

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-K

Annual report pursuant to section 13 and 15(d)

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### FILER

#### **COLLECTIVE BRANDS, INC.**

CIK: **1060232** | IRS No.: **431813160** | State of Incorporation: **DE** | Fiscal Year End: **0130**  
Type: **10-K** | Act: **34** | File No.: **001-14770** | Film No.: **08728117**  
SIC: **5661** Shoe stores

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

FORM 10-K

(Mark One)

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

For the fiscal year ended February 2, 2008

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

COLLECTIVE  
BRANDS INC.

COLLECTIVE BRANDS, INC.

(Exact name of registrant as specified in its charter)

Delaware

State or other jurisdiction of  
incorporation or organization

43-1813160

(I.R.S. Employer  
Identification No.)

3231 Southeast Sixth Avenue, Topeka, Kansas

(Address of principal executive offices)

66607-2207

(Zip Code)

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

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, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒      Accelerated filer ☐      Non-accelerated filer ☐      Smaller reporting company ☐  
(Do not check if a smaller reporting company)

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 \$1,596 million based on the closing price of \$24.53 as reported on the New York Stock Exchange on August 3, 2007, the last trading day of the registrant’s second fiscal quarter.

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

Common Stock, \$.01 par value  
63,801,066 shares at March 27, 2008

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated
Proxy Statement for the Annual Meeting of Stockholders to be held on May 22, 2008 (Proxy Statement)	Part III

## Forward Looking Statements

This report contains forward-looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, products, future store openings and closings, international expansion opportunities, possible strategic initiatives, new business concepts, capital expenditure plans, fashion trends, consumer spending patterns 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 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; changes in existing or potential duties, tariffs or quotas and the application thereof; 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 are located or in which we operate stores or otherwise do business; changes in trade, intellectual property, customs and/or tax laws; fluctuations in currency exchange rates; litigation including intellectual property and employment litigation; availability of suitable store locations on acceptable terms; the ability to terminate leases on acceptable terms; the ability to hire, train and retain associates; performance of other parties in strategic alliances; general economic, business and social conditions in the countries from which we source products, supplies or have or intend to open stores; 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 and/or slowdowns by unions that play a significant role in the manufacture, distribution or sale of product; congestion at major ocean ports; changes in commodity prices such as oil; and changes in the value of the dollar relative to the Chinese Yuan and other currencies. 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 to reflect the occurrence of unanticipated events.

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**FORM 10-K**  
**FOR THE FISCAL YEAR ENDED FEBRUARY 2, 2008**  
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## PART I

### ITEM 1. BUSINESS

#### General

Collective Brands, Inc. (“Collective Brands” or the “Company”) is a leader in bringing compelling lifestyle, fashion and performance brands for footwear and related accessories to consumers worldwide. We operate strategic business units covering a powerful brand portfolio, as well as multiple price points and selling channels including retail, wholesale, ecommerce and licensing. Collective Brands is the holding company for Payless ShoeSource, Inc. (“Payless”), The Stride Rite Corporation (“Stride Rite”), and Collective International, LP (“Collective Licensing”). Payless is one of the largest footwear specialty retailers in the Western Hemisphere. It is dedicated to democratizing fashion and design in footwear and accessories and inspiring fun, fashion possibilities for the family at a great value. Stride Rite markets the leading brand of high-quality children’s shoes in the United States as well as products for children and adults under well-known brand names, including Stride Rite®, Robeez®, Sperry Top-Sider®, Saucony® and Keds®. Collective Licensing is a youth lifestyle marketing and global licensing business.

All references to years are to our fiscal year unless otherwise stated. Fiscal year 2007 ended on February 2, 2008.

Payless is one of the largest footwear retailers in the Western Hemisphere, with 4,552 retail stores in 15 countries and territories as of year-end 2007. Our Payless ShoeSource retail stores in the United States, Canada, the Caribbean, Central America, and South America sold nearly 170 million pairs of footwear and approximately 40 million units of accessories during fiscal 2007. 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. 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. Our stores feature several designer and mainstream footwear brands including Abaete for Payless™, Airwalk®, American Eagle™, Champion®, and Dexter®. We seek to compete effectively by getting to market with differentiated, trend-right merchandise before mass-market discounters and at the same time as department and specialty retailers but at a more compelling value. As of year-end 2007, each Payless ShoeSource store stocked on average approximately 6,600 pairs of footwear. We focus our marketing efforts on women consumers between the ages of 18 and 44 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 one-third of these target consumers purchased at least one pair of footwear from our stores last year. Payless also operates a shoe dyeing unit called Dyelights®, in which customers order custom-dyed shoes usually for occasions such as weddings. In addition, we operate [payless.com®](#) where customers can buy our products on-line and store associates can order products for customers that are not sold in all of our stores.

Stride Rite is the leading marketer of high quality children’s footwear in the United States and is a major marketer of casual and athletic footwear for adults. Stride Rite was founded on the strength of the Stride Rite children’s brand, but today includes a portfolio of great American brands addressing different market segments within the footwear industry. Stride Rite is predominantly a wholesaler of footwear, selling its products mostly in North America in a wide variety of retail formats including premier department stores, independent shoe stores, value retailers and specialty stores. Stride Rite markets products in countries outside North America largely through owned operations, independent distributors and licensees. Stride Rite also markets its products directly to consumers by selling children’s footwear through its Stride Rite children’s retail stores and a broader selection of its footwear through Stride Rite outlet stores and e-commerce sites. In total, Stride Rite operated 340 retail locations as of the end of 2007. Stride Rite designs and markets children’s footwear, for consumers between the ages of six months and ten years, including dress and casual footwear, boots, sandals, athletic shoes and sneakers, in various styles. Those products are marketed under the Stride Rite®, Robeez®, and other brand names at moderate to premium price points. In addition, Stride Rite designs and markets marine performance footwear and outdoor recreational, hand-sewn, dress casual and casual footwear, and boots for adults under our Sperry Top-Sider® and Sperry® trademarks. Stride Rite also designs and markets technical running, athletic lifestyle, walking, and outdoor trail shoes and athletic apparel under the Saucony® brand name and casual footwear and sneakers for adults and children under the Keds® trademark. Additionally, Stride Rite designs casual footwear for women under the Grasshoppers® label.

#### History

Payless was founded in Topeka, Kansas in 1956 with a strategy of selling low-cost, high-quality family footwear on a self-service basis. In 1962, Payless became a public company. In 1979, it was acquired by The May Department Stores Company (“May Company”). On May 4, 1996, Payless became an independent public company again as a result of a spin-off from May Company. On March 30, 2007, we acquired Collective Licensing, a Denver-based brand development, management and

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licensing company. On August 16, 2007, we changed our name to Collective Brands, Inc., and the next day we completed our acquisition of Stride Rite.

Stride Rite was founded in Boston, Massachusetts in 1919, as the Green Shoe Manufacturing Company (“Green Shoe”). Green Shoe became a public company in 1960 and was listed on the New York Stock Exchange. It adopted The Stride Rite Corporation name in 1966 in recognition of its well respected brand name. Stride Rite’s first retail store was opened in 1972. The Sperry Top-Sider and Keds brand names were purchased from Uniroyal in 1979. During 2005 Stride Rite completed its acquisition of Saucony and in 2006 Stride Rite purchased Robeez.

Our principal executive offices are located at 3231 Southeast Sixth Avenue, Topeka, Kansas 66607-2207, and our telephone number is (785) 233-5171. Our common stock is listed for trading on the New York Stock Exchange under the symbol “PSS.”

### **Segments and Geographic Areas**

We operate our business in four reporting segments: Payless Domestic, Payless International, Stride Rite Retail and Stride Rite Wholesale. See Note 19 to the Notes to the Consolidated Financial Statements for a discussion on financial results by segment.

1. The Payless Domestic reporting segment is comprised of retail stores under the Payless ShoeSource name in the U.S., the Company’s sourcing operations and Collective Licensing.

- The Payless International segment includes retail operations in Canada; Puerto Rico; the U.S. Virgin Islands; 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 are operated as joint ventures in which we maintain a 60-percent ownership interest.
- 2.

3. The Stride Rite Retail reporting segment consists of Stride Rite’s retail children’s stores, outlet stores and the leased children’s shoe departments at Macy’s.

- The Stride Rite Wholesale reporting segment consists primarily of Stride Rite’s wholesale operations which includes Stride Rite Children’s Wholesale Division, Keds, Saucony and Sperry Top-Sider. In addition, the segment includes sales to licensed dealers, international distributors and licensees. We sell footwear to approximately 8,000 customers in nearly 70 countries and territories worldwide.
- 4.

### **Stores**

At the end of 2007, we operated a total of 4,892 retail stores. This was comprised of 3,954 in the Payless Domestic segment, 598 stores in the Payless International segment, and 340 stores in the Stride Rite Retail segment.

#### *Payless Domestic*

The average size of a store in the Payless Domestic segment is approximately 3,200 square feet. Depending upon the season and the sales volume of the store, stores employ a widely varying number of associates including a store manager or shared store manager. Stores use a combination of full-time and part-time associates. By including materially remodeled stores in our calculation as new stores, Payless ShoeSource domestic stores were 13 years old on average at the end of 2007. At year-end, 407 stores had been updated to one of Payless’ new store formats. There were 385 “Hot Zones” and 22 “Fashion Labs”™. Payless ShoeSource stores operate in a variety of real estate formats such as shopping malls, central business districts, free-standing buildings, strip centers, and leased departments in ShopKo stores. At year-end, 435 locations incorporated a “Payless Kids” area which has nearly 1,000 additional square feet of selling space devoted to an expanded assortment of children’s shoes.

In 1999, we entered into a 10-year 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 132 of these locations, and they are included in the table below.

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The number of retail stores by geographic region for the Payless Domestic segment is represented in the table below.

Alabama	35
Alaska	8
Arkansas	40
Arizona	89
California	536
Colorado	55
Connecticut	45
District of Columbia	8
Delaware	9
Florida	289
Georgia	98
Hawaii	16
Iowa	33
Idaho	30
Illinois	186
Indiana	60
Kansas	35
Kentucky	33
Louisiana	58
Massachusetts	98
Maryland	73
Maine	13
Michigan	132
Minnesota	48
Missouri	77
Mississippi	48
Montana	14
North Carolina	63
North Dakota	6
Nebraska	34
New Hampshire	18
New Jersey	130
New Mexico	28
Nevada	36
New York	260
Ohio	134
Oklahoma	45
Oregon	50
Pennsylvania	157
Rhode Island	14
South Carolina	37
South Dakota	15
Tennessee	47
Texas	390
Utah	51
Virginia	78
Vermont	7
Washington	88
Wisconsin	78
West Virginia	14
Wyoming	5
Guam	2
Saipan	1
<b>Total Domestic Segment Store Count</b>	<b>3,954</b>

Since opening our first store in Canada in 1997, our international presence has grown substantially. We entered Latin America in September 2000. As of year-end, we had 598 stores in 10 countries, Puerto Rico and the U.S. Virgin Islands. We intend to open our first Payless ShoeSource stores in Colombia in 2008.

The average size of a store in the Payless International segment is approximately 2,800 square feet. Stores in Latin America tend to be smaller than stores in other locations because Latin America tends to have smaller shop spaces than North America. Securing a site large enough for Payless often requires assembling two or three contiguous spaces. We are actively pursuing opportunities to expand square footage for key locations in Latin America. By including materially remodeled stores in our calculation as new stores, our international stores were on average seven years old at the end of 2007. At year-end, 50 stores had been updated to one of our new store formats. There were 49 “Hot Zones” and one “Fashion Lab™”. Our international stores operate in a variety of real estate formats, including shopping malls, central business districts, free-standing buildings, and strip centers.

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The number of retail stores by Province, Country and Territory for the Payless International segment is represented in the table below.

Canada	
Alberta	41
British Columbia	41
Manitoba	10
New Brunswick	7
Nova Scotia	11
Ontario	142
Prince Edward Island	2
Quebec	52
Saskatchewan	11
Total Canada	<u>317</u>
Central America Region	
Costa Rica	22
Dominican Republic	16
El Salvador	21
Guatemala	38
Honduras	17
Nicaragua	12
Panama	18
Trinidad/Tobago	13
Total Central America	<u>157</u>
South America Region	
Ecuador	36
Puerto Rico	83
U.S. Virgin Islands	<u>5</u>
Total Payless International Segment Store Count	<u><u>598</u></u>

### *Stride Rite Retail*

Stride Rite retail children's stores are located primarily in larger regional shopping centers, clustered generally in the major marketing areas of the U.S. The average size of a Stride Rite retail children's store is approximately 1,700 square feet. Stride Rite outlet stores average approximately 2,800 square feet because outlet stores carry a broad range of footwear for adults in addition to children's footwear. Most of our outlet stores are located in shopping centers consisting only of outlet stores. At the end of 2007, each Stride Rite retail store carried on average approximately 8,900 pairs of shoes. By including materially remodeled stores in our calculation as new stores, Stride Rite retail segment stores were on average approximately nine years old at the end of 2007.

The number of retail stores by type for the Stride Rite Retail segment is represented in the table below.

Stride Rite Children's Stores	231
Outlet Stores	102
Leased Children's Shoe Departments – Macy's	<u>7</u>
Total Stride Rite Retail Stores	<u><u>340</u></u>

### *Stride Rite Wholesale*

In addition to the Stride Rite retail stores, we had 165 Stride Rite locations managed by licensed dealers (not included in the store count above) at the end of 2007. A licensed dealer is an independent shoe retailer that sells a high percentage of Stride Rite product, and who brands the store as Stride Rite both on the exterior and interior of the store. We generate sales from dealers by selling them our product. Dealers do not pay franchise or on-going fees. Stride Rite sales representatives monitor the dealers' assortments and appearance. We give guidance to the dealers on store remodeling. Dealers are not obliged to participate in Stride Rite retail store promotions.



## **International Business**

During 2007, Collective Brands had \$479.6 million, or 16%, of its sales from international locations. Our distribution is getting more diverse each year as international sales have tended to grow faster than our overall sales.

### *Payless International*

Sales in 2007 were \$427.0 million, up 6% versus the prior year. The 2007 operating profit from continuing operations was up 3%, led by strong results in our Latin America markets, which is an emerging market for Payless. As a result of our success in Latin America, we announced in 2007 that we will open our first stores in Colombia during 2008. Results from Colombia will be a part of the Payless International segment.

### *Stride Rite Wholesale*

We sell footwear in nearly 70 countries and territories worldwide. We use our owned operations, independent distributors and licensees to market our various product lines outside of the United States. We record revenue from foreign sources through the sale of branded footwear products by our owned operations in Canada, the Netherlands, the United Kingdom and Germany, from sales in certain countries to independent distributors of our products, and from royalties to authorized licensees of our products. License and distribution arrangements enable us to develop sales in certain international markets without incurring development costs and the capital commitment required to maintain related foreign operations, employees, inventories or localized marketing programs. We assist in designing products that are appropriate to each foreign market, but are consistent with the global brand position. Independent licensees and distributors purchase goods from either us or authorized third-party manufacturers pursuant to distribution agreements or manufacture branded products consistent with our standards pursuant to license agreements. Distributors and licensees are responsible for independently marketing and distributing our branded products in their respective territories with product and marketing support provided by us. We are also a party to foreign license agreements in which independent companies operate Stride Rite and Keds retail stores outside the United States. A total of 11 Stride Rite and two Keds stores are currently operating in El Salvador, Guatemala, Haiti, Honduras, Costa Rica, Dominican Republic and Venezuela pursuant to such agreements.

## **Store and Wholesale Operations Management**

Collective Brands manages certain store operation functions, such as marketing, information technology and finance, in a mostly centralized fashion from its Topeka, Kansas and Lexington, Massachusetts corporate offices. The company also manages other store support functions, such as loss prevention and store-level human resources, in a more decentralized fashion.

### *Payless Domestic and Payless International*

In general, each retail location is managed by a Store Manager. Store Managers report to District Managers who, in turn, report to Directors of Retail Operations. District Managers typically oversee 24 stores on average, and Directors of Retail Operations typically oversee, on average, 11 District Managers or 264 stores. Each of these positions is responsible for managing the operations of our stores including functions such as opening and closing, store displays, inventory management, staffing, and managing the customer experience. In 2007, we substantially completed our North American rollout of more technologically advanced point-of-sale terminals and inventory scanning devices, as well as our U.S. rollout of a new labor scheduling system. These technology improvements provide benefits such as faster checkout, easier tagging and inventory management, and more effective customer focused staffing.

### *Stride Rite Retail*

Retail locations are managed by a Store Manager who reports to a District Manager. District Managers typically oversee approximately 25 stores. These positions are responsible for managing the operations of our stores including functions such as opening and closing, store displays, inventory management, and staffing. Stride Rite stores offer customers a more full-service experience such as retrieving shoes and personalized sizing and fitting of each child by trained specialists.

### *Stride Rite Wholesale*

The Stride Rite Wholesale business is divided by major brands, each with their own dedicated sales forces. Generally each sales executive is assigned a specific geographic region.

## **Employees**

At the end of 2007, Collective Brands employed over 31,000 associates worldwide. Nearly 28,000 associates worked in stores, while the remaining associates worked in other capacities such as corporate support, Asia-based procurement, licensing,





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and distribution centers. Approximately 400 of our distribution center associates and 165 of our other associates are covered by collective bargaining agreements. Our employee base at year-end was approximately 50% full-time and 50% part-time.

### *Payless Domestic*

Approximately 24,000 associates at year-end worked in the Payless Domestic segment. The mix of full-time to part-time associates was about 40% and 60%, respectively.

### *Payless International*

The Payless International segment employed over 3,400 associates at year-end. The mix of full-time to part-time associates was about 64% and 36%, respectively.

### *Stride Rite Retail*

The Stride Rite Retail segment employed almost 2,200 associates at year-end. The mix of full-time to part-time associates was about 40% and 60%, respectively.

### *Stride Rite Wholesale*

Almost 1,400 associates at year-end were employed in various sales and support capacities in the Stride Rite Wholesale segment. Nearly 100% were full-time.

## **Competition**

As a multi-channel provider of footwear and accessories, we face several different forms of competition.

The retail footwear and accessories market is highly competitive. It is comprised of department stores, footwear specialty stores, discount mass-merchandisers, sporting goods stores, and on-line competitors. 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.

### *Payless Domestic and Payless International*

We seek to compete effectively through our Payless segments by getting to market with differentiated, trend-right merchandise before mass-market discounters such as Wal-Mart and Target. Payless strives to get trend-right merchandise to market at the same time but at more compelling values than department stores and specialty retailers. Main competitors include Kohl' s, J.C. Penney, Macy' s, and Famous Footwear as well as ALDO and Sears Canada.

### *Stride Rite Retail and Stride Rite Wholesale*

We believe that the creation of attractive styles, in multiple widths, together with specialized engineering for fit, durability, comfort, quality and high service standards are significant factors for Stride Rite to compete successfