by reference from the Company's Quarterly Report on Form 10−Q (File Number 1−4770) for the quarter ended August 2, 2003, filed with the SEC on September 12, 2003.

4. Incorporated by reference from Exhibit 10.1 of the Company's Form 10−Q (File Number 1−1633) for the quarter ended May 4, 1996.

5. Incorporated by reference from the Company's Registration Statement on Form 10 (File Number 1−11633) dated February 23, 1996, as amended through April 15, 1996.

6. Incorporated by reference from the Company's Registration Statement on Form S−4 (File Number 333−109388) filed with the SEC on October 2, 2003, as amended.

7. Incorporated by reference from the Company's Annual Report on Form 10−K (File Number 1−4770) for the year ended February 1, 2003, filed with the SEC on April 18, 2003.

8. Incorporated by reference from the Company's Annual Report on Form 10−K (File Number 1−14770) for the year ended February 3, 2001, filed with the SEC on April 19, 2001.

9. Incorporated by reference from the Company's Annual Report on Form 10−K (File Number 1−14770) for the year ended February 2, 2002, filed with the SEC on April 16, 2002.

10. Incorporated by reference from the Company's Current Report on Form 8−K (File Number 1−4770) filed with the SEC on January 22, 2004.

11. Incorporated by reference from the Company's Annual Report on Form 10−K (File Number 1−4770) for the year ended January 31, 2004, filed with the SEC on April 9, 2004.

12. Incorporated by reference from the Company's Current Report on Form 8−K (File Number 1−4770) filed with the SEC on May 31, 2005.

13. Incorporated by reference from the Company's Current Report on Form 8−K (File Number 1−4770) filed with the SEC on June 22, 2005.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

14. Incorporated by reference from the Company's Current Report on Form 8−K (File Number 1−4770) for the year ended January 29, 2005, filed with the SEC on August 4, 2005.

15. Incorporated by reference from the Company's Current Report on Form 8−K (File Number 1−4770) filed with the SEC on November 11, 2005.

The Company will furnish to shareowners upon request, and without charge, a copy of the 2005 Annual Report and the 2006 Proxy Statement, portions of which are incorporated by reference in the Form 10−K. The Company will furnish any other Exhibit at cost.

(c) Financial Statement Schedules have been either omitted due to inapplicability or because required information is shown in the Consolidated Financial Statements, Notes thereto, or Item 15(a).

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 7, 2006

By: /s/ Ullrich E. Porzig
Ullrich E. Porzig
Senior Vice President — Chief Financial Officer and Treasurer

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

Signature	Date	Signature	Date
/s/ Matthew E. Rubel Chief Executive Officer, President and Director (Principal Executive Officer)	Date: April 7, 2006	/s/ Ullrich E. Porzig Senior Vice President — Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	Date: April 7, 2006
/s/ Howard R. Fricke Chairman of the Board and Director	Date: April 7, 2006	/s/ Daniel Boggan Jr Director	Date: April 7, 2006
/s/ Michael E. Murphy Director	Date: April 7, 2006	/s/ Mylle H. Mangum Director	Date: April 7, 2006
/s/ Robert C. Wheeler Director	Date: April 7, 2006	/s/ John F. McGovern Director	Date: April 7, 2006
/s/ Michael A. Weiss Director	Date: April 7, 2006	/s/ Michael A. George Director	Date: April 7, 2006
/s/ Judith K. Hofer Director	Date: April 7, 2006		

EXHIBIT 10.8

PAYLESS SHOESOURCE, INC. 401(k) PROFIT SHARING PLAN

As Amended Effective November 10, 2005, or as otherwise specified

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Source: PAYLESS SHOESOURCE I, 10–K, April 07, 2006

PAYLESS SHOESOURCE, INC.
401(k) PROFIT SHARING PLAN

INTRODUCTION

Effective April 1, 1996, Payless ShoeSource, Inc. withdrew from and ceased to be a participating Employer in The May Department Stores Company Profit Sharing Plan (the "May Plan"), and established the Payless ShoeSource, Inc. Profit Sharing Plan (the "Plan"). Effective January 1, 1997, a portion of the Plan covering Associates of Payless ShoeSource of Puerto Rico, Inc. was spun off. As of August 1, 1997, Payless amended and restated the Plan, primarily to establish a company matching contribution based on Members' contributions effective January 1, 1998, to institute automatic enrollment in before-tax contributions by Members, and to comply with certain changes in the law. On June 1, 1998, Payless restructured its corporate organization into a holding company structure with Payless ShoeSource, Inc., a Delaware corporation, as the parent corporation and the named Company for this Plan. Effective March 20, 2000, the Company amended and restated the Plan, primarily to include provisions for loans and the acceptance of rollover contributions from other qualified plans, a change to daily valuation and other miscellaneous changes.

Effective January 1, 2002, the Company amended and restated the Plan to effect the adoption of mandatory and certain permissive provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). The EGTRRA amendments to the Plan are intended to be made in good faith compliance with the requirements of EGTRRA and are to be construed in accordance with EGTRRA and guidance issued thereunder. While the EGTRRA amendments are generally effective January 1, 2002, some of the amendments are effective May 1, 2002, as indicated below. In addition, effective May 1, 2002, the Plan was amended to permit Full Time Associates to participate in the Plan upon the completion of 90 days of employment service with a participating Employer or other member of the Group. Effective January 1, 2003 the Company again amended and restated the Plan to reflect the terms of the final Treasury Regulations governing required minimum distributions. Effective March 28, 2005, the Company amended the Plan to reduce the limit for certain mandatory distributions as described in IRS notice 2005-5. Other amendments made herein are effective on the dates as specified. The Plan was further amended November 10, 2005 to provide for a guaranteed minimum Company Matching Contribution effective beginning with the 2005 Plan Year. Additional amendments were made effective January 1, 2006 to permit Full-Time Associates to make elective contributions to the Plan after completing 60 days of employment and to be eligible to receive the Company Matching Contribution after completing 180 days of employment. The hardship provisions of the Plan were also amended to expand the definition of a "hardship", consistent with Treasury regulations.

The terms and provisions of this new plan are as follows:

SECTION 1

DEFINITIONS

1.01 ACCOUNTS means the Company Accounts and Member Accounts established under Section 6.

1.02 ADMINISTRATIVE DELEGATE means one or more persons or institutions to which the Committee has delegated certain administrative functions pursuant to a written agreement.

1.03 AFTER-TAX CONTRIBUTIONs means Member Contributions which are not Before-Tax Contributions and which are made by the Member in accordance with Section 4.01(a).

1.04 ALLOCATION PAY AMOUNT means with respect to each eligible Member, (a) one (1) times the amount of Pay as defined in Section 1.33 up to the Social Security Wage Base ("SSWB") for the Plan Year, plus (b) two (2) times the amount of such Pay in excess of the SSWB for the Plan Year. Notwithstanding any provision of this Section 1.04 or of Section 3.03 to the contrary, in no event shall the percentage of Members' Pay to be allocated for any year below the SSWB be less than fifty percent (50%) of the percentage of Pay allocated with respect to Members' Pay in excess of the SSWB, nor may the latter percentage of Pay (above the SSWB) exceed the former percentage of Pay (below the SSWB) by more than 5.7% (or such other percentage as may be the maximum permitted differential under Code Section 401(l) from time to time).

In determining each eligible Member's Allocation Pay Amount, only Pay received during the part of the Plan Year the Member is eligible for the Company Contribution feature of the Plan, pursuant to Section 2, shall be considered, and the SSWB to be applied for such Member shall be proportionally prorated if such eligibility is for less than a full Plan Year.

Notwithstanding the foregoing, with respect to any Plan Year for which applying the definition of Allocation Pay Amount set forth above would cause the allocation made pursuant to Section 3.03 to violate the permitted disparity limitations of Treas. Reg. Section 1.401(l)-2, Allocation Pay Amount shall be adjusted to permit Section 3.03 to operate in compliance with the limitations of Treas. Reg. Section 1.401(l)-2.

1.05 ASSOCIATE means any person who is classified as an employee by an Employer and who receives Pay from an Employer. The term Associate also may include, based upon the express written determination of the Company or the Committee, a U.S. citizen employed, at the request of the Company, by a member of the Group (defined in Section 1.21) to the extent such employee otherwise qualifies for membership under Section 2, in which case such Group member shall be deemed to be an "Employer" hereunder, as to such person or persons only. The term "Associate" shall not include (i) any person covered under a collective bargaining agreement unless and until the Employer and the collective bargaining representatives so agree, (ii) any non-resident alien, and (iii) any "leased employee" within the meaning of Code Section 414(n)(2).

1.06 AUTHORIZED LEAVE OF ABSENCE means any leave of absence authorized by the Employer under rules established by the Employer.

1.07 BEFORE-TAX CONTRIBUTIONS means contributions which the Member elects (in accordance with Section 4.01(b)) to have the Employer make directly to the Plan on behalf of the Member, which election shall constitute an election under Code Section 401(k)(2)(A). The "Member's Before-Tax Contributions" shall refer to Before-Tax Contributions made to the Plan by the Employer on behalf of the Member.

1.08 BENEFICIARY means the person or persons entitled under Section 9.02 to receive any payments payable under this Plan on account of a Member's death.

1.09 BOARD means the Board of Directors of the Company.

1.10 CODE means the Internal Revenue Code of 1986, as amended from time to time.

1.11 COMMITTEE means the Profit Sharing Committee comprised of three or more members as determined and appointed from time to time by the Board.

1.12 COMPANY means Payless ShoeSource, Inc., a Delaware corporation, and any other organization which may be a successor to it.

1.13 COMPANY ACCOUNTS means accounts reflecting the portion of each Member's interest in the Investment Funds which are attributable to Company Matching Contributions ("Company Matching Accounts") and to Company Profit Sharing Contributions ("Company Profit Sharing Accounts") and to any contributions made by an Employer under prior plans, as well as to any income and/or earnings attributable to such Company Contributions and prior plan contributions.

1.14 COMPANY MATCHING CONTRIBUTIONS means contributions made by the Company or an Employer, based on a Member's Before-Tax and/or After-Tax Contributions, pursuant to Section 3.02.

1.15 COMPANY PROFIT SHARING CONTRIBUTIONS means discretionary contributions made by the Company or an Employer, based on Net Profits, pursuant to Section 3.03.

1.16 EFFECTIVE DATE originally meant April 1, 1996. However, the effective date of this amendment and restatement of the Plan shall be March 20, 2000, unless otherwise specified herein.

1.17 EMPLOYER means the Company and, if authorized by the Company to participate herein, any subsidiary of the Company or any affiliated corporation, partnership or sole proprietorship which elects to participate herein.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

1.18 ERISA means the Employee Retirement Income Security Act of 1974, as amended from time to time.

1.19 FIDUCIARY means the Employer, the Trustee, each of the members of the Committee described in Section 14, and any investment manager designated pursuant to Section 15.

1.20 FISCAL YEAR means the Company's Fiscal Year.

1.21 GROUP means the Company and any other company which is related to the Company as a member of a controlled group of corporations in accordance with Code Section 414(b), as a trade or business under common control in accordance with Code Section 414(c) or as an affiliated service group in accordance with Code Section 414(m) or the regulations under Code Section 414(o). For the purposes of the Plan, for determining whether or not a person is an employee of the Group and the period of employment of such person, each such other company shall be included in the "Group" only for such period or periods during which such other company is a member with the Company of a controlled group or under common control.

1.22 HOUR OF SERVICE means any hour for which an Associate (including a leased employee) is directly or indirectly compensated, or entitled to compensation, by the Employer or by any member of the Group, whether or not such Group member has adopted the Plan, for any of the following:

(a) the performance of duties during the applicable computation period;

(b) a period during which no duties are performed (irrespective of whether the employment relationship has terminated) due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, Military Service, or Authorized Leave of Absence;

(c) a period for which back pay is awarded or agreed to, provided that no Hour of Service has been credited under subsection (a) or (b) with respect to the same period.

Hours of Service and applicable computation periods shall be determined in accordance with the requirements of 29 C.F.R. Section 2530.200b.

1.23 INVESTMENT FUND means any fund for investment of contributions as described in Section 5.01.

1.24 MAY PLAN means The May Department Stores Company Profit Sharing Plan.

1.25 MEMBER means any person included in the membership of this Plan as provided in Section 2.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

1.26 MEMBER ACCOUNTS means the Member Before-Tax Accounts, the Member After-Tax Accounts and the Member Rollover Contribution Accounts. To the extent an Associate makes a Rollover Contribution pursuant to Section 11.02 and the Associate is otherwise eligible but has not yet completed the participation requirements of Section 2.01, such contribution shall also be a Member Account.

1.27 MEMBER AFTER-TAX ACCOUNTS means the Member Accounts with respect to a Member's After-Tax Contributions.

1.28 MEMBER BEFORE-TAX ACCOUNTS means the Member Accounts with respect to a Member's Before-Tax Contributions.

1.29 MEMBER CONTRIBUTIONS means the Member's Before-Tax Contributions and After-Tax Contributions.

1.30 MEMBER ROLLOVER CONTRIBUTION ACCOUNTS means the Member Accounts with respect to an Associate's or Member's Rollover Contributions.

1.31 MILITARY SERVICE means effective December 13, 1996, any period of obligatory military service with the Armed Forces of the United States of America, or voluntary service in lieu of such obligatory service, provided that the Associate returns to active employment with the Employer within the period during which the Employer would be required to re-employ the Associate under Federal law. Notwithstanding any provision of this Plan to the contrary, contributions, benefits, loan repayment and service credit with respect to qualified Military Service will be provided in accordance with Code Section 414(u).

1.32 NET PROFITS means the consolidated net profits of the Company for any given Fiscal Year, determined by generally accepted accounting principles except that (i) no deduction or provision shall be made for any federal, state or other taxes measured by net income, nor for any contributions to the Trust or to any other pension or profit sharing plan, and (ii) there shall be excluded any proceeds from life insurance of which the Company is beneficiary (whether paid in a single sum or otherwise) and any gains or losses on the sale of capital assets. Such term shall also mean any accumulated and undistributed Net Profits (as defined in the preceding sentence) earned in prior Fiscal Years to the extent that such accumulated and undistributed Net Profits constitute surplus of the Company and its subsidiaries available for contributions hereunder.

1.33 PAY means the aggregate of (i) all regular pay, commissions, overtime pay, cash incentives, prizes and cash awards, plus (ii) amounts which the Associate elects to have the Employer contribute directly to the Plan on the Associate's behalf in accordance with Section 4.01(b). Pay shall include any amounts not otherwise includable in the Member's taxable income pursuant to Code Section 125. Pay shall not include amounts for a pension, a retirement allowance, a retainer or a fee under contract, deferred compensation (including amounts deferred under the Deferred Compensation Plan of The May Department Stores Company and the Deferred Compensation Plan of Payless ShoeSource, Inc.), severance pay, distributions from this Plan,

amounts earned before an individual becomes a Member, or items of extraordinary income including but not limited to amounts resulting from the exercise of stock options, spinoff cash, spinoff stock and restricted stock awards. Pay in excess of $200,000 shall be disregarded, although such amount shall be adjusted at the same time and in such manner as permitted under Code Section 415(d).

1.34 POOLED INVESTMENT ACCOUNT means an account established pursuant to an administrative services agreement between the Company and the Trustee.

1.35 PLAN means this Payless ShoeSource Inc. 401(k) Profit Sharing Plan.

1.36 PLAN YEAR means a calendar year ending each December 31.

1.37 PRIOR PLAN means either The May Department Stores Company Profit Sharing Plan, the Volume Shoe Corporation Profit Sharing Plan, or such other qualified plan as may be so designated by the Committee.

1.38 QUALIFIED DOMESTIC RELATIONS ORDER means a "qualified domestic relations order" as that term is defined in Code Section 414(p), provided that such order was entered on or after January 1, 1985.

1.39 RETIREMENT means a Member's termination of employment on or after age 55 and after completing at least five (5) Years of Service or attaining the fifth anniversary of participation, as of which date the Member's benefit shall be nonforfeitable.

1.40 ROLLOVER CONTRIBUTIONS means contributions which the Associate or Member, as applicable, elects to make in accordance with Section 11.02.

1.41 SOCIAL SECURITY WAGE BASE means, with respect to each Plan Year, the maximum amount of wages which are subject to tax in such year under the Federal Old Age, Survivors and Disability Insurance System.

1.42 TOTAL AND PERMANENT DISABILITY OR DISABILITY means the qualification for disability under Title 11 of the Federal Social Security Act.

1.43 TRANSFERRED ACCOUNTS means Member and Company Accounts transferred from the May Plan.

1.44 TRUST AGREEMENT means the agreement or agreements provided for in Section 14, as amended from time to time.

1.45 TRUST FUND means all the assets of the Investment Funds and any other assets which are held in one or more trusts by the Trustee or Trustees for the purposes of this Plan.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

1.46 TRUSTEE means the corporation(s), person or persons which may at any time be acting as Trustee or Trustees under the Trust Agreement.

1.47 UNIT means one of the units representing an interest in an Investment Fund as provided in Section 6.03.

1.48 UNIT VALUE means the value of each Unit in an Investment Fund as of the Valuation Date as determined pursuant to Section 6.04.

1.49 VALUATION DATE means any day that the New York Stock Exchange is open for business or any other date chosen by the Committee. Prior to March 31, 2000, Valuation Date means the last business day of each calendar month and any other date chosen to perform a valuation.

1.50 YEAR OF SERVICE for purposes of determining eligibility under Section 2 means a year of employment during which the Associate has been paid for not less than 1,000 Hours of Service for an Employer or any other member of the Group. An Associate shall be credited with a year of employment on each anniversary date of his commencement of employment with an Employer during which he earns not less than 1,000 Hours of Service for an Employer or any other member of the Group. Periods of temporary illness, temporary layoff, Military Service, and Authorized Leaves of Absence shall not be deemed as breaking continuity of employment and shall be counted in determining Years of Service. The term "Year of Service" shall also include an employment year during which, except to the extent otherwise provided in Treasury Regulations, a "leased employee" within the meaning of Code Section 414(n) has been paid for not less than 1,000 Hours of Service for the Employer even though during such period the leased employee was not an Associate as defined in Section 1.05. The term "Year of Service" shall include any period required to be included by the Family and Medical Leave Act of 1993.

The extent to which service with another organization, part or all of whose business operations are acquired by the Company (or by an Employer), shall be credited as "Years of Service" hereunder or as "Vesting Service" under Section 1.51 shall be determined by the Company or by the Committee on a case-by-case basis.

1.51 VESTING SERVICE for purposes of determining a Member's vested interest under Section 6.07 is based on "elapsed time" and is to be determined in accordance with the following definitions:

(a) "EMPLOYMENT COMMENCEMENT DATE" means the date upon which an Associate first performs an Hour of Service.

(b) "HOUR OF SERVICE" means an hour for which an Associate is paid or entitled to payment for the performance of duties for the Employer or any other member of the Group.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(c) "PERIOD OF SERVICE" means a period beginning on the Associate's Employment Commencement Date (or Reemployment Commencement Date, as the case may be) and ending on his Severance from Service Date.

(d) "SEVERANCE FROM SERVICE DATE" means the earlier to occur of:

(i) the last date upon which an Associate terminates employment with the Employer or any other member of the Group (either voluntarily or involuntarily), retires or dies; or

(ii) the first anniversary of the date upon which the Associate was first absent from service with the Employer (with or without pay) for any other reason (i.e., vacation, sickness, disability, leave of absence or layoff).

Notwithstanding the foregoing, the Severance from Service Date of an Associate who is absent from service with the Employer beyond the first anniversary of the first day of such absence on account of maternity or paternity (as described in Code Sections 410(a)(5)(E) or 411(a)(6)(E)) shall be the second anniversary of the first day of such absence; and the period of time between such first and second anniversaries shall not be treated as a Period of Service or as a Period of Severance.

(e) "PERIOD OF SEVERANCE" means a period beginning on an Associate's Severance from Service Date and ending upon the Associate's Reemployment Commencement Date.

(f) "REEMPLOYMENT COMMENCEMENT DATE" means the first date, following a Severance from Service Date, upon which the Associate performs an Hour of Service for the Employer or any other member of the Group.

(g) "SERVICE SPANNING RULES." In determining whether or not an Associate has completed a twelve month Period of Service for purposes of vesting, the following Periods of Severance shall be treated as Periods of Service:

(i) If an Associate terminates employment with the Employer (either voluntarily or involuntarily) or retires, and then performs an Hour of Service within the twelve month period beginning on the Severance from Service Date, such Period of Severance shall be treated as a Period of Service; and

(ii) If an Associate terminates employment with the Employer (either voluntarily or involuntarily) or retires during an absence from service of twelve months or less for any reason other than a termination or retirement, and then performs an Hour of Service within a period of twelve months from the date the Employee was first absent from service, the Period of Severance shall be treated as a Period of Service.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

SECTION 2

MEMBERSHIP

2.01 CONDITIONS OF ELIGIBILITY.

(a) Each Associate who on April 30, 2002 was a Member of or is eligible to be a Member of the Plan shall continue to be a Member of this Plan entitled to make Member Contributions pursuant to Section 4 and eligible to share in Company Contributions pursuant to Section 3.

(b) Each other Associate shall be eligible to become a Member of the Plan when the Associate has completed one Year of Service and attained age 21, with membership to commence as of the first day of the month coincident with or following the date he has met these eligibility requirements. Such Associate shall be eligible:

(i) to make Member Contributions pursuant to Section 4;

(ii) to share in Company Matching Contributions pursuant to Section 3.02;

(iii) to share in Company Profit Sharing Contributions, if any, pursuant to Section 3.01.

Notwithstanding the foregoing, effective January 1 2006, a Full Time Associate shall be eligible to make Member Contributions pursuant to Section 4 as of the first day of the month coincident with or following the date he has completed 60 days of employment with the Employer and attained age 21. Further, a Full-Time Associate shall be eligible to receive a Company Matching Contribution coincident with or following the date he has completed 180 days of service with the Company and satisfied the requirements of Section 3.03. For the purposes of the preceding sentence, a "Full Time Associate" is an Associate classified on the Employer's records as a Full Time Associate. In many locations, this means the Associate is normally scheduled to work 32 or more hours per week. However, the Associate's classification on the Employer's records, and not the actual number of hours worked in any period, determines Full Time status.

(c) Each Member shall be deemed to have elected to make a three percent (3%) Before-Tax Contribution pursuant to Section 4.01(b), commencing with the first paycheck issued with respect to the first payroll period beginning on or after the first day of the month coincident with or following the date the Employer determines he met the foregoing eligibility requirements. Notwithstanding this "deemed" election, an Associate or Member may elect pursuant to procedures established by the Committee to not make, or to suspend making, said three percent (3%) automatic Before-Tax Contribution, or pursuant to Section 4.01(a) or (b) to make an After-Tax or a Before-Tax Contribution of an amount other than three percent (3%).

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(d) Associates employed by the Company's Puerto Rican Subsidiaries are not eligible for membership hereunder. If any such Associate has Accounts in this Plan, such Accounts shall continue to be revalued as of each succeeding Valuation Date pursuant to Section 6.04.

2.02 RE-EMPLOYMENT. A former Member who has retired or has otherwise terminated employment and is rehired shall become a Member on the first day of the calendar month after the Employer becomes aware of his rehire.

SECTION 3

COMPANY CONTRIBUTIONS

3.01 AMOUNT OF COMPANY PROFIT SHARING CONTRIBUTION. The Company or an Employer may contribute to the Trust, as of the end of each Plan Year, a percentage of the Company's Net Profits as a Company Profit Sharing Contribution. The amount of such contribution, if any, shall be determined by the Board of Directors in its discretion. Any such contribution shall be made as soon as practicable after the close of the Company's Fiscal Year. All such contributions advanced to the Plan by the Company shall be reimbursed to the Company by the Employer.

3.02 AMOUNT OF COMPANY MATCHING CONTRIBUTION. The Company shall, in its discretion, contribute to the Trust, as of the end of each Plan Year, a total combined amount as to this Plan and the Payless ShoeSource, Inc. Profit Sharing Plan for Puerto Rico Associates ("Puerto Rico Plan") equal to 2 1/2% of its Net Profits, until determined otherwise by the Board of Directors, in the form of a Company Matching Contribution. Effective beginning with the 2005 Plan Year, the Board has determined that a minimum guaranteed Company Matching Contribution of $.20 per $1.00 of Member Contributions up to 5% of Pay will be contributed each Plan Year by the Company. Such Company Matching Contributions may be made by an Employer, rather than by the Company, as to that Employer's participating Associates. The total amount of such contribution shall be allocated in proportion to the amount that each Member's Contributions under Sections 4.01(a) and (b) for such Plan Year, up to a total of 5% of such Member's Pay, bears to the total amount of all Member Contributions up to 5% of such Members' Pay. Such Company Matching Contribution shall be determined and paid to the Trustee as soon as practicable after the close of each Fiscal Year.

3.03 ALLOCATION OF COMPANY CONTRIBUTIONS. The Company Contributions shall be allocated only to the Company Accounts of Members who are employed by the Employer on the last day of the Plan Year and on behalf of Members whose employment has terminated during the Plan Year by reason of Retirement, death or Disability. Company Profit Sharing Contributions shall be credited to eligible Members' Company Profit Sharing Contribution Accounts. Company Profit Sharing Contributions allocated prior to or as of July 31, 1997 shall be fully vested; Company Profit Sharing Contributions allocated thereafter shall be subject to the vesting provisions of Section 6.07. Company Matching Contributions shall be subject to the vesting provisions of Section 6.07 and to the withdrawal penalty provisions of Section 8.02(a). No Company Matching Contribution shall be made with respect to a Member Before-Tax Contribution in excess of the Code Section 402(g) and 414(v) limit, as revised from time to time.

3.04 PROFIT SHARING ALLOCATION FORMULA. The Company Profit Sharing Contribution, if any, shall be allocated to all Members eligible to share in the contribution according to the ratio that each Member's Allocation Pay Amount for the Plan Year bears to the total Allocation Pay Amount for all eligible Members for the Plan Year. For this purpose the term eligible Members includes Members in both the Puerto Rico Plan and this Plan.

3.05 INVESTMENT OF THE COMPANY CONTRIBUTION. The amounts allocated to each Member pursuant to Section 3.03 shall be credited to his Company Accounts and invested in one or more of the Investment Funds described in Section 5.01 and in the percentages designated by the Member in the investment election filed pursuant to Section 5.02 effective at the time the amount is allocated.

3.06 RETURN OF COMPANY CONTRIBUTIONS.

(a) If, after the Company Contribution has been made and allocated, it should appear that, through oversight or a mistake of fact or law, a Member (or an Associate who should have been considered a Member) who should have been entitled to share in such contribution, receives no allocation or receives an allocation which was less than he should have received, the Company may, at its election and in lieu of reallocating such contribution, make a special make-up contribution for the Company Account of such Member in an amount sufficient to provide for him the same addition to his Company Account as he should have received. Similarly, if a Member received an allocation which was more than he should have received (or an Associate was inappropriately included in the Plan), the Company, at its election, may reallocate such contribution, offset other Company contributions against such allocation, or use such allocation to pay Plan expenses.

(b) Each contribution made to the Trust shall be made on the condition that it is currently deductible by the Company or Employer under Code Section 404 for the taxable year with respect to which the contribution is made. If a contribution subsequently is determined, whether in whole or in part, not to be currently deductible as provided in the preceding sentence, then, within one year of the date of disallowance of the deduction of such Company Contribution, an amount equal to the disallowed deduction shall be returned to the Company or Employer.

(c) Earnings attributable to a contribution that is returned pursuant to Subsection (a) or (b) above shall not be withdrawn, but losses attributable thereto shall reduce the amount returned to the Company and/or Employer.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

SECTION 4

MEMBER CONTRIBUTIONS

4.01 PROCEDURE FOR MAKING CONTRIBUTIONS.

(a) AFTER-TAX CONTRIBUTIONS. Subject to the limitations set forth in Sections 4.02, 4.03 and 4.04, each Member may contribute to the Plan an amount (in whole percentage points) equal to not less than 1% nor more than 15% (effective May 1, 2002, 75%) of his Pay as he shall have designated pursuant to procedures established by the Company (which may establish lower permissible After-Tax Contributions for Highly Compensated Employees); provided, however, that a Member shall not contribute, or elect to have contributed on his behalf, amounts with respect to Pay received by him after the close of the calendar year during which his employment terminates and further provided that any Before-Tax Contributions made on behalf of the Member shall reduce, by the percentage which he elects to have contributed pursuant to Section 4.01(b)(i), the percentage of Pay that the Member may contribute pursuant to this Section 4.01(a).

(b) BEFORE-TAX CONTRIBUTIONS.

(i) Subject to the limitations set forth below, each Member may elect that his Employer shall contribute directly to the Trust Fund an amount equal to a whole percentage of his Pay, not less than 1% nor greater than such percentage as may be determined from time to time by the Company which amount shall be his Before-Tax Contribution. The maximum Before-Tax Contribution by a Member determined to be a Highly Compensated Employee under Section 4.02, for the Plan Year in question, may be further restricted or limited by the Company or Committee from time to time.

(ii) Pursuant to Section 2.01(c), each eligible Member shall be deemed to have elected to make a three percent (3%) Before-Tax Contribution, unless the Member elects otherwise in accordance with procedures established by the Committee.

(c) Notwithstanding any election in accordance with Section 4.01(b), if the Committee at any time determines that all or any portion of the Member's Before-Tax Contributions should be treated as After-Tax Contributions in order for the Before-Tax Contribution provisions of the Plan to qualify as a "qualified cash or deferred arrangement" for purposes of Code Section 401(k), or if the Actual Deferral Percentage standards set forth in Code Section 401(k)(3) are not met at the end of the Plan Year, then the Committee, in its sole and absolute discretion,

(i) may, in accordance with Section 4.02 below, limit the amount which shall be contributed by the Employer as Before-Tax Contributions after the date of such determination on behalf of all or any portion of the Members and,

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(ii) may, except with respect to situations in which Section 4.01(h) applies, (and prior to March 15 of the calendar year following the Plan Year in which such contributions are made) declare all or such portion of the Before-Tax Contributions theretofore or thereafter made on behalf of all or a portion of the Members to be After-Tax Contributions. Effective January 1, 1997, if Before-Tax Contributions are made to another plan or plans, this Plan and such other plans must be aggregated for purposes of Section 410(b) of the Code (other than the average benefit percentage test).

(d) The Employer shall (i) deduct a Member's After-Tax Contributions from the Pay of the Member in such installments as the Employer may deem appropriate, (ii) contribute a Member's Before-Tax Contributions on behalf of the Member, and (iii) reduce the Pay that is paid to the Member directly in cash by an amount equal to the Member's Before-Tax Contributions in such installments as the Employer shall deem appropriate. The amounts so deducted and so contributed shall be paid by the Employer to the Trustee not later than 15 days following the end of the month with respect to which such amounts are to be so deducted and contributed or within such shorter period of time as may be designated under the Code, ERISA or related regulations. The Employer may, from time to time, make estimated contribution payments to the Trustee during each month.

(e) Effective with the first payroll period beginning in any calendar month, or as of such other effective time as may be determined by the Committee, a Member may elect to change the rate of his After-Tax Contributions to any other rate permitted by Subsection (a) of this Section 4.01 and may elect to change the amount to be contributed by the Employer directly to the Trust Fund as Before-Tax Contributions to an amount equal to an amount permitted by Subsection (b) of this Section 4.01 with respect to such contributions to be made after the effective date of the election, pursuant to procedures established by the Committee.

(f) Not later than 15 days prior to the beginning of a payroll period of a Member, or not later than such other date as may be determined by the Committee, such Member may elect, pursuant to procedures established by the Committee, (i) to suspend making After-Tax Contributions and (ii) that the Employer should suspend making Before-Tax Contributions on his behalf, all as of the beginning of such payroll period. Not later than 15 days prior to the beginning of a payroll period of a Member, or not later than such other date as may be determined by the Committee, such Member may elect (i) to resume making After-Tax Contributions and, (ii) that the Employer shall resume making Before-Tax Contributions on his behalf, by indicating any amount of contributions permitted under Subsection (a) and designating an amount equal to any amount of Pay as Before-Tax Contributions that is permitted under Subsection (b) hereof.

(g) Contributions pursuant to this Section 4.01 shall be credited to Member Accounts.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(h) Notwithstanding any election in accordance with Subsection (b), the total amount of a Member's Before-Tax Contributions and other contributions made by the Member under Code Section 401(k) to another plan qualified under Code Section 401(a) for any calendar year shall not exceed $11,000 (as adjusted from time to time by the Secretary of the Treasury or his delegate, pursuant to Code Section 415(d)). If any Member may reach the $11,000 limit (as adjusted) the Committee can direct that all or any portion of such Member's Contributions during such year shall be After-Tax Contributions regardless of such Member's elections pursuant to Sections 4.01(a) and 4.01(b). Effective May 1, 2002, all employees who are eligible to make elective deferrals under this Plan and who have attained age 50 before the close of the Plan Year shall be eligible to make catch-up contributions in accordance with, and subject to the limitations of, section 414(v) of the Code. Such catch-up contributions shall not be taken into account for purposes of the provisions of the Plan implementing the required limitations of sections 402(g) and 415 of the Code. The Plan shall not be treated as failing to satisfy the provisions of the Plan implementing the requirements of sections 401(k)(3), 401(k)(11), 401(k)(12), 410(b), or 416 of the Code, as applicable, by reason of the making of such catch-up contributions.

(i) The Committee shall provide each new Member a notice that explains the procedure for making Before-Tax Contributions under Sections 4.01(b) and 2.01(c), including the Member's right to elect to make no Before-Tax Contribution from his or her Pay and the manner in which the amount of such contributions may be changed. In addition, the Committee shall provide an annual notice to each Member indicating his or her Before-Tax Contributions as a percentage of Pay, describing the right to alter and the procedure for changing such percentage, and explaining the timing for implementation of any such change.

4.02 LIMITATIONS ON AND DISTRIBUTIONS OF BEFORE-TAX CONTRIBUTIONS FOR HIGHLY COMPENSATED EMPLOYEES.

The Committee is authorized to reduce to the extent necessary the maximum contributions under Section 4.01(b) for Highly Compensated Employees prior to the close of the Plan Year if the Committee reasonably believes that the reduction is necessary to prevent the Plan from failing Code Section 401(k)(3). Such adjustments shall be made in accordance with rules prescribed by the Employer.

If the Plan fails to satisfy Code Section 401(k)(3), the Plan shall correct the failure within 12 months after the last day of such Plan Year under any method of combination of methods allowed under Code Section 401(k)(8) or Treasury Regulation Section 1.401(k)-1(f), taking into account any adjustments necessary due to changes to Code Section 401(k)(8)(C) that are reflected in the regulations. For purposes of this Section 4.01, the actual deferral percentage of Non-Highly Compensated Employees shall be determined as of the Plan Year for which

the Plan must satisfy one of the tests in Code Section 401(k)(3), unless the Employer elects to determine such actual deferral percentage as of the Plan Year preceding the Plan Year for which the Plan must satisfy one of the tests in Code Section 401(k)(3). Any such election shall not be changed except as provided by the Secretary of the Treasury.

Effective January 1, 1997, if for any Plan Year, the Plan satisfies neither of the tests set forth in Code Section 401(k)(3), the Trustee shall be directed by the Committee to return to each Highly Compensated Employee his or her portion of the excess contributions (plus the income or less the loss allocable to such excess contributions) for such Plan Year within 12 months after the last day of such Plan Year. A Highly Compensated Employee shall forfeit any Matching Contributions which were contributed on account of any portion of the excess contributions even if such Matching Contributions are vested. Each Highly Compensated Employee's portion of the excess contributions for a Plan Year shall be determined under a two step process. First, the aggregate amount of excess contributions shall be calculated. This shall be done by reducing the actual deferral percentages of those Highly Compensated Employees with the highest actual deferral percentages to the extent necessary but not below the next highest level of actual deferral percentages. This process shall be repeated, to the extent necessary, until the actual deferral percentages for the group of Highly Compensated Employees satisfies one of the tests set forth in Code Section 401(k)(3). The aggregate amount of excess contributions shall be calculated by multiplying the actual deferral percentage reduction for each Highly Compensated Employee by his or her compensation (within the meaning of Code Section 414(s)) for the Plan Year and adding the product of each such multiplication. Second, the aggregate amount of excess contributions to be returned shall be allocated by reducing the Before-Tax Contributions of those Highly Compensated Employees with the highest amount of Before-Tax Contributions to the extent necessary but not below the next highest amount of Before-Tax Contributions. This process shall be repeated, to the extent necessary, until all excess contributions to be returned shall be allocated among the Highly Compensated Employees. The income or loss allocable to a Highly Compensated Employee's portion of the excess contribution will be determined under such reasonable method as the Committee shall establish, provided the method does not discriminate in favor of Highly Compensated Employees, is used consistently for all Members and for all corrective distributions under the Plan for the Plan Year, and is used by the Plan for allocating income to Members' accounts.

If the Trustee is required to distribute both elective deferrals and excess contributions for a Plan Year, the Trustee shall (a) calculate and distribute elective deferrals before determining the excess contributions to be distributed to Highly Compensated Employees; (b) calculate the actual deferral percentage including the amount of excess deferrals distributed pursuant to (a) above; and (c) distribute excess contributions to Members by reducing the excess contributions distributed to a Member by the amount of excess elective deferrals distributed to such Member.

The actual contribution percentage and the actual deferral percentage of a Highly Compensated Employee who is eligible to participate in two or more qualified plans which have cash or deferred arrangements or matching contributions or after-tax contributions features (other than an employee stock ownership plan) maintained by the Employer or a member of the Group shall be calculated by treating all such cash or deferred arrangements in which the Highly Compensated Employee is eligible to participate as one cash or deferred arrangement for purposes

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

of calculating the actual deferral percentage for such Highly Compensated Employee, and all such features in which the Highly Compensated Employee is eligible to participate as one feature for purposes of calculating the actual contribution percentage for such Highly Compensated Employee with respect to years ending within the same calendar year.

4.03 DISTRIBUTIONS OF EXCESS DEFERRALS.

If a Member's elective deferrals for any calendar year exceed $10,500 (or such higher amount prescribed under Section 402(g) of the Code), then the Member may file an election form prescribed by the Committee with the Employer/Company designating in writing the amount of the Member's Excess Before-Tax Deferrals to be distributed from this Plan. Any such election form must be filed with the Committee no later than the first March 1 following the close of such calendar year in order for the Committee to act on it. If such an election form is timely filed, the Trustee shall distribute to the Member the amount of such Excess Before-Tax Deferrals which the Member has allocated to this Plan together with any income or less any loss allocable to such amount on or before the first April 15 following the close of such calendar year. In the case of a Highly Compensated Employee, any matching contributions which were contributed on account of the Excess Before-Tax Deferrals being distributed will be forfeited, even if such matching contributions are vested. For purposes of this Section 4.03, the income or loss allocable to such Excess Before-Tax Deferrals will be determined under such reasonable method as the Committee shall establish, provided the method does not discriminate in favor of Highly Compensated Employees, is used consistently for all Members and for all corrective distributions under the Plan for the Plan Year, and is used by the Plan for allocating income to Members' accounts.

4.04 LIMITATIONS ON AND DISTRIBUTIONS OF AFTER-TAX EMPLOYEE CONTRIBUTIONS AND MATCHING CONTRIBUTIONS FOR HIGHLY COMPENSATED EMPLOYEES.

The Committee is authorized to reduce to the extent necessary the maximum amount of Employee After-Tax Contributions and Employer Matching Contributions under Sections 4.01(a) and 3.02 contributed on behalf of any Highly Compensated Employee prior to the close of the Plan Year if the Committee reasonably believes that such adjustment is necessary to prevent the Plan from failing Code Section 401(m)(2). Such reduction shall be made in accordance with rules prescribed by the Employer.

If the Plan fails to satisfy Code Section 401(m)(2), the Plan shall correct the failure within 12 months after the last day of such Plan Year under any method or combination of methods allowed under Treasury Regulation 1.401(m)-1(e), taking into account any adjustments necessary due to changes to Code Section 401(m)(6)(c) that are not reflected in the regulations. For purposes of this Section 4.04, the actual contribution percentage of Non-Highly Compensated Employees shall be determined as of the Plan Year for which the Plan must satisfy one of the tests in Code Section 401(m)(2), unless the Employer elects to determine such actual contribution

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

percentage as of the Plan Year preceding the Plan Year for which the Plan must satisfy one of the tests in Code Section 401(m)(2). Any such election shall not be changed except as provided by the Secretary of the Treasury.

Effective January 1, 1997, if for any Plan Year, the Plan fails to satisfy either of the tests set forth in Code Section 401(m)(2), the Trustee shall be directed by the Committee to distribute to each Highly Compensated Employee his or her vested portion (and forfeit the nonvested portion) of the excess aggregate contributions (plus the income or less the losses allocable to such excess aggregate contributions) for such Plan Year within 12 months after the last day of such Plan Year. Each Highly Compensated Employee's portion of the excess aggregate contributions for a Plan Year shall be determined under a two step process. First, the aggregate amount of excess aggregate contributions shall be calculated. This shall be done by reducing the actual contribution percentages of those Highly Compensated Employees with the highest actual contribution percentages to the extent necessary but not below the next highest level of actual contribution percentages. This process shall be repeated, to the extent necessary, until the actual contribution percentage for the group of Highly Compensated Employees satisfies one of the tests set forth in Code Section 401(m)(2). The aggregate amount of excess aggregate contributions shall be calculated by multiplying the actual contribution percentage reduction for each Highly Compensated Employee by his or her compensation (within the meaning of Code Section 414(s)) for the Plan Year and adding the product of each such multiplication. Second, the aggregate amount of excess aggregate contributions to be distributed or forfeited shall be allocated by first reducing any After-Tax Contributions and then any Matching Contributions made by or on behalf of Highly Compensated Employees with the highest total amount of After-Tax Contributions and Matching Contributions to the extent necessary but not below the next highest total amount of After-Tax Contributions and Matching Contributions. This process shall be repeated, to the extent necessary, until all excess aggregate contributions to be distributed or forfeited shall be allocated among the Highly Compensated Employees. A Highly Compensated Employee whose After-Tax Contributions are determined to be excess aggregate contributions shall forfeit any Matching Contributions which were contributed on account of such After-Tax Contributions, even if such Matching Contributions are vested. The income or loss allocable to a Highly Compensated Employee's portion of the excess aggregate contributions will be determined under such reasonable method as the Committee shall establish, provided the method does not discriminate in favor of Highly Compensated Employees, is used consistently for all Members and for all corrective distributions under the Plan for the Plan Year, and is used by the Plan for allocating income to Members' accounts.

4.05 LIMITATIONS ON MULTIPLE USE OF ALTERNATIVE LIMITATION.

(a) Repeal of Multiple Use Test.

The Multiple use test described in Treasury Regulation section 1.401(m)-2 shall not apply for Plan Years beginning after December 31, 2001.

(b) Special Definitions.

All terms used in this Section 4 shall have the meaning given such terms in Code Sections 401(k) and 401(m) and the regulations thereunder.

SECTION 5

INVESTMENT PROVISIONS

5.01 INVESTMENT FUNDS.

(a) There shall be established as part of the Trust Fund a reasonable range of investment options. The Committee may from time to time, in its discretion, change, delete or add Investment Funds available within the Trust Fund; provided that unless and until the Plan is amended accordingly, the Plan shall continue to provide a Payless Common Stock Fund as an investment option.

(b) Income from and proceeds of sales of investments in each Investment Fund shall be reinvested in the same Investment Fund. Any income or other taxes payable with respect to a Fund shall be charged to such Fund.

(c) A Trustee may, from time to time, make temporary investments in short term obligations of the United States Government, commercial paper, or other investments of a short term nature, pending investment in an Investment Fund.

5.02 INVESTMENT DIRECTION.

(a) A Member may elect that his Member Contributions be invested in 1% increments totaling 100% in one or more of the Investment Funds. Such election must be made pursuant to procedures prescribed by the Committee. Such election shall be effective until and unless a Member makes a different election for any period, but only as provided for under Subsection 5.02(b) and Subsection 5.02(c). If the Member fails to file a timely initial investment election, he shall be deemed to have elected to have 100% of his Member Contributions invested in the stable, fixed income investment as may be determined by the Committee. Until such time as the Committee determines otherwise and so notifies Members, a Member's share of any Company Contributions, when allocated as of Plan Year-end, shall be invested in the same Investment Funds in the same proportions as the Member has elected in connection with investment of his Member Contributions at the time the Company Contribution is contributed to the Trust.

(b) A Member may change his election with respect to future Member and Company Contributions effective pursuant to procedures prescribed by the Committee and may not change his election in any other manner except as provided in Subsection 5.02(c).

(c) Effective as of the date determined by the Committee, and pursuant to procedures prescribed by the Committee, a Member may elect to have any or all of the value in any of the Investment Funds which are credited to his Member and/or Company Accounts transferred and invested in any one or more of the Investment Funds.

(d) Notwithstanding this Section 5.02, effective March 20, 2000, during the black out period as determined by the Committee and the Trustee established to change to daily valuation or a change in recordkeepers, no investment transfers or changes may be made by a Member unless provided in Section 6.06. Notwithstanding anything to the contrary, no loans, withdrawals or distributions shall be made during any such blackout period except as provided by the Committee.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

SECTION 6

ACCOUNTS

6.01 MEMBER ACCOUNTS. The Committee shall maintain or cause to be maintained for each Member under each Investment Fund in which his Member Contributions are invested separate Member Accounts which shall reflect the portion of his interest in such Investment Fund which is attributable to his contributions. The Member's After-Tax Contributions shall be credited to a separate Member After-Tax Account. The Member's Before-Tax Contributions shall be credited to a separate Member Before-Tax Account. The Member's or Associate's Rollover Contribution shall be credited to a separate Member Rollover Contribution Account.

6.02 COMPANY ACCOUNTS. The Committee shall maintain or cause to be maintained for each Member under each Investment Fund in which his Company Contributions are invested separate Company Accounts which shall reflect the portion of his interest in such Investment Fund which is attributable to Company Contributions, as well as to contributions made by an Employer under prior plans and to any income or earnings attributable to such Company Contributions and prior plan contributions. The Member's Company Matching Contributions shall be credited to a separate Company Matching Contribution Account. The Member's Company Profit Sharing Contribution, if any, shall be credited to a separate Company Profit Sharing Contribution Account.

6.03 MAINTENANCE OF ACCOUNTS. For the purposes of maintaining Accounts pursuant to this Section 6, each Investment Fund shall be divided into Units, and the Interest of each Member in such Investment Fund shall be evidenced by the number of Units in such Investment Fund credited to his Accounts.

6.04 VALUATION OF ACCOUNTS. As of each Valuation Date the Committee shall determine the value of a Unit in each Account by dividing the current market value of all property in each such Account as of such Valuation Date (after deducting any expenses or other amounts including withdrawals properly chargeable against such Account) by the number of Units then outstanding to the credit of all Members in each such Account.

6.05 MEMBER STATEMENTS. The Committee shall furnish or cause to be furnished to each Member a statement of his Company and Member Accounts, at least once each year, or more frequently if required by applicable law.

6.06 SHARES OF PAYLESS SHOESOURCE, INC. ("PAYLESS STOCK") IN THE PAYLESS COMMON STOCK FUND.

(a) Each Member (or beneficiary of a deceased Member) who has Accounts invested in the Payless Common Stock Fund shall, as a named fiduciary within the meaning of Section 403(a)(1) of ERISA, have the right to direct the Trustee with respect to the vote of the number of shares of Payless Stock attributable to Units credited to him in the Payless

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

Common Stock Fund as of the latest practicable Valuation Date prior to or contemporaneous with the record date set by the Company for each meeting of shareowners of the Company. For such purpose the Trustee shall furnish to each such Member prior to each such meeting the proxy statement for such meeting, together with a form to be returned to the Trustee on which may be set forth the Member's instructions as to the manner of voting such shares of stock. Upon receipt of such instructions, the Trustee shall vote such shares in accordance therewith. If a Member's instructions are not received by the Trustee in a timely manner, the Trustee shall vote such Member's shares in the same proportion as the shares of Common Stock for which instructions were actually timely received from Members. The Trustee shall not divulge the instructions of any Member.

(b) Each Member (or beneficiary of a deceased Member) who has Accounts invested in the Payless Common Stock Fund shall, as a named fiduciary within the meaning of Section 403(a)(1) of ERISA, have the right with respect to the number of shares of Payless Stock attributable to Units credited to him in the Payless Common Stock Fund as of the latest practicable Valuation Date, to direct the Trustee in writing as to the manner in which to respond to a tender or exchange offer with respect to Payless Stock, and the Trustee shall respond in accordance with the instructions so received. The Trustee shall utilize its best efforts to timely distribute or cause to be distributed to each Member such information as will be distributed to shareowners of the Company in connection with any such tender or exchange offer, together with a form requesting instructions on whether or not such shares will be tendered or exchanged. If the Trustee shall not receive timely direction from a Member as to the manner in which to respond to such a tender or exchange offer, the Trustee shall not tender or exchange any shares of Payless Stock with respect to which such Member has the right of direction. Tenders as a result of a self-tender offer by the Company shall continue notwithstanding any investment change blackout. The Trustee shall not divulge the instructions of any member. The proceeds from the tender or exchange of shares attributable to Units in Payless Common Stock Investment Fund accounts of Members shall be transferred to one of the Investment Funds described in Section 5.01 pursuant to a procedure established by the Committee.

6.07 VESTING IN MEMBER AND COMPANY ACCOUNTS.

(a) VESTING SCHEDULE. A Member shall have a fully vested interest at all times (i) in his Member Accounts and (ii) in his Company Profit Sharing Contribution Account balance determined as of July 31, 1997. A Member who has completed at least two full Years of Service as of August 1, 1997 also shall be fully vested at all times (i) in his Company Matching Contribution Account and (ii) in his Company Profit Sharing Contribution Account determined at any time after July 31, 1997. The Company Matching Contribution Account of a Member who is not or was not credited with at least two Years of Service as of August 1, 1997 and his Company Profit Sharing Contribution Account attributable to Company Profit Sharing Contributions, if any, based on such Member's

eligibility for such contributions after August 1, 1997, shall vest according to the following schedule:

Vesting Service	Vested Interest
Fewer than 2 years	0%
2 years	25%
3 years	50%
4 years	75%
5 years or more	100%

Notwithstanding the foregoing, a Member's interest in his Company Matching Contribution Account and his Company Profit Sharing Contribution Account shall become fully vested if the Member terminates employment on account of Retirement, death or Disability.

(b) CASH-OUT DISTRIBUTIONS TO PARTIALLY VESTED MEMBERS AND RESTORATION OF FORFEITURES. If, pursuant to Section 10.01, a partially-vested Member receives a cash-out distribution before he incurs a Forfeiture Break in Service (as defined in Subsection (e) below), the cash-out distribution will result in an immediate forfeiture of the nonvested portion(s) of the Member's Company Matching and Company Profit Sharing Contribution Account(s). See Subsection (e) below. A partially-vested Member is a Member whose Vested Interest, determined under Section 6.07(a), in either his Company Matching Contribution Account or his Company Profit Sharing Contribution Account, or both, is less than 100%. A cash-out distribution is a distribution of the entire vested portion of the Member's Account(s).

(i) A partially-vested Member who is reemployed by an Employer after receiving a cash-out distribution of the vested portion of his Account(s) shall have such forfeited amount restored, unless the Member no longer has a right to restoration under this subparagraph (i). The amount restored by the Plan Administrator shall be the same dollar amount as the dollar amount of his Account(s) on the Valuation Date immediately preceding the date of the cash-out distribution, unadjusted for any gains or losses occurring subsequent to that Valuation Date but reduced by the amount of the prior cash-out distribution. Restoration of the Member's Account balance(s) includes restoration of all Code Section 411(d)(6) protected benefits with respect to the restored Account(s) in accordance with applicable Treasury regulations. The Plan Administrator will not restore a reemployed Member's Account balance(s) under this subparagraph (i) if the Member has incurred a Forfeiture Break in Service (as defined in Subsection (d) below).

(ii) If restoration of the Member's Account(s) is permitted under subparagraph (i) above, the Plan Administrator will restore the Member's Account(s) on the same day as the date of allocation of the Company Contribution for the Plan Year during which such Member was reemployed by an Employer. To restore the Member's Account(s), the Plan Administrator, to the extent necessary, will allocate to the Member's Account(s):

(A) first, the amount, if any, of Member forfeitures otherwise available for allocation under Subsection (f) below;

(B) second, deductible Employer contributions for the Plan Year to the extent made under a discretionary formula; and

(C) third, as otherwise permitted by law.

The Plan Administrator will not take into account any allocation under this Subsection (b) in applying the limitation on allocations under Section 13.

(iii) The deemed cash-out rule applies to a 0% vested Member. A 0% vested Member is a Member whose Account(s) derived from Employer contributions is (are) entirely forfeitable at the time of his termination of employment. Under the deemed cash-out rule, the Plan Administrator will treat the 0% vested Member as having received a cash-out distribution on the date of the Member's termination of employment or, if the Member's Account(s) is (are) entitled to an allocation of Employer contributions for the Plan Year in which he terminates employment, on the last day of that Plan Year.

(c) DETERMINATION OF VESTING SERVICE. For purposes of determining a Member's Vested Interest in his Company Contributions Account(s) under Subsection (a) above, a Member shall be credited with that number of years of Vesting Service determined by adding together all of the Associate's Periods of Service, whether or not consecutive. Notwithstanding the foregoing, Vesting Service shall not include any Period of Service before the Plan Year in which an Associate attains age eighteen (18). Only whole years of service shall be taken into account for purposes of applying the schedule set forth in Subsection (a) above, and, for purposes of determining a Member's number of whole years of service, non-successive Periods of Service must be aggregated, with 365 days of service being deemed to constitute one year. For purposes of determining a Member's Period of Service, the Service Spanning rules described in Section 1.51(g) shall apply.

(d) FORFEITURE BREAK IN SERVICE. For purposes of this Section 6.07, a "Break in Service" is a Period of Severance of at least 365 consecutive days. A "Forfeiture Break in Service" occurs when a Member or former Member incurs 5 consecutive Breaks in Service.

(e) FORFEITURE OCCURS. A Member's forfeiture, if any, of his Account balance(s) derived from Company contributions occurs under the Plan on the earlier of:

(i) the last day of the last pay period ending within the Plan Year in which the Member first incurs a Forfeiture Break in Service; or

(ii) the date the Member receives a cash-out distribution.

The Plan Administrator shall determine the percentage of a Member's Account(s) forfeiture, if any, under this Subsection (e) solely by reference to the vesting schedule of Section 6.07(a). As of the last day of each Plan Year, the total amount of forfeitures which occurred during such Plan Year shall be calculated and such amount shall be applied (i) to restore under (b) above any amounts previously forfeited from rehired Members' Accounts, (ii) to pay Administrative Expenses under Section 7.01 and (iii) the balance, if any, shall be added to and allocated with the Company Matching Contribution for that Plan Year.

(f) FORMER MAY PLAN MEMBERS. The provisions of this Subsection (f) apply to a Member who previously was employed by the Employer, when it was part of the Group which included The May Department Stores Company, and who at the termination of his employment had Company Accounts in the May Plan which were forfeited as a result of termination of employment. If such Member has not incurred five consecutive Breaks in Service as defined in Section 6.07(b), the value of the Member's Company Account forfeited under the May Plan will be restored under this Plan (in the manner described in Subsection (b) above) and will be 100% vested.

SECTION 7

EXPENSES

7.01 ADMINISTRATIVE EXPENSES. To the extent permitted by applicable law, the costs and expenses for administering this Plan, consisting of Trustee fees and expenses, Investment Manager fees and expenses, fees and expenses of outside experts, expenses of maintaining records under Section 6 of the Plan, and all other administrative expenses of the Plan, shall be paid out of the Trust Fund unless the Company elects to pay them with its own funds. Costs incident to the purchase and sale of securities, such as brokerage fees, commissions and stock transfer fees, are not regarded as administrative expenses and shall be borne by the appropriate Investment Fund as determined by the Trustee or Committee.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

SECTION 8

WITHDRAWALS DURING EMPLOYMENT

8.01 WITHDRAWALS PROHIBITED UNLESS SPECIFICALLY AUTHORIZED. No withdrawal from the Plan shall be permitted prior to a Member's termination of employment, except as provided in Section 8.02.

8.02 AUTHORIZED WITHDRAWALS.

(a) Prior to his termination of employment, a Member may elect to withdraw, in cash, any or all of the value in his Member After-Tax Accounts. However, in the event a Member elects to withdraw all or a portion of his After-Tax Contributions made after August 1, 1997, such Member shall forfeit his right to fifty percent (50%) of the Company Matching Contribution, if any, otherwise allocable in connection with his Member Contributions for the Plan Year in which the withdrawal occurs.

(b) Prior to his termination of employment, a Member may elect to withdraw, in the event of a "hardship", an amount in cash up to (i) the total amount of the Before-Tax Contributions made to the Trust on his behalf, or (ii) the value in his Member Before-Tax Account, whichever is less. In any event the amount withdrawn may not be greater than the amount determined by the Committee as being required to meet the immediate financial need created by the "hardship" and not reasonably available from other resources of the Member, whichever amount is less. The term "hardship" means a heavy financial hardship in light of immediate and heavy financial needs as determined by the Committee in accordance with Internal Revenue Service regulations. The amount of an immediate and heavy financial need may include any amounts necessary to pay any federal, state or local taxes or penalties reasonably anticipated to result from the distribution. The determination shall be made in a nondiscriminatory manner. Hardship shall include but not be limited to the following:

(i) Medical expenses described in Code Section 213(d) previously incurred by the Member, the Member's spouse, or any of the Member's dependents (as defined in Code Section 125) or necessary for these persons to obtain medical care described in Section 213(d);

(ii) Purchase (excluding mortgage payments) of a principal residence for the Member;

(iii) Payment of tuition, related educational fees, and room and board expenses for the next 12 months of post-secondary education for the Member, his or her spouse, children, or dependents (as defined in Code Section 152);

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(iv) The need to prevent the eviction of the Member from his or her principal residence or foreclosure on the mortgage of the Member's principal residence.

(v) (Effective January 1, 2006). Payments for burial or funeral expenses for a Member's deceased parent, spouse, children or dependents (as defined in Section 152 of the Code and effective January 1, 2006), without regard to Section 152(d)(1)(B).

(vi) (Effective January 1, 2006). Expenses for the repair of damage to Member's principal residence that would qualify for the casualty deduction under Section 165 of the Code (determined without regard to whether the loss exceeds 10% of adjusted gross income).

The Committee may adopt written guidelines which identify additional circumstances constituting hardship and which provide procedures to be followed in the administration of hardship withdrawal requests, which guidelines are hereby incorporated herein.

In addition, such hardship must be one which in the judgment of the Committee, based on the Member's representations, cannot be relieved (1) through reimbursement or compensation by insurance or otherwise, (2) by reasonable liquidation of the Member's assets to the extent such liquidation would not itself cause an immediate and heavy financial need, (3) by cessation of Member Contributions under the Plan, (4) by other distributions or loans from employee benefit plans, including this Plan, maintained by the Company or any other employer or (5) by borrowing from commercial sources on reasonable commercial terms. The Member shall be required to submit documentation, to be determined by the Committee, with his hardship withdrawal request to enable the Committee to make a judgment regarding the validity of such hardship withdrawal request. For any Member who has attained age 59 1/2, the "hardship" requirement shall be deemed waived.

(c) A Member who was a Participant in or eligible to be a Participant in the Volume Shoe Corporation Profit Sharing Plan (the "Volume Plan") as of December 31, 1988 and who had an account balance in the Volume Plan attributable to Employer Contributions made to the Volume Plan before July 31, 1976 and which account became a Company Account under The May Department Stores Company Profit Sharing Plan and which has been transferred to this Plan, shall be entitled to withdraw the market value of such account balance determined (and frozen) as of December 31, 1988.

(d) Associates with Member Rollover Contribution Accounts may elect to withdraw their Member Rollover Contribution Accounts prior to termination of employment.

(e) A withdrawal election shall be made pursuant to application procedures established by the Committee. Contribution totals and Account values shall be determined as of the Valuation Date coinciding with or next following the filing of the withdrawal election. If the Member Accounts from which withdrawal is made are in more than one Investment Fund, the withdrawal shall be pro rata from each such Investment Fund except in the case the Member is subject to

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

Section 16 of the Securities Exchange Act of 1934 or has been designated as a "Designated Insider," in which case such Member's withdrawal will be taken first from such Member's Investment Funds other than the Payless Common Stock Fund.

SECTION 9

BENEFITS UPON RETIREMENT, DEATH, DISABILITY OR TERMINATION OF EMPLOYMENT

9.01 BENEFITS. Upon a Member's Retirement, death, Disability, or other termination of employment, the value of his Member Accounts and of his vested Company Accounts shall be determined as of the Valuation Date prior to the date the distribution is calculated. A temporary Authorized Leave of Absence for Military Service or for other purposes approved by the Employer shall not, while any such Authorized Leave of Absence is validly in effect, be regarded as a termination of employment.

9.02 BENEFICIARY. Any benefits payable on account of a Member's death shall be paid to such Member's spouse. If such Member has no spouse or if such Member's spouse shall have consented to the naming of another beneficiary, such benefits shall be paid to the person or persons (including, without limitation, estates, trust, or other entities) last named as beneficiary by such Member on an appropriate form filed with the Committee. A spouse's consent shall acknowledge the effect of the consent and be in writing, witnessed by a Plan representative or notary public. A spouse's consent shall be irrevocable. If no beneficiary has been so named or the named beneficiary does not survive the Member, any payment to be made under this Plan on account of a Member's death shall be paid to such Member's spouse, or, if he has no spouse, to such Member's estate. Whenever permitted by the Code or regulations thereunder, the Committee may waive the requirements that a spouse's consent be obtained. Such waiver may be on a case by case basis or by categories.

SECTION 10

PAYMENT OF BENEFITS

10.01 TIME OF PAYMENT.

(a) All amounts distributable to a Member or Beneficiary pursuant to Section 9 shall, unless the Member makes an approved election pursuant to Section 10.01(b) or 10.01(c), be paid in a lump sum payment to be made as soon as practicable after the Valuation Date as of which the Account values are determined pursuant to Section 9.01; provided, however, that any additional amounts which may be allocated to a Member's Company Accounts resulting from a Company Contribution in respect of the calendar year in which employment terminates shall be paid as soon as practicable after such contribution.

Notwithstanding any provision of this Section 10 to the contrary, if the present value of the nonforfeitable accrued benefit of a Member, including Company Contributions, Member Contributions, Rollover Contributions and earnings thereon (but excluding accumulated deductible employee contributions, if any) exceeds $1,000, no partial or total distribution shall be made unless the Member has consented thereto in writing in the manner required by law.

(b) A Member who was a Member of the May Plan as of June 30, 1990 may elect that all Transferred Accounts distributable to him pursuant to Section 9 shall be paid in annual installments over a period not to exceed ten years beginning with the Valuation Date as of which the lump sum payment would otherwise be made. In the event of the death of a Member prior to the expiration of such period, all amounts which have not been distributed to him shall be paid in a lump sum to his designated Beneficiary or his estate if there is no designated Beneficiary. Subject to the foregoing, each such installment shall be paid as of a Valuation Date and, until all the Accounts of the Member have been fully distributed, they shall continue to be revalued as of each succeeding Valuation Date pursuant to Section 6.04.

Notwithstanding the paragraph above, a Member who as of December 31, 1988 was or was entitled to be a Participant in the Volume Shoe Corporation Profit Sharing Plan may elect that all Transferred Accounts distributable to him pursuant to Section 9 be paid in the form of equal monthly installments over a period not to exceed 120 months. Such payments shall otherwise be made in accordance with the foregoing portion of this Subsection 10.01(b).

(c) A Member who is entitled to receive a distribution in excess of $1,000 may elect to defer such distribution to the required minimum distribution age, as determined by law from time to time. An election to defer distribution shall conform to such requirements as to form, content, manner, and timing as shall be determined by the Committee and which requirements shall be applied in a manner which does not discriminate in favor of

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

Members who are highly compensated employees (within the meaning of Code Section 414(q)). All Accounts of a Member who elects to defer his distribution shall continue to be revalued as of each succeeding Valuation Date pursuant to Section 6.04. A deferred distribution shall be paid when such Member attains the required minimum distribution age or at such earlier or later time as shall be determined by the Committee as permitted by law. In the event of the death of a Member prior to distribution of the deferred amounts, all amounts shall be distributed in a lump sum to his designated Beneficiary or to his estate if there is no designated Beneficiary. The value for payment shall be determined as of the Valuation Date coincident with or next following such Member's birthday coincident with the Member's required minimum distribution age or such other payment date determined by the Committee.

10.02 FORM OF PAYMENT. All distributions shall be made in the form of cash, except that distributions from the Payless Common Stock Fund shall be made in the form of full shares of Payless Common Stock, as applicable (with payment in cash for a fraction of a share) or in cash if elected by the Member or Beneficiary. The rights extended to a Member hereunder shall also apply to any Beneficiary or alternate payee of such Member.

10.03 INDIRECT PAYMENT OF BENEFITS. If any Member or Beneficiary has been adjudged to be legally, physically or mentally incapable or incompetent, payment may be made to the legal guardian or other legal representative of such Member or Beneficiary as determined by the Committee. Such payments shall constitute a full discharge with respect thereto.

10.04 INABILITY TO FIND MEMBER. If a Member or Beneficiary or other person to whom a benefit payment is due cannot be found during the three years subsequent to the date a distribution was required to be made under this Plan, the Accounts shall be forfeited at the end of such three-year period. The value of such Accounts as of the date the distribution was required to be made shall be restored if such Member or Beneficiary or other person makes a claim.

10.05 REQUIRED MINIMUM DISTRIBUTIONS.

Notwithstanding anything to the contrary contained in the Plan, the entire interest of a Member will be distributed in accordance with Code Section 401(a)(9) and the regulations thereunder beginning no later than the Member's Required Beginning Date. The provisions of this Section will apply for purposes of determining required minimum distributions for calendar years beginning with the 2003 calendar year. Notwithstanding the other provisions of this Section, distributions may be made under a designation made before January 1, 1984, in accordance with section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act (TEFRA) and the provisions of the Plan that relate to section 242(b)(2) of TEFRA.

(a) If the Member dies before distributions begin, the Member's entire interest will be distributed, or begin to be distributed, no later than as follows:

(1) If the Member's surviving spouse is the Member's sole designated beneficiary, then distributions to the surviving spouse will begin by December 31

of the calendar year immediately following the calendar year in which the Member died, or by December 31 of the calendar year in which the Member would have attained age 70-1/2, if later.

(2) If the Member's surviving spouse is not the Member's sole designated beneficiary, then distributions to the designated beneficiary will begin by December 31 of the calendar year immediately following the calendar year in which the Member died.

(3) If there is no designated beneficiary as of September 30 of the year following the year of the Member's death, the Member's entire interest will be distributed by December 31 of the calendar year containing the fifth anniversary of the Member's death.

(4) If the Member's surviving spouse is the Member's sole designated beneficiary and the surviving spouse dies after the Member but before distributions to the surviving spouse begin, this subsection, other than subsection (a)(1), will apply as if the surviving spouse were the Member.

For purposes of this subsection, unless subsection (a)(4) applies, distributions are considered to begin on the Member's Required Beginning Date. If subsection (a)(4) applies, distributions are considered to begin on the date distributions are required to begin to the surviving spouse under subsection (a)(1). To the extent the Plan provides for distributions in the form of annuities, if distributions under an annuity purchased from an insurance company irrevocably commence to the Member before the Member's Required Beginning Date (or to the Member's surviving spouse before the date distributions are required to begin to the surviving spouse under subsection (a)(1)), the date distributions are considered to begin is the date distributions actually commence.

(b) Unless the Member's interest is distributed in the form of an annuity purchased from an insurance company or in a single sum on or before the Required Beginning Date, as of the first distribution calendar year distributions will be made in accordance with subsections (c) and (d). To the extent the Plan provides for distributions in the form of annuities, if the Member's interest is distributed in the form of an annuity purchased from an insurance company, distributions thereunder will be made in accordance with the requirements of Code Section 401(a)(9) and the Treasury regulations.

(c) During the Member's lifetime, the minimum amount that will be distributed for each distribution calendar year is the lesser of:

(1) the quotient obtained by dividing the Member's account balance by the distribution period in the Uniform Lifetime Table set forth in section 1.401(a)(9)-9 of the Treasury regulations, using the Member's age as of the Member's birthday in the distribution calendar year; or

(2) if the Member's sole designated beneficiary for the distribution calendar year is the Member's spouse, the quotient obtained by dividing the Member's account balance by the number in the Joint and Last Survivor Table set forth in section 1.401(a)(9)-9 of the Treasury regulations, using the Member's and spouse's attained ages as of the Member's and spouse's birthdays in the distribution calendar year.

Required minimum distributions will be determined beginning with the first distribution calendar year and up to and including the distribution calendar year that includes the Member's date of death.

(d) If the Member dies on or after the date distributions begin and there is a designated beneficiary, the minimum amount that will be distributed for each distribution calendar year after the year of the Member's death is the quotient obtained by dividing the Member's account balance by the longer of the remaining life expectancy of the Member or the remaining life expectancy of the Member's designated Beneficiary, determined as follows:

(1) The Member's remaining life expectancy is calculated using the age of the Member in the year of death, reduced by one for each subsequent year.

(2) If the Member's surviving spouse is the Member's sole designated beneficiary, the remaining life expectancy of the surviving spouse is calculated for each distribution calendar year after the year of the Member's death using the surviving spouse's age as of the spouse's birthday in that year. For distribution calendar years after the year of the surviving spouse's death, the remaining life expectancy of the surviving spouse is calculated using the age of the surviving spouse as of the spouse's birthday in the calendar year of the spouse's death, reduced by one for each subsequent calendar year.

(3) If the Member's surviving spouse is not the Member's sole designated beneficiary, the designated beneficiary's remaining life expectancy is calculated using the age of the beneficiary in the year following the year of the Member's death, reduced by one for each subsequent year.

If the Member dies on or after the date distributions begin and there is no designated beneficiary as of September 30 of the year after the year of the Member's death, the minimum amount that will be distributed for each distribution calendar year after the year of the Member's death is the quotient obtained by dividing the Member's account balance by the Member's remaining life expectancy calculated using the age of the Member in the year of death, reduced by one for each subsequent year.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(e) If the Member dies before the date distributions begin and there is a designated beneficiary, the minimum amount that will be distributed for each distribution calendar year after the year of the Member's death is the quotient obtained by dividing the Member's account balance by the remaining life expectancy of the Member's designated beneficiary, determined as provided in subsection (d). If the Member dies before the date distributions begin and there is no designated beneficiary as of September 30 of the year following the year of the Member's death, distribution of the Member's entire interest will be completed by December 31 of the calendar year containing the fifth anniversary of the Member's death. If the Member dies before the date distributions begin, the Member's surviving spouse is the Member's sole designated beneficiary, and the surviving spouse dies before distributions are required to begin to the surviving spouse under subsection (a)(1), this Section will apply as if the surviving spouse were the Member.

(f) The following definitions shall apply for purposes of this Section:

(1) Designated beneficiary shall mean the individual who is designated as the beneficiary under the terms of the Plan and is the designated beneficiary under Code Section 401(a)(9) and section 1.401(a)(9)−1, Q&A−4 of the Treasury regulations.

(2) A distribution calendar year is a calendar year for which a minimum distribution is required. For distributions beginning before the Member's death, the first distribution calendar year is the calendar year immediately preceding the calendar year which contains the Member's Required Beginning Date. For distributions beginning after the Member's death, the first distribution calendar year is the calendar year in which distributions are required to begin under subsection (a). The required minimum distribution for the Member's first distribution calendar year will be made on or before the Member's Required Beginning Date. The required minimum distribution for other distribution calendar years, including the required minimum distribution for the distribution calendar year in which the Member's Required Beginning Date occurs, will be made on or before December 31 of that distribution calendar year.

(3) Life expectancy means an individual's life expectancy as computed by use of the Single Life Table in section 1.401(a)(9)−9 of the Treasury regulations.

(4) The Member's account balance is the account balance as of the last valuation date in the calendar year immediately preceding the distribution calendar year (valuation calendar year) increased by the amount of any contributions made and allocated or forfeitures allocated to the account balance as of dates in the valuation calendar year after the valuation date and decreased by distributions made in the valuation calendar year after the valuation date. The account balance for the valuation calendar year includes any amounts rolled over or transferred to

the Plan either in the valuation calendar year or in the distribution calendar year if distributed or transferred in the valuation calendar year.

(5) Required Beginning Date means the first day of April following the calendar year in which the Member attains age 70-1/2 or, if later, the calendar year in which the Member retires. In the case of a Member who is a "five percent owner" as defined in Section 21.07(f)(3), Required Beginning Date means the first day of April following the calendar year in which the Member attains age 70-1/2.

10.06 COMMENCEMENT OF BENEFIT DISTRIBUTION TO BENEFICIARY. Distributions to the Beneficiary entitled under Section 9.02 to receive any payments payable under this Plan on account of a Member's death shall be made in a lump sum payment not later than December 31 of the calendar year following the calendar year in which the Member died.

10.07 COMMENCEMENT OF BENEFIT DISTRIBUTION TO ALTERNATE PAYEE. Distributions to an alternate payee entitled under Section 16.01 to receive any payments payable under this Plan pursuant to the terms of a Qualified Domestic Relations Order shall be made in accordance with the terms of such Qualified Domestic Relations Order and this Plan on or after the date on which the Member has attained his "earliest retirement age" (as defined under Code Section 414(p)) under the Plan. Notwithstanding the foregoing, distribution to an alternate payee may be made prior to the Member's attainment of his earliest retirement age if, but only if: (1) the Qualified Domestic Relations Order specifies distribution at that time or permits an agreement between the Plan and the alternate payee to authorize an earlier distribution; (2) the distribution is a single sum distribution of the alternate payee's entire benefit entitlement under the Plan; and (3) in the event the present value of the alternate payee's benefits under the Plan exceeds $1,000, the alternate payee consents to any distribution occurring prior to the Member's attainment of earliest retirement age.

Nothing in this Section 10.07 shall be construed to permit a Member to (1) receive a distribution at a time not otherwise permitted under the Plan, (2) permit the alternate payee to receive a form of payment not otherwise permitted under the Plan, or (3) cause his Plan accounts to be valued or otherwise determined in a manner not otherwise permitted under the Plan.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

SECTION 11

PERMITTED ROLLOVER OF PLAN DISTRIBUTIONS

11.01 ROLLOVER TO OTHER PLANS. Notwithstanding any provision of the Plan to the contrary that would otherwise limit a distributee's election under this Section, a distributee may elect, at the time and pursuant to procedures prescribed by the Committee, to have any portion of an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee in a direct rollover. Such distribution may commence no less than thirty (30) days nor more than ninety (90) after any notice required under Treas. Reg. Section 1.411(a)−11(c) (or its successor) and explanation of his right to rollover his distribution and tax explanation in accordance with Internal Revenue Rules are given to a Member or other distributee, provided that the Member has been clearly informed that he has a right to a period of at least thirty (30) days after receiving said notice to consider the decision as to whether to elect a distribution or, if applicable, a distribution option, and the Member nevertheless affirmatively elects distribution preceding the expiration of thirty (30) days. A portion of the distribution shall not fail to be an eligible rollover distribution merely because the portion consists of after−tax Member contributions which are not includible in gross income. However, such portion may be transferred only to an individual retirement account or annuity described in Sections 408(a) or (b) of the Code, or a qualified defined contribution plan described in Sections 401(a) or 403(a) of the Code that agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible.

11.02 ROLLOVER FROM OTHER PLANS. An Associate eligible to participate in the Plan, regardless of whether he has satisfied the participation requirements of Section 2.01, may transfer to the Plan an Eligible Rollover Distribution provided that such distribution is from an Eligible Retirement Plan other than an individual retirement account described in Code Section 408(a) or an individual retirement annuity described in Code Section 408(b); and, provided further, that this Plan shall not accept the portion of any eligible rollover distribution that is not includible in gross income. If such transfer is not a direct transfer, such a transfer may be made only if the following conditions are met:

(a) the transfer occurs on or before the 60th day following the Associate's receipt of the distribution from the Eligible Retirement Plan; and

(b) The amount transferred is equal to any portion of the distribution the Associate received from the Eligible Retirement Plan, not in excess of the fair market value of all property received in such a distribution reduced by employee contributions, as defined in Code Section 402(a)(5)(E).

The Committee shall develop such procedures, and may require such information, from a Member desiring to make such a transfer, as it deems necessary or desirable to determine that the proposed transfer will meet the requirements of the Section.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

Upon approval by the Committee or its Administrative Delegate, the amount transferred shall be deposited in the Trust Fund and shall be credited to the Member's account. Such rollover amount shall be one hundred percent (100%) vested in the Member, shall share in the income allocations in accordance with Section 5, but shall not share in the Company Profit Sharing Contributions, the Company Matching Contributions or the forfeiture allocations. Upon termination of employment, the total amount of the rollover contribution shall be distributed in accordance with the terms of the Plan.

Upon such a transfer by an Associate who is otherwise eligible to participate in the Plan but who has not yet completed the participation requirement of Section 2.01, his rollover amount shall represent his sole interest in the Plan until he becomes a Member.

11.03 DEFINITIONS. The following definitions shall apply for the purposes of this Section 11:

(a) ELIGIBLE ROLLOVER DISTRIBUTION. An eligible rollover distribution is any distribution of all or any portion of the balance to the credit of the distributee, except that an eligible rollover distribution does not include: any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the distributee or the joint lives (or joint life expectancies) of the distributee and the distributee's beneficiary or for a specified period of ten years or more; any distribution to the extent such distribution is required under Code Section 401(a)(9) and any hardship distribution.

(b) ELIGIBLE RETIREMENT PLAN. An eligible retirement plan is an individual retirement account described in Code Section 408(a), an individual retirement annuity described in Code Section 408(b), an annuity plan described in Code Section 403(a), an annuity contract described in Code Section 403(b), an eligible plan described in Code Section 457(b) maintained by a state, a political subdivision of a state, or any instrumentality of a state or political subdivision of a state, or a qualified trust described in Code Section 401(a), which accepts or will make, as applicable, an Eligible Rollover Distribution. This definition shall also apply to an Eligible Rollover Distribution to a Member's surviving spouse, or a former spouse who is an alternate payee under a Qualified Domestic Relations Order.

(c) DISTRIBUTEE. A distributee includes a Member or former Member. In addition, the Member or former Member's surviving spouse and the Member's or former Member's spouse or former spouse who is the alternate payee under a qualified domestic relations order, as defined in Code Section 414(p), are distributees with regard to the interest of the spouse or former spouse.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(d) DIRECT TRANSFER. A direct transfer is a payment by the Plan to the eligible retirement plan specified by the distributee as described in Code Section 401(a)(31).

SECTION 12

LOANS

12.01 AVAILABILITY OF LOANS. Loans shall be permitted under this Plan as established by the policy of the Committee. Any such loan shall be subject to such conditions and limitations as the Committee deems necessary for administrative convenience and to preserve the tax-qualified status of the Plan. Loans are available to Associates who have a Member Rollover Contribution Account.

12.02 AMOUNT OF LOANS. No loan to any Associate, Member or Beneficiary may be made to the extent that such loan, when added to the outstanding balance of all other loans to the Associate, Member or Beneficiary, would exceed the lesser of (a) $50,000 reduced by the excess (if any) of the highest outstanding balance of loans during the one-year period ending on the day before the loan is made, over the outstanding balance of loans from the Plan on the date the loan is made, or (b) one-half the present value of the nonforfeitable accrued benefit of the Participant. For the purpose of the above limitation, all loans from all plans of the Employer and other members of a group of employers described in Code Sections 414(b), 414(c), 414(m) and 414(o) are aggregated. Furthermore, any loan shall by its terms require that repayment (principal and interest) be amortized in level payments, not less frequently than quarterly, over a period not extending beyond four and one-half years from the date of the loan. If such loan is used to acquire a dwelling unit which within a reasonable time (determined at the time the loan is made) will be used as the principal residence of the Participant, the repayment period shall not extend beyond twenty nine and one-half years from the date of the loan. An assignment or pledge of any portion of the Participant's interest in the Plan and a loan, pledge, or assignment with respect to any insurance contract purchased under the Plan will be treated as a loan under this paragraph.

12.03 TERMS OF LOANS.

(a) Loans shall be made available to all Associates, Members and Beneficiaries on a reasonably equivalent basis.

(b) Loans shall not be made available to Highly Compensated Employees (as defined in Code Section 414(q)) in an amount greater than the amount made available to other Employees.

(c) Loans must be adequately secured using not more than fifty percent (50%) of the Member's Vested Account balance, and bear a reasonable interest rate as determined from time to time by the Committee.

(d) An Associate or Member loan for less than $1,000 is not permitted; provided, however, that if such Associate or Member also receives a loan from the Puerto Rico Plan, such minimum amount limitation shall not apply.

(e) In the event of a default, foreclosure on the note and attachment of security will not occur until a distributable event occurs under the Plan with respect to the Member.

(f) No loans will be made to any Associate or Member who on any day during the Company's applicable fiscal year is a beneficial owner of more than five percent (5%) of the outstanding stock of the Company.

(g) All loans shall be made pursuant to a written Member loan program incorporated herein by reference.

(h) Loans are available from the following accounts, and will be withdrawn from the Members accounts in the following hierarchy:

(a) Member Accounts

(b) Vested Company Accounts

(c) Member Rollover Contribution Accounts

(i) Loans will be taken and repaid from and to the Investment Funds on a pro rata basis, except in the case the Member is subject to Section 16 of the Securities Exchange Act of 1934 or has been designated as a "Designated Insider," in which case such Member's loan will be taken first from such Member's Investment Funds other than the Payless Common Stock Fund.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

SECTION 13

LIMIT ON CONTRIBUTIONS TO THE PLAN

This Section 13 is intended to conform the Plan to the requirements of Code Section 415 and limits the contributions that can be made by and for an individual under the Plan.

13.01 LIMIT ON CONTRIBUTIONS. Notwithstanding any provision of the Plan to the contrary:

(a) The amounts allocated to a Participant during the Limitation Year under the Plan and allocated to the Participant under any other defined contribution plan to which the Employer or any other member of the Group has contributed shall be proportionately reduced, to the extent necessary, so that the Annual Addition does not exceed the least of:

(1) $40,000; or

(2) 100% of the Participant's remuneration from the Employer or any member of the Group during the Limitation Year; or

(3) such other limits set forth in Code Section 415.

The amount set forth in subparagraph (1) above shall automatically be adjusted to reflect adjustments made by applicable law. Remuneration for purposes of this Section means remuneration as defined in Treasury Regulation Section 1.415-2(d)(10) and, effective January 1, 1998, shall also include the deferrals described in Code Section 415(c)(3)(D)(including effective January 1, 2001, elective amounts not included in gross income by reason of Code Section 132(f)(4)).

(b) For purposes of this Section, Limitation Year means the 12 month period commencing on January 1 and ending on December 31.

(c) For purposes of this Section, Annual Additions means the sum for the Limitation Year of Employer contributions, Employee contributions (determined without regard to any rollover contributions as defined in Code Sections 402(a)(5), 403(a)(4), 403(b)(8) and 408(d)(3), without regard to catch-up contributions under Code Section 414(v) and without regard to Employee contributions to a simplified employee pension plan which are excludible from gross income under 408(k)(6) of the Code) and forfeitures.

13.02 ADJUSTMENT FOR EXCESSIVE ANNUAL ADDITIONS.

(a) If, as a result of the allocation of forfeitures, a reasonable error in estimating a Member's Pay or other facts and circumstances to which Treasury Regulation Section 1.415-6(b)(6) shall be applicable, the "annual additions" under this Plan would cause the

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

maximum "annual additions" to be exceeded for any Member, the Committee shall (1) return any Member Contributions credited for the "limitation year" to the extent that the return would reduce the "excess amount" in the Member's Accounts, (2) hold any "excess amount" remaining after the return of any member Contributions in a "Section 415 suspense account", (3) use the "Section 415 suspense account" in the next "limitation year" (and succeeding "limitation years" if necessary) to reduce either Company Contributions for that Member if that Member is covered by the Plan as of the end of the "limitation year" or if such Member is not covered by the Plan at the end of the "limitation year" to reduce Company Contributions for all Members in the Plan, before any Company Contributions or Member Contributions which would constitute "annual additions" are made to the Plan for such "limitation year," (4) reduce Company Contributions for such "limitation year" by the amount of the "Section 415 suspense account" allocated and reallocated during such "limitation year." For purposes of (3) above, the Plan may not distribute "excess amounts" to Members or former Members.

(b) For purposes of this Section, "EXCESS AMOUNT" for any Member for a "limitation year" shall mean the excess, if any, of (1) the "annual additions" which would be credited to his account under the terms of the Plan without regard to the limitations of Code Section 415 over (2) the maximum "annual additions" determined pursuant to Section 13.01(a).

(c) For purposes of this Section, "SECTION 415 SUSPENSE ACCOUNT" shall mean an unallocated account equal to the sum of "excess amount" for all Members in the Plan during the "limitation year." The "Section 415 suspense account" shall not share in any earnings or losses of the Trust Fund.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

SECTION 14

ADMINISTRATION OF THE PLAN

14.01 PLAN ADMINISTRATOR. The Company shall be the Plan Administrator of the Plan for purposes of ERISA and shall be a "named fiduciary" as determined in ERISA Section 402(a)(2).

14.02 DELEGATION OF AUTHORITY.

(a) Authority to administer the Plan has been delegated to the Committee and the Administrative Subcommittee, if any, in accordance with Sections 1.42 (Total and Permanent Disability), 4.01 (Member Contributions), 6.01 (Member Accounts), 6.02 (Company Accounts), 6.05 (Member Statements), 8.02 (Authorized Withdrawals), 13.02 (Adjustment for Excessive Annual Additions), 20.02 (Withdrawal of an Employer) and this Section 14.

(b) Authority with respect to the Investment Funds of the Plan has been delegated to the Trustee in accordance with Sections 7.01 (Administrative Expenses), 5.01(c) (Investment Funds), 15 (Management of the Trust Fund) and 6.06 (shares of Payless ShoeSource, Inc. (Payless Stock) in the Payless Common Stock Fund).

(c) Authority to direct the investment of the Plan's funds has been delegated to the Investment Subcommittee, if any, in accordance with Section 15.03(b), (c) and (d) (Investments and Reinvestments).

(d) The Committee shall also have the authority and discretion to engage an Administrative Delegate who shall perform, without discretionary authority or control, administrative functions within the frame work of policies, interpretations, rules practices and procedures made by the Committee or other Plan Fiduciary. Any action made or taken by the Administrative Delegate may be appealed by an affected Member to the Committee in accordance with the claims review procedure in Section 16.05. Any decisions which call for interpretations of the Plan provisions not previously made by the Committee shall be made only by the Committee. The Administrative Delegate shall not be considered a fiduciary with respect to the services it provides.

14.03 COMMITTEE AND SUBCOMMITTEES.

(a) The Committee may appoint two subcommittees (an "Administrative Subcommittee" and an "Investment Subcommittee"), each Subcommittee to consist of at least three persons, who need not be members of the Board. The Committee and each Subcommittee, if appointed, shall elect from its members a Chairman and a Secretary, and may appoint one or more Assistant Secretaries who may, but need not be, members of the Committee or such Subcommittee, and may employ such agents, such legal counsel and such clerical, medical,

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

accounting, actuarial and other services as it may from time to time deem advisable to assist in the administration of the Plan. The Committee and each Subcommittee may, from time to time, appoint agents and delegate to such agents such duties as it considers appropriate and to the extent that such duties have been so delegated, the agent shall be exclusively responsible for the proper discharge of such duties.

(b) The Administrative Subcommittee shall have the general responsibility for the administration of the Plan and the carrying out of its provisions, and shall have general powers with respect to Plan administration, including, but not limited to, the powers listed in this Section 14.03. The Administrative Subcommittee shall have the discretionary authority to interpret and construe the Plan, the power to establish rules for the administration of the Plan and the transaction of its business, the power to remedy and resolve inconsistencies and omissions, and the power to determine all questions which arise in the administration, interpretation, or application of the Plan, including but not limited to questions regarding the eligibility, status, Account value and any rights of any Member, Beneficiary, and any other person hereunder.

(c) The Investment Subcommittee shall have the powers provided for in Section 15.03(b).

(d) The Committee and each Subcommittee shall act by a majority of its members and the action of such majority expressed by a vote at a meeting, or in writing without a meeting, shall constitute the action of the Committee or such Subcommittee. All decisions, determinations, actions or interpretations with respect to the Plan by the Committee or either Subcommittee and the individual committee or subcommittee members shall be in the Committee's, Subcommittee's or individual member's sole discretion. The decision, determination, action or interpretation of the Committee or either Subcommittee and the respective individual members of the Committee or Subcommittee in respect to all matters within the scope of its authority shall be conclusive and binding on all persons. No member of the Committee or either Subcommittee shall have any liability to any person for any action or omission except each for his own individual willful misconduct. If a Subcommittee is not appointed, the Committee shall exercise such Subcommittee's authority and perform its duties as described herein.

(e) Nothing in this Section 14 or in any other provision of the Plan shall be deemed to relieve any person who is a fiduciary under the Plan for purposes of ERISA from any responsibility or liability for any responsibility, obligation or duty which Part 4 of Title I of ERISA shall impose upon such person with respect to this Plan.

14.04 ACCOUNTS AND REPORTS. The Committee shall maintain or cause to be maintained accounts reflecting the fiscal transactions of the Plan and shall keep in convenient form such data as may be necessary for the administration of the Plan. The Committee shall prepare annually a report showing in reasonable detail the assets and liabilities of the Plan and setting forth a brief account of the operation of the Plan for the preceding year.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

14.05 NON-DISCRIMINATION. Neither the Committee nor either Subcommittee shall exercise its discretion in such a way as to result in discrimination in favor of officers, shareholders or highly compensated employees (within the meaning of Code Section 414(q)).

SECTION 15

MANAGEMENT OF THE TRUST FUND

15.01 USE OF THE TRUST FUND. All assets of the Plan shall be held as a Trust Fund in one or more trusts and shall be used to provide the benefits of this Plan. No part of the corpus or income shall be used for, or diverted to, purposes other than for the exclusive benefit of Members and their Beneficiaries under this Plan and administrative expenses of this Plan.

15.02 TRUSTEES. The Trust Fund may, at the direction of the Company, be divided into one or more separate trusts, each of which may have a separate Trustee appointed from time to time by the Company and subject to removal by the Company. The Trustee or Trustees of each trust shall have complete authority and discretion with respect to the investment and reinvestment of the assets of each trust, subject, however, to (i) the provisions in the Trust Agreements between the Trustee or Trustees and the Company, and (ii) the provisions of this Plan. Any or all of such separate trusts shall be referred to collectively from time to time as the Trust Fund. Any division of the Trust Fund into one or more separate trusts shall be at the direction of the Company.

15.03 INVESTMENTS AND REINVESTMENTS. The investment and reinvestment of the assets of the Trust Fund shall be in accordance with the following:

(a) The Company shall have the authority to instruct the Trustee or Trustees to accept and follow the instructions of any designated investment manager (within the meaning of ERISA Section 3(38)) with respect to the investment and reinvestment of the assets constituting a money market or stable value fund, a fixed income fund, a common stock fund, or any other Investment Funds the Company may designate.

(b) The Investment Subcommittee shall have the powers, with respect to investment and reinvestment of the assets constituting the Investment Funds, to promulgate limitations, restrictions, rules or guidelines with respect to the investment policies and classes of investments in which the assets of the Investment Funds may be invested or reinvested by the Trustee or Trustees, including any such investments made pursuant to the instructions of any investment manager. In the event an investment manager designated pursuant to Section 15.03(a) resigns or otherwise is unable to act, the Investment Subcommittee shall have such power and authority as otherwise would be exercisable by such Investment Manager.

(c) In the event that the assets of the Trust Fund shall be divided into one or more separate trusts pursuant to the authority provided for in Section 15.02, then the powers of the Investment Subcommittee as provided for in Section 15.03(b) may be exercised with respect to one or more of such trusts within the discretion of the Investment Subcommittee.

(d) The powers of the Investment Subcommittee as provided in Section 15.03(b) may be exercised at any time or from time to time by the Investment Subcommittee within the discretion of the Investment Subcommittee and shall be pursuant to a written agreement between

the Investment Subcommittee and the Trustee or Trustees or, if an investment manager has been appointed, between the Investment Subcommittee and the investment manager.

(e) The Trust Agreement between the Company and the Trustee or Trustees implementing the Plan shall contain provisions effectuating the provisions of this Section 15 of the Plan.

SECTION 16

CERTAIN RIGHTS AND OBLIGATIONS OF EMPLOYERS AND MEMBERS

16.01 DISCLAIMER OF EMPLOYER LIABILITY.

(a) No liability shall attach to any Employer with respect to a benefit or claim hereunder and Members and their Beneficiaries, and all persons claiming under or through them, shall have recourse only to the Trust Fund for payment of any benefit hereunder.

(b) The rights of the Members, their Beneficiaries and other persons are hereby expressly limited and shall be only in accordance with the provisions of the Plan. Nothing contained herein shall be deemed to give a Member any interest in any specific property of the Trust or any interest other than a right to receive payments pursuant to the provisions of the Plan.

16.02 EMPLOYER-ASSOCIATE RELATIONSHIP. Neither the establishment of this Plan nor its communication through a Summary Plan Description (or otherwise) shall be construed as conferring any legal or other rights upon any Associate or any other person to continue in employment or as interfering with or affecting in any manner the right of an Employer to discharge any Associate or otherwise act with relation to him. Each Employer may take any action (including discharge) with respect to any Associate or other person and may treat him without regard to the effect which such action or treatment might have upon him as a Member of this Plan.

16.03 BINDING EFFECT. Each Member, by executing an enrollment form, beneficiary designation and otherwise agreeing to participate in the Plan agrees for himself, his beneficiary(ies), heirs, successors and assigns to be bound by all of the provisions of the Plan.

16.04 CORPORATE ACTION. With respect to any action permitted or required by the Plan, the Company may act through its appropriate officers.

16.05 CLAIM AND APPEAL PROCEDURE. A Member or beneficiary may file with the Committee or its designee at any time a written claim in connection either with a benefit payable hereunder or otherwise. The Committee or its designee, normally within 90 days after receipt of a written claim, shall render a written decision on the claim, unless an additional 90 days is required by special circumstances which shall be explained to the claimant. If the claim is denied, either in whole or in part, the decision shall include the reason or reasons for the denial; a specific reference to the Plan provision or provisions which are the basis for the denial; a description of any additional material or information necessary for the claimant to perfect the claim; an explanation as to why the information or material is necessary; and an explanation of the Plan's entire claim procedure. The claimant may file with the Committee, within 60 days after receiving the written decision from the Committee, a written notice of request for review of the Committee's decision. The review shall be made by a committee of up to three individuals (which may include members of the Committee) appointed by the Company or by the Committee. Said committee

shall render a written decision on the claim containing the specific reasons for their decision, including a reference to the Plan's provisions, normally within 60 days after receipt of the request for review, unless an additional 60 days is required by special circumstances which shall be explained to the claimant. If a Member or beneficiary does not file written notice of a claim with the Committee or its designee at the times set forth above, he shall have waived any right to a benefit other than as originally proposed by the Company or the Committee.

SECTION 17

NON-ALIENATION OF BENEFITS

17.01 PROVISIONS WITH RESPECT TO ASSIGNMENT AND LEVY. No benefit payable under this Plan shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, levy or charge, and any attempt so to anticipate, alienate, sell, transfer, assign, encumber, levy upon or charge the same shall be void; nor shall any such benefit be in any manner liable for or subject to the debts, contracts, liabilities, engagements or torts of the person entitled to such benefit, except as specifically provided herein. Notwithstanding the foregoing, the creation, assignment, or recognition of a right to any benefit payable to an alternate payee with respect to a Qualified Domestic Relations Order shall not be treated as an assignment or alienation prohibited by this Section. Any other provision of the Plan to the contrary notwithstanding, if a Qualified Domestic Relations order requires the distribution of all or part of a Member's benefits under the Plan, the establishment or acknowledgment of the alternate payee's right to benefits under the Plan in accordance with the terms of such Qualified Domestic Relations Order shall in all events be deemed to be consistent with the terms of the Plan.

Notwithstanding the above a Member's benefit will be offset against any amount he or she is ordered or required to pay to the Plan pursuant to an order or requirement which arises under a judgment of conviction for a crime involving the Plan, under a civil judgment entered by a court in an action involving a fiduciary breach, or pursuant to a settlement agreement between the Participant and the Department of Labor or the Pension Benefit Guaranty Corporation. Any such offset shall be made pursuant to Section 206(d) of ERISA.

17.02 ALTERNATE APPLICATION. If a Member or Beneficiary under this Plan becomes bankrupt or attempts to anticipate, alienate, sell, transfer, assign, pledge, encumber or charge any benefit under this Plan, except as specifically provided herein, or if any benefit shall, in the discretion of the Committee, cease, and in that event the Committee may hold or apply the same or any part thereof to or for the benefit of such Member or Beneficiary, his spouse, children or other dependents, or any of them, or in such other manner and in such proportion as the Committee may deem proper.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

SECTION 18

AMENDMENTS

18.01 COMPANY'S RIGHTS. The Company reserves the right at any time and from time to time in its sole discretion to alter, amend, or modify, in whole or in part, any or all of the provisions of this Plan, provided, however, no such alteration, amendment or modification shall be made which shall decrease the accrued benefit of any Member. Anything in this Plan to the contrary notwithstanding, the Company in its sole discretion may make any modifications or amendments, additions or deletions in or to this Plan as to benefits or otherwise and retroactively if necessary, and regardless of the effect thereof on the rights of any particular Member or Beneficiary, which it deems appropriate and/or necessary in order to comply with or satisfy any conditions of any law or regulation relating to the qualification of this Plan and the trust or trusts created pursuant hereto and to keep this Plan and said trusts qualified under Code Section 401(a) and to have the trust or trusts declared exempt from taxation under Code Section 501(a).

18.02 PROCEDURE TO AMEND. This Plan may be amended by action of the Company's Board of Directors and evidenced by a written amendment signed by the Company's Secretary or by any other person so authorized by or pursuant to authority of the Board of Directors.

18.03 PROVISION AGAINST DIVERSION. No part of the assets of the Trust Fund shall, by reason of any modification or amendment or otherwise, be used for, or diverted to, purposes other than for the exclusive benefit of Members and their Beneficiaries under this Plan and administrative expenses of this Plan.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

SECTION 19

TERMINATION

19.01 RIGHT TO TERMINATE. The Company reserves the right to terminate this Plan, in whole or in part, at any time and, if this Plan shall be terminated either in its entirety or with respect to any Employer included hereunder, the provisions of Section 19.03 shall apply and the Accounts of affected Members shall become (or remain) fully vested and nonforfeitable.

19.02 WITHDRAWAL OF AN EMPLOYER. If an Employer shall cease to be a participating Employer in this Plan, the Trust Fund and the Accounts of the Members of the withdrawing Employer and their Beneficiaries shall be revalued as if such withdrawal date were a Valuation Date. The Committee shall then direct the Trustee either to distribute the Accounts of the Members of the withdrawing Employer as of the date of such withdrawal on the same basis as if the Plan had been terminated pursuant to Section 19.03 or to deposit in a trust established by the withdrawing Employer pursuant to a plan substantially similar to this Plan assets equal in value to the assets of the Trust Fund allocable to the Accounts of the Members of the withdrawing Employer.

19.03 DISTRIBUTION IN EVENT OF TERMINATION OF TRUST. If this Plan is terminated at any time including a partial termination as defined in Code Section 411(d)(3), or if contributions are completely discontinued and the Company determines that the trust shall be terminated, in whole or in part, the Trust Fund and all Accounts shall be revalued as if the termination date were a Valuation Date and the affected Members' Accounts shall be distributed in accordance with Section 10.

19.04 ADMINISTRATION IN EVENT OF CONTINUANCE OF TRUST. If this Plan shall be terminated in whole or in part or contributions completely discontinued but the Company determines that the trust shall be continued pursuant to the terms of the Trust Agreement, the trust shall continue to be administered as though the Plan were otherwise in effect. Upon the subsequent termination of the trust, in whole or in part, the provisions of Section 19.03 shall apply.

19.05 MERGER, CONSOLIDATION OR TRANSFER. In the case of any merger or consolidation with, or transfer of Plan assets or liabilities to, any other plan, each Member shall be entitled to receive a benefit immediately after the merger, consolidation or transfer (if the transferee plan then terminated) which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation or transfer (if the Plan had then terminated).

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

SECTION 20

CONSTRUCTION

20.01 APPLICABLE LAW. The provisions of this Plan except as otherwise governed by ERISA shall be construed, regulated, administered and enforced according to the laws of the State of Kansas and, whenever possible, to be in conformity with the applicable requirements of ERISA and the Internal Revenue Code.

20.02 GENDER AND NUMBER. Wherever applicable, the masculine pronoun as used herein shall include the feminine pronoun and the singular pronoun shall include the plural.

Source: PAYLESS SHOESOURCE I, 10−K, April 07, 2006

SECTION 21

TOP-HEAVY REQUIREMENTS

21.01 GENERALLY. For any Plan Year in which the Plan is a Top-Heavy Plan, the provisions of Sections 21.02 and 21.03 shall automatically take effect in accordance with Code Section 416.

21.02 MINIMUM ALLOCATIONS.

(a) Minimum Employer Allocations and allocations of Plan forfeitures for a Member who is not a Key Employee shall be required under the Plan for the Plan Year as set forth in Section 21.02 (b) and(c).

(b) The amount of the minimum allocation shall be the lesser of the following, percentages of Pay: (i) four percent (4%) or, (ii) the highest percentage at which such allocations are made under the Plan for the Plan Year on behalf of a Key Employee. For purposes of this paragraph (b), all defined contribution plans required to be included in an Aggregation Group shall be treated as one plan. This paragraph (b) shall not apply if the Plan is required to be included in an Aggregation Group and the Plan enables a defined benefit plan required to be included in the Aggregation Group to meet the requirement of Code Sections 401(a)(4) or 410. For purposes of this paragraph (b), the calculation of the percentage at which allocations are made for a Key Employee shall be based only on his Pay not in excess of $200,000, such amount to be adjusted periodically for increases in the cost of living in accordance with Code Section 401(a)(17). The minimum allocation described in this paragraph (b) shall be in addition to (and shall not be reduced by) any Member Contributions under Section 4 (whether Before-Tax or After-Tax) and any allocation of forfeitures, if any, to which a Member may be entitled.

(c) For purposes of this Section 21.02, the term "Member" shall be deemed to refer to all Members who have not separated from service at the end of the Plan Year including, without limitation, individuals who declined to make contributions to the Plan.

21.03 PARTICIPANTS UNDER DEFINED BENEFIT PLANS. If any Member other than a Key Employee is also a participant under a defined benefit plan of an Employer which is a Top-Heavy Plan, then Section 21.03(a) shall not apply and the required minimum annual contribution for such Member under this Plan shall be 7 percent (7 %) of such Member's Pay. Such contribution shall be made without regard to the amount of contribution, if any, made to the Plan on behalf of Employees.

21.04 DETERMINATION OF TOP HEAVINESS.

(a) The determination of whether a plan is Top-Heavy shall be made in accordance with paragraphs (b) through (d) of this Section 21.04.

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

(b) If the Plan is not required to be included in an Aggregated Group with other plans, then it shall be Top-Heavy only if when considered by itself, it is a Top-Heavy Plan and it is not included in a permissive Aggregation Group that is not a Top-Heavy Group.

(c) If the Plan is required to be included in an Aggregation Group with other plans, it shall be Top-Heavy only if the Aggregation Group, including any permissively aggregated plans, is Top-Heavy.

(d) If a plan is not a Top-Heavy Plan and is not required to be included in an Aggregation Group, then it shall not be Top-Heavy even if it is permissively aggregated in an Aggregation Group which is a Top-Heavy Group.

21.05 CALCULATION OF TOP-HEAVY RATIOS. A plan shall be Top-Heavy and an Aggregation Group shall be a Top-Heavy Group with respect to any Plan Year as of the Determination Date if the sum as of the Determination Date of the Cumulative Accrued Benefits and the Cumulative Accounts of Employees who are Key Employees for the Plan Year exceeds 60 percent (60%) of a similar sum determined for all Employees, excluding former Key Employees.

21.06 CUMULATIVE ACCOUNTS AND CUMULATIVE ACCRUED BENEFITS.

(a) The Cumulative Accounts and Cumulative Accrued Benefits for any Employee shall be determined in accordance with paragraphs (b) through (e) of this Section 21.06.

(b) Cumulative Account shall mean the sum of the amount of an Employee's accounts under a defined contribution plan (for an unaggregated plan) or under all defined contribution plans included in an Aggregation Group (for aggregated plans) determined as of the most recent plan Valuation Date within a 12-month period ending on the Determination Date, increased by any allocations due after such Valuation Date and before the Determination Date.

(c) Cumulative Accrued Benefit means the sum of the present value of an Employee's accrued benefits under a defined benefit plan (for an unaggregated plan) or under all defined benefit plans included in an Aggregation Group (for aggregated plans), determined under the actuarial assumptions set forth in such plan or plans, as of the most recent plan Valuation Date within a 12-month period ending on the Determination Date as if the Employee voluntarily terminated service as of such Valuation Date.

(d) Accounts and benefits shall be calculated to include all amounts attributable to both Matching Allocations and Employee contributions but excluding amounts attributable to voluntary deductible Employee contributions.

(e) Accounts and benefits shall be increased by the aggregate distributions during the one-year period ending on the Determination Date made with respect to an Employee

Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

under the plan or plans as the case may be or under a terminated plan which, if it had not been terminated, would have been required to be included in the Aggregation Group. In the case of a distribution made for a reason other than separation from service, death, or disability, this provision shall be applied by substituting "five-year period" for "one-year period."

(f) Rollovers and direct plan-to-plan transfers shall be handled as follows:

(i) If the transfer is initiated by the Employee and made from a plan maintained by one Employer to a plan maintained by another Employer, the transferring plan continues to count the amount transferred under the rules for counting distributions. The receiving plan does not count the amount if accepted after December 31, 1983, but does count it if accepted prior to December 31, 1983.

(ii) If the transfer is not initiated by the Employee or is made between plans maintained by the Employers, the transferring plan shall no longer count the amount transferred and the receiving plan shall count the amount transferred.

(iii) For purposes of this subsection (f), all Employers aggregated under the rules of Code Sections 414(b), (c) and (m) shall be considered a single employer.

(g) The accrued benefits and accounts of any individual who has not performed services for the Employer during the one-year period ending on the Determination Date shall not be taken into account.

21.07 OTHER DEFINITIONS.

(a) Solely for purposes of this Section 21, the definitions in paragraphs (b) through (i) of this Section 21.07 shall apply, to be interpreted in accordance with the provisions of Code Section 416 and the regulations thereunder.

(b) Aggregation Group means a plan or group of plans which included all plans maintained by the Employer in which a Key Employee is a participant or which enables any plan in which a Key Employee is a participant to meet the requirements of Code Section 401(a)(4) or Code Section 410, as well as all other plans selected by the Company for permissive aggregation, the inclusion of which would not prevent the group of plans from continuing to meet the requirements of such Code sections.

(c) Determination Date means, with respect to any Plan Year, the last day of the preceding Plan Year.

(d) Employee means any person employed by an Employer and shall also include any Beneficiary of such persons, provided that the requirements of Sections 21.02 and 21.03 shall not apply to any person included in a unit of Employees covered by an agreement

which the Secretary of Labor finds to be a collective bargaining agreement between Employee representatives and one or more Employers if there is evidence that retirement benefits were the subject of good faith bargaining between such Employee representatives and such Employer or Employers.

(e) Employer means any corporation which is a member of a controlled group of corporations (as defined in Code Section 414(b)) which includes the Company or any trades or businesses (whether or not incorporated) which are under common control (as defined in Code Section 414(c)) with the Company, or a member of an affiliated service group (as defined in Code Section 414(m)) which includes the Company,

(f) Key Employee means any Employee or former Employee (including any deceased Employee) who is, at any time during the Plan Year which includes the Determination Date, any one or more of the following: (1) an officer of an Employer who has annual Pay of more $130,000 (as adjusted under Code Section 416(i)(1))(2) any person owning (or considered as owning within the meaning of the Code Section 318) more than five percent of the outstanding stock of an Employer or stock possessing more than five percent of the total combined voting power of such stock; (3) a person who would be described in subsection (2) above if "one percent" were substituted for "five percent" each place it appears in subsection (2) above, and who has annual Pay of more than $150,000 (for purposes of determining ownership under this subsection, Code Section 318(a)(2)(C) shall be applied by substituting "five percent" for "50 percent" and the rules of subsections (b), (c) and (m) of Code Section 414 shall not apply).

IN WITNESS WHEREOF, the Company has caused this amended Plan to be executed by a duly authorized officer effective November 10, 2005.

PAYLESS SHOESOURCE, INC.

By: /s/ Jay A. Lentz

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Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

EXHIBIT 10.15

PAYLESS SHOESOURCE, INC.

STOCK OWNERSHIP PLAN

(as amended January 1, 2006)

1. PURPOSE AND EFFECT OF PLAN

The purpose of the Plan is to provide associates, including executive officers, an opportunity to purchase Common Stock of Payless ShoeSource, Inc. (the "Company") through payroll deductions at a discount on a tax deferred basis. It is believed that this will help attract, motivate and retain highly qualified and talented associates who are important to the Company's success. The Plan is also intended to offer equity ownership in the Company to associates to encourage them to enhance the value of the Company and therefore the price of the Company's Common Stock and the shareowners' return.

The Plan is intended to comply with Code section 423 and to be a "tax conditioned plan" within the meaning of SEC Rule 16b-3(c).

2. SHARES RESERVED FOR THE PLAN

There shall be reserved for issuance and purchase by Eligible Associates under the Plan an aggregate of 2,000,000 shares of Common Stock, subject to adjustment as provided in Section 16. Shares purchased for the Plan shall be purchased in the open market or in private transactions, or a combination thereof.

3. DEFINITIONS

Where indicated by initial capital letters, the following terms shall have the following meanings:

ACT: The Securities Exchange Act of 1934.

BASE COMPENSATION: The regular earnings of an Eligible Associate (before withholding or other deductions), including overtime, after any salary

reduction contributions pursuant to elections under a plan subject to Code sections 125 or 401(k) and excluding bonuses and any other special payments; provided, that the Committee may expand or narrow the definition of Base Compensation from time to time so long as such definition is consistent with the requirements of Section 423 of the Code.

BOARD: The Board of Directors of the Company.

BUSINESS DAY: Each day on which shares of Common Stock are or could be traded on the New York Stock Exchange, or such other definition as the Committee may from time to time specify.

CODE: The Internal Revenue Code of 1986, as amended, or any subsequently enacted federal revenue law. A reference to a particular section of the Code shall include a reference to any regulations issued under the section and to the corresponding section of any subsequently enacted federal revenue law.

COMMITTEE: The committee established pursuant to Section 13 to be responsible for the general administration of the Plan.

COMMON STOCK: The Company's common stock, $.01 par value.

COMPANY: Payless ShoeSource, Inc., a Missouri corporation, provided, that immediately after the effective time of the Merger such term shall mean Payless ShoeSource, Inc. (formerly Payless ShoeSource Holdings, Inc.), a Delaware corporation, and any successor by merger, consolidation or otherwise.

ELIGIBLE ASSOCIATE: Each employee, including each executive officer, of the Company and its domestic Subsidiaries who meet the eligibility requirements of Section 4.

EMPLOYER: A Participating Company that is the employer of a Participant.

ENROLLMENT PROCEDURE: The procedure specified from time to time by the Committee to enable an Eligible Associate to participate in the Plan and to authorize payroll deductions pursuant to Section 5.

FAIR MARKET VALUE: The weighted average price per share paid for all shares purchased on the date in question with respect to a determination of the Purchase Price of Common Stock purchased other than from the Company by an independent trustee or purchasing agent in arms-length transactions. For all other purposes, Fair Market Value shall mean the average of the reported lowest and highest sales prices per share for the Common Stock on the New York Stock Exchange on the date in question, or, if there are no such sales on that date, the reported lowest and highest sales prices per share for the Common Stock on the New York Stock Exchange for the last Business Day prior to the date in question for which sales of the Common Stock were reported.

INVESTMENT ACCOUNT: The account established for each Participating Associate to hold Common Stock purchased under the Plan pursuant to Section 5.

INVESTMENT DATE: The date on which the shares of Common Stock are purchased for the Plan.

"MERGER" means the merger of Payless Merger Corp., a Missouri corporation and wholly-owned subsidiary of Payless ShoeSource, Inc. (formerly Payless ShoeSource Holdings, Inc.), a Delaware corporation, with the Company, pursuant to an Agreement and Plan of Merger among the Company, Payless Merger Corp. and Payless ShoeSource, Inc. (formerly Payless ShoeSource Holdings, Inc.).

MONTH: A calendar month.

PARENT: Any corporation (other than the Company) in an unbroken chain of corporations ending with the Company if, as of an Investment Date, each of the corporations other than the Company owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

PARTICIPATING COMPANIES: The Company and its domestic Subsidiaries.

PARTICIPANT OR PARTICIPATING ASSOCIATE: Eligible Associates who elect to participate in the Plan pursuant to Section 5.

PAYROLL DEDUCTION ACCOUNT: The account established for a Participating Associate to hold payroll deductions pursuant to Section 5.

PLAN: The "Payless ShoeSource, Inc. Stock Ownership Plan," as set forth herein and as amended from time to time.

PURCHASE PRICE: The price for each whole and fractional share of Common Stock, including those purchased by dividend reinvestment, which shall be 95% of the Fair Market Value of such whole or fractional share on the Investment Date; provided, however, the Committee may change such purchase price so long as the purchase price is not lower than the lesser of (i) 85% of the Fair Market Value of the Common Stock on the first day of the applicable purchase period, and (ii) 85% of the Fair Market Value of the Common Stock on the Investment Date.

PURCHASE PERIOD: That period specified by the Committee during which payroll deductions shall be accumulated for the purchase of Common Stock under the Plan; provided, that such period shall not have a duration that exceeds the limitations provided in Section 423(b)(7) of the Code.

RULE 16B-3: Rule 16b-3 of the Securities and Exchange Commission promulgated under the Act, as now and hereafter amended.

SUBSIDIARY OR SUBSIDIARIES: Any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company if, as of an Investment Date, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

TRUSTEE: The trustee of the Plan designated by the Committee as provided in Section 13.

4. ELIGIBLE ASSOCIATES

Participation in the Plan shall be open to each associate of a Participating Company (including each executive officer of the Company) who has been continuously employed by one or more Participating Companies for at least six months; provided, that the Committee may establish such other or different employment requirements as it may deem appropriate so long as such other or different requirements are consistent with the provisions of Section 423 of the Code. For purposes of this section any break in service of less than thirty days shall not be deemed to constitute a discontinuance of employment, unless the Committee shall otherwise provide.

No director of the Company or of any its Subsidiaries who is not an associate shall be eligible to participate in the Plan.

5. ELECTION TO PARTICIPATE; METHOD OF PURCHASE; INVESTMENT ACCOUNTS; DIVIDENDS

5.1 ELECTION TO PARTICIPATE. Each Eligible Associate may become a Participant effective on the first day of any Month coincident with or following the date the Participant becomes an Eligible Associate by complying with the Enrollment Procedure authorizing specified regular payroll deductions from the Participant's Base Compensation. Such regular payroll deductions shall be subject to a minimum deduction of $5.00 per weekly pay period and $10.00 per bi-weekly pay period and a maximum deduction of $480.00 per weekly pay period and $960.00 per bi-weekly pay period; provided, that the Committee may increase or decrease such minimum and maximum deductions from time to time. All regular payroll deductions shall be credited to the Payroll Deduction Account that the Company has established in the name of the Participant.

5.2 PURCHASE OF COMMON STOCK. Each Participating Associate having eligible funds in the Participant's Payroll Deduction Account on an Investment Date shall be deemed, without any further action, to have purchased the number of shares which the eligible funds in the Participant's Payroll Deduction Account could purchase at the Purchase Price on that Investment Date. All shares purchased shall be maintained by the Trustee in separate Investment Accounts for Participating Associates. Fractional shares will be allocated to accounts under the Plan unless the Committee otherwise provides; provided that share certificates shall only be issued for whole shares. If fractional shares are not allocated to accounts under the Plan, amounts that otherwise would have been applied to the purchase of fractional shares will continue to be held for the Participant and be applied towards the purchase of shares on the last day of the next Purchase Period.

5.3 TIMING AND MANNER OF PURCHASE. The Committee shall designate Purchase Periods during which funds shall be accumulated in Payroll Deduction Accounts for the purchase of Common Stock. Until otherwise specified the Purchase Periods shall consist of each Month in a year. The Investment Date shall occur during an interval immediately following the end of each Purchase Period having such duration as the Committee shall from time to time specify, provided that until the Committee otherwise specifies, such interval shall be the ten Business Days immediately following the end of the Purchase Period. However, nothing contained in this Plan shall authorize the Committee, the Company or any affiliate of the Company to exercise any direct or indirect control or influence over the times when, or the prices at which, the

Trustee or its independent agent may purchase the Common Stock for the Plan, the amounts of the Common Stock to be purchased, the manner in which the Common Stock is to be purchased, or the selection of a broker or dealer (other than the Trustee) through which purchases may be executed; provided, that the Company, the Committee and affiliates of the Company, shall not be deemed to have such control or influence solely because the Committee revises not more than once in any three month period the basis for determining the amount of the Company's contributions to the Plan, the basis for determining the frequency of the Company's allocations to the Plan, or any formula in the Plan that determines the amount or timing of shares to be purchased by the Trustee.

5.4 DIVIDENDS AND OTHER DISTRIBUTIONS. All cash dividends paid with respect to the whole and fractional shares of the Common Stock and shares so purchased shall be reinvested in Common Stock on the immediately following Investment Date and added to the shares held for a Participating Associate in the Participant's Investment Account. Stock dividends and stock splits received by the Plan will be credited to Participants having Common Stock allocated to their Investment Account to the extent that they are attributable to such allocated Common Stock. Property, other than shares of Common Stock or cash, received by the Trustee as a distribution with respect to Common Stock allocated to Participant Common Stock accounts will be distributed in kind to Participants in proportion to the number of shares of Common Stock contained in their Investment Account.

5.5 STOCK PURCHASES. The Trustee shall effect purchases of Common Stock on the open market or in private transactions. Purchases shall be made using total amounts contained in all Payroll Deduction Accounts immediately preceding the purchase. The Company will pay the difference between the Purchase Price and the price at which such shares are purchased for the Plan on or prior to the required closing date for the purchase. Expenses incurred in the purchase of shares shall also be paid by the Company.

5.6 PAYMENT OF DEDUCTIONS TO THE TRUSTEE. Participating Companies shall pay to the Trustee or to the order of the Trustee payroll deductions made during a Month prior to the time required for the closing of purchases of Common Stock for the Plan, as directed by the Committee. Interest shall not accrue on any amount paid to the Trustee or otherwise allocated to an Investment Account pending investment in Common Stock or other distribution.

6. CHANGE IN PARTICIPATION, WITHDRAWALS AND DISTRIBUTIONS

6.1 PERIOD OF PARTICIPATION. After an Eligible Associate has become a Participant in the Plan, such participation will continue thereafter, so long as the Plan continues in effect, until the employment of the Participant with all Participating Companies terminates, the Participant ceases to make contributions to the Plan and makes a complete withdrawal from the Plan, or the Participant ceases to be an Eligible Associate.

6.2 CHANGE IN PARTICIPATION. A Participant may change the amount of the Participant's payroll deductions in accordance with rules established by the Committee.

6.3 PARTIAL WITHDRAWALS. The Trustee shall deliver whole shares allocated to a Participant's Investment Account upon written request for a partial withdrawal received in accordance with rules established by the

Committee so long as the Participant's Investment Account following such delivery contains at least one share or such other amount as the Committee may from time to time require. Deliveries shall be made as soon as practicable after the request is received.

6.4 COMPLETE WITHDRAWAL, TERMINATION OF EMPLOYMENT, DEATH. A Participant may effect a complete withdrawal from the Plan by giving notice in accordance with rules established by the Committee. A withdrawal from the Plan shall also be deemed to occur at such time as the Participant ceases to be an Eligible Associate for any reason, including death, or upon the occurrence of such other event as may herein be specified as one which triggers a withdrawal. The Employer shall give prompt notice to the Trustee of such withdrawal. Upon any such withdrawal the Participant, or the Participant's beneficiary or estate in the case of death, shall be entitled to receive from the Trustee, as soon as practicable after the Trustee shall have completed its purchases of Common Stock hereunder with all funds attributable to amounts received by the Trustee with respect to the part of the Purchase Period that precedes the effective date of such withdrawal: (a) the number of whole shares of Common Stock credited to the account of such Participant, (b) cash in the amount of any fractional share credited to the Participant's Investment Account and (c) any cash balance credited to such Participant's Accounts which has not been invested by the Trustee. In the case of the death of the Participant the deliveries shall be made to the beneficiary designated by the Participating Associate in a writing filed with the Company. If no beneficiary has been designated, or if the designated beneficiary does not survive the Participating Associate, such amount and all shares shall be delivered to the Participant's estate.

6.5 PLAN RE-ENTRY; SUSPENSION DURING APPROVED LEAVE. A Participant who withdraws from the Plan and continues to otherwise be an Eligible Associate may re-enter the Plan in accordance with such rules as the Committee may establish; provided that until the Committee otherwise specifies, re-entry may be effected at any time in accordance with the Enrollment Procedure. A Participant whose contributions under the Plan shall have been temporarily discontinued shall not be considered to have withdrawn from the Plan.

7. REGISTRATION OF SHARES

The shares to be delivered to a Participant will be issued in such registration as shall have been specified by the Participant in accordance with procedures established by the Committee. The Committee may, in its discretion, restrict the use of any form of registration other than registration solely in the name of the Participant and may permit such other registrations as may be permitted under Section 423 of the Code and related Code sections and rules. The shares of a Participant who is a minor may, with the consent of the Committee, and upon written instructions by such associate, be registered in the name of an adult as custodian for such minor associate.

8. REQUIRED NOTICE OF SUBSEQUENT SALE

As a condition of participation in the Plan, each Participating Associate agrees to notify the Company if the Participant sells or otherwise disposes of any of the Participant's shares of Common Stock within two years of the Investment Date on which such shares were purchased.

9. STATEMENT OF ACCOUNT

As soon as practicable after the end of each calendar quarter each Participant will receive from the Trustee or the Company a statement of the Participant's account with respect to such period, subject to the right of the Committee to prescribe the form and content of such statement and to otherwise change the frequency, coverage and delivery of such statement.

10. EXERCISE OF VOTING AND OTHER RIGHTS

Prior to the time when the Trustee makes delivery to the Participating Associate of the shares of Common Stock held in the Participant's Investment Account, the Trustee will exercise all voting rights pertaining to the shares of Common Stock allocated to the Investment Account of each Participant only in accordance with written directions, if any, given to the Trustee by such Participant prior to the date fixed for the exercise of such voting rights. In the absence of such direction, the Trustee shall not vote allocated shares but may vote any unallocated Common Stock in its discretion. All stock rights or offers received by the Trustee with respect to any Common Stock held by it hereunder shall be exercised by the Trustee to the extent appropriately specified in writing by Participants with respect to Common Stock allocated to the Investment Accounts of such Participants. Rights or offers relating to any unallocated Common Stock shall be exercised or otherwise disposed of by the Trustee in its discretion.

11. DESIGNATION OF BENEFICIARY

A Participant may file with the Company a written designation of a beneficiary with respect to the assets in the accounts of the Participant in the event of the Participant's death, provided that no such designation shall be effective unless so filed prior to the death of the Participant. The written designation of a beneficiary filed with the Company may be changed or revoked by the sole action of the Participant unless such action is precluded by statute. If upon the death of a Participant there is doubt as to the right of any beneficiary to receive any amount, the Committee may direct the Trustee to retain such amount, without liability for any interest thereon, until the rights thereto are determined, or the Committee may direct the Trustee to distribute such amount into any court of appropriate jurisdiction, in either of which events neither the Trustee nor the Committee nor any Employer shall be under any further liability to anyone with respect to such amount.

12. SALE OF SHARES

A Participating Associate shall have the right to direct the Trustee to sell shares in the Participant's Investment Account in lieu of a withdrawal or distribution of the shares in kind; provided that the Committee may adopt rules regulating such elections, the timing of such sales, and requirements that sales be aggregated with other sales. The Committee may also choose to completely or temporarily suspend or terminate such rights. Upon any permitted direction to sell, the Trustee will sell all shares allocated to the Investment Account that are covered by the direction together with any fractional interest that may be aggregated with other fractional interests into a whole share, and remit the proceeds of such sale, less brokerage commissions and other selling expenses to the Participant or other permitted distributee. The Trustee may, consistent with applicable securities laws, sell the shares in private transactions, in the open market, or to the Company. If so directed the Trustee shall sell the shares to the Company. Any sale of shares to the Company shall be effected at Fair Market Value on the date of purchase.

13. ADMINISTRATION OF THE PLAN

13.1 THE COMMITTEE. The Plan shall be administered by the Committee, which shall consist of not less than two members appointed by the Board. Committee members shall be directors, officers or salaried employees of the Company. The Board from time to time may appoint members previously appointed and may fill vacancies, however caused, in the Committee.

13.2 THE TRUSTEE. The Committee will designate one or more individuals, a bank, trust company or investment firm having trust powers to act as trustee under the Plan (the "Trustee"), with the right in the Committee to change such designation in its discretion. The Trustee will hold all funds received by it under the Plan and, until delivery thereof to the Participants hereunder, all shares of Common Stock acquired by the Trustee under the Plan. The Trustee may rely on all orders, requests, and instructions with respect to the Plan given in writing and signed by any person authorized by the Committee or the Company's Board of Directors, and the Trustee shall not be liable to any person for any action taken in accordance therewith. The Trustee or such other agent as the Trustee may appoint to effect purchases under the Plan shall be an "agent independent of the issuer" within the meaning of Regulation M of the Securities and Exchange Commission, as amended.

13.3 AUTHORITY OF THE COMMITTEE. Subject to the express provisions of the Plan, the Committee shall have the authority to take any and all actions (including directing the Trustee as to the acquisition of shares) necessary to implement the Plan, to interpret the Plan, to prescribe, amend and rescind rules and regulations relating to it, and to make all other determinations necessary or advisable in administering the Plan. All of such determinations shall be final and binding upon all persons. A quorum of the Committee shall consist of a majority of its members and the Committee may act by vote of a majority of its members at a meeting at which a quorum is present, or without a meeting by a written consent to the action taken signed by all members of the Committee. The Committee may request advice or assistance or employ such other persons as are necessary for proper administration of the Plan. To the extent that the Committee exercises discretionary authority with respect to the establishment and modification of rules, regulations and guidelines for the administration of the Plan, such rules and rule changes shall be made to apply uniformly to all Participants, consistent with the requirements of Section 423 of the Code.

14. LIMITATION ON PURCHASES

No Participating Associate may purchase during any one calendar year under the Plan (or under any other plan of the Company, a Parent or Subsidiary qualified under Code section 423) shares of Common Stock having an aggregate Fair Market Value (determined by reference to the Fair Market Value on each Investment Date) in excess of the limitations of Code section 423(b)(8).

A Participating Associate's Payroll Deduction Account may not be used to purchase Common Stock on any Investment Date to the extent that after such purchase the Participating Associate would own (or be considered as owning within the meaning of Code section 424(d)) stock possessing 5 percent or more of the total combined voting power of the Company or its Parent or Subsidiary. For this purpose, Common Stock which the Participating Associate may purchase under any outstanding rights to purchase shall be treated as owned by such Participating Associate. As of the first Investment Date on which this

paragraph limits a Participating Associate's ability to purchase Common Stock, the associate shall cease to be an Eligible Associate.

15. RIGHTS NOT TRANSFERABLE

Rights under the Plan are not transferable by a Participating Associate otherwise than by will or the laws of descent and distribution, and are exercisable, during the Associate's lifetime, only by the Associate.

16. CHANGE IN CAPITAL STRUCTURE

In the event of a stock dividend, stock split or combination of shares, recapitalization or merger in which the Company is the surviving corporation or other change in the Company's capital stock (including, but not limited to, the creation or issuance to shareholders generally of rights, options or warrants for the purchase of Common Stock or preferred stock of the Company), the number and kind of shares of stock or securities of the Company to be subject to the Plan, the maximum number of shares or securities which may be delivered under the Plan, the selling price and other relevant provisions shall be appropriately adjusted by the Committee, whose determination shall be binding on all persons.

If the Company is a party to a consolidation or a merger in which the Company is not the surviving corporation, a transaction that results in the acquisition of substantially all of the Company's outstanding stock by a single person or entity, or a sale or transfer of substantially all of the Company's assets, the Committee may take such actions with respect to the Plan as the Committee deems appropriate.

Notwithstanding anything in the Plan to the contrary, the Committee may take the foregoing actions without the consent of any Participant, and the Committee's determination shall be conclusive and binding on all persons for all purposes.

17. AMENDMENT OF THE PLAN

The Board of Directors may at any time, or from time to time, amend the Plan in any respect; provided, however, that the shareholders of the Company must approve any amendment that would (i) increase the number of securities that may be issued under the Plan, or (ii) modify the requirements as to eligibility for participation in the Plan.

18. TERMINATION OF THE PLAN

The Plan and all rights of associates hereunder shall terminate:

a. on the Investment Date that Participating Associates become entitled to purchase a number of shares greater than the number of reserved shares remaining available for purchase; or

b. at any date at the discretion of the Board of Directors.

In the event that the Plan terminates under circumstances described in (a) above, reserved shares remaining as of the termination date shall be issued to Participating Associates on a pro rata basis. Upon termination of the Plan, all

amounts in an associate's Payroll Deduction Account that are not used to purchase Common Stock will be refunded.

19. EFFECTIVE DATE OF PLAN

The Plan was approved by the Board of Directors on March 20, 1997, and shall become effective on August 1, 1997, subject to receiving shareholder approval.

20. GOVERNMENT AND OTHER REGULATIONS

The Plan, and the grant and exercise of the rights to purchase shares hereunder, and the Company's obligation to sell and deliver shares upon the exercise of rights to purchase shares, shall be subject to all applicable federal, state and foreign laws, rules and regulations, and to such approvals by any regulatory or government agency as may, in the opinion of counsel for the Company, be required.

21. INDEMNIFICATION AND LIABILITY OF COMMITTEE AND TRUSTEE

The Committee and all persons employed by each Participating Company who are engaged in administering the Plan shall be entitled to rely upon all valuations, certificates and reports furnished by the Trustee or by any accountant or actuary selected by the Committee and upon all opinions given by any legal counsel selected by the Committee. The members of the Committee, the Trustee, each Participating Company, and all persons employed by each Participating Company and the Trustee who are engaged in administering the Plan (a) shall be fully protected with respect to any action taken by them in good faith and all actions so taken shall be conclusive and binding upon all persons having or claiming to have any interest under the Plan; and (b) shall not be personally liable by reason of any instrument made or executed by them or on their behalf or in the course of administering the Plan or for any mistake of judgment made by them or any other person, or for any neglect, omission or wrongdoing of any other person or for any loss to the Plan unless resulting from their own willful misconduct. No member of the Committee shall have any liability to any person for any action or omission except each for his own individual willful misconduct.

Service on the Committee shall constitute service as a director of the Company so that members of the Committee shall be entitled to indemnification and reimbursement as directors of the Company pursuant to its Articles of Incorporation and Bylaws.

In addition to the foregoing, each member of the Committee, the Trustee, and each director and officer of each Participating Company shall be indemnified by the Company against all expenses (including costs and attorneys fees) actually and necessarily incurred or paid by such person in connection with the defense of any action, suit or proceeding in any way relating to or arising from the Plan to which the Participant may be made a party by reason of the party being or having been such member of the Committee, Trustee, director or officer or by reason of any action or omission or alleged action or omission by him in such capacity, and against any amount or amounts which may be paid by him (other than to the Employer) in reasonable settlement of any such action, suit or proceeding, where the Company has consented to such settlement. In cases where such action, suit or proceeding shall proceed to final adjudication, such indemnification shall not extend to matters as to which it shall be adjudged that such member of the Committee, Trustee, director or officer is liable for willful misconduct in the performance of the duties of such person as such. The right of indemnification herein provided shall not be exclusive of other rights to which any member of the Committee, Trustee, director or officer may now or hereafter be entitled, shall continue as to a person who has ceased to be such member of the Committee,

Trustee, director or officer and shall inure to the benefit of the heirs, executors, administrators, successor or assigns of such members of the Committee, director or officer.

22. APPLICABLE LAW

The place of administration of the Plan shall conclusively be deemed to be within the State of Kansas and the validity, construction, interpretation and administration of the Plan and of any rules or regulations or determinations or decisions made thereunder, and the rights of any and all persons having or claiming to have any interest therein or thereunder, shall be governed by and be determined exclusively and solely in accordance with, the laws of the State of Kansas. Without limiting the generality of the foregoing, the period within which any action arising under or in connection with the Plan, or any payment or award made or purportedly made under or in connection therewith, must be commenced shall be governed by the laws of the State of Kansas, irrespective of the place where the act or omission complained of took place and of the residence of any party to such action and irrespective of the place where the action may be brought.

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Exhibit 11.1

PAYLESS SHOESOURCE, INC.
COMPUTATION OF NET EARNINGS PER SHARE FROM CONTINUING OPERATIONS
FOR THE LAST THREE FISCAL YEARS

(Thousands, except per share data)

	Jan. 28, 2006	Jan. 29, 2005	Jan. 31, 2004
Basic Computation:			
Net earnings from continuing operations	$74,228	$35,147	$16,942
Weighted average common shares outstanding	67,520	67,947	67,852
Basic earnings per share from continuing operations	$ 1.09	$ 0.52	$ 0.25
Diluted Computation:			
Net earnings from continuing operations	$74,228	$35,147	$16,942
Weighted average common shares outstanding	67,520	67,947	67,852
Net effect of dilutive stock options and restricted stock based on the treasury stock method	334	73	179
Outstanding shares for diluted earnings per share	67,854	68,020	68,031
Diluted earnings per share from continuing operations	$ 1.09	$ 0.52	$ 0.25

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EXHIBIT 21.1

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 FINANCE, INC.	NEVADA
PAYLESS SHOESOURCE, INC.	MISSOURI
PAYLESS SHOESOURCE DISTRIBUTION, INC.	KANSAS
PAYLESS SHOESOURCE MERCHANDISING, INC.	KANSAS
PAYLESS SHOESOURCE WORLDWIDE, INC.	KANSAS
PSS CANADA, INC.	KANSAS
PAYLESS SHOESOURCE CANADA INC.	CANADA
PAYLESS SHOESOURCE CANADA GP INC.	CANADA
PAYLESS SHOESOURCE CANADA LP	CANADA
PAYLESS SHOESOURCE (BVI) HOLDINGS, LTD.	BRITISH VIRGIN ISLANDS
DYELIGHTS, INC.	DELAWARE
SHOE SOURCING, INC.	KANSAS
PAYLESS CA MANAGEMENT LTD.	BRITISH VIRGIN ISLANDS
PSS HOLDINGS	CAYMAN ISLANDS
PSS LATIN AMERICA HOLDINGS	CAYMAN ISLANDS
PAYLESS SHOESOURCE GOLD VALUE, INC.	KANSAS
PAYLESS SHOESOURCE INTERNATIONAL LIMITED	HONG KONG
DYNAMIC ASSETS LIMITED	HONG KONG
PSS LABOR LEASING, INC.	KANSAS
PAYLESS SHOESOURCE ANDEAN HOLDINGS	CAYMAN ISLANDS
PSS CANADA FINANCE, LP	CANADA
PAYLESS SHOESOURCE ASIA PTE. LTD.	SINGAPORE
PAYLESS SHOESOURCE JAPAN CO. LTD.	JAPAN
PAYLESS SHOESOURCE URUGUAY SRL FINANCE CO.	URUGUAY
PAYLESS SHOESOURCE SPAIN, S.L.	SPAIN
PAYLESS SHOESOURCE OF PUERTO RICO, INC.	PUERTO RICO

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Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-25877, 333-28483, 333-30371, 333-67684, 333-50671 on Forms S-8 and Registration Statement No. 333-126670 on Form S-3 of our reports relating to the financial statements and financial statement schedule (which report expresses an unqualified opinion and includes an explanatory paragraph relating to a change in accounting principle) of Payless ShoeSource, Inc. and subsidiaries and management's report on the effectiveness of internal control over financial reporting dated March 31, 2006, appearing in the Annual Report on Form 10-K of Payless ShoeSource, Inc. and subsidiaries for the year ended January 28, 2006.

Kansas City, Missouri
April 7, 2006

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EXHIBIT 31.1

CERTIFICATIONS

I, Matthew E. Rubel, certify that:

1. I have reviewed this annual report on Form 10-K of Payless ShoeSource, Inc., a Delaware corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 7, 2006

/s/ Matthew E. Rubel

Matthew E. Rubel
Chief Executive Officer and President

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Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

EXHIBIT 31.2

CERTIFICATIONS

I, Ullrich E. Porzig, certify that:

1. I have reviewed this annual report on Form 10-K of Payless ShoeSource, Inc., a Delaware corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 7, 2006

/s/ Ullrich E. Porzig

Ullrich E. Porzig
Senior Vice President
Chief Financial Officer and Treasurer

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Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

EXHIBIT 32.1

SECTION 1350 CERTIFICATION

IN CONNECTION WITH THE ANNUAL REPORT OF PAYLESS SHOESOURCE, INC. (THE "COMPANY") ON FORM 10-K FOR THE PERIOD ENDING JANUARY 28, 2006, AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON THE DATE HEREOF (THE "REPORT"), I, MATTHEW E. RUBEL, CHIEF EXECUTIVE OFFICER AND PRESIDENT OF THE COMPANY, CERTIFY, PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, THAT TO MY KNOWLEDGE:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

Date: April 7, 2006

/s/ Matthew E. Rubel

Matthew E. Rubel
Chief Executive Officer and President

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Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006

EXHIBIT 32.2

SECTION 1350 CERTIFICATION

IN CONNECTION WITH THE ANNUAL REPORT OF PAYLESS SHOESOURCE, INC. (THE "COMPANY") ON FORM 10-K FOR THE PERIOD ENDING JANUARY 28, 2006, AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON THE DATE HEREOF (THE "REPORT"), I, ULLRICH E. PORZIG, SENIOR VICE PRESIDENT - CHIEF FINANCIAL OFFICER AND TREASURER OF THE COMPANY, CERTIFY, PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002, THAT TO MY KNOWLEDGE:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

Date: April 7, 2006

/s/ Ullrich E. Porzig

Ullrich E. Porzig
Senior Vice President
Chief Financial Officer and Treasurer

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Source: PAYLESS SHOESOURCE I, 10-K, April 07, 2006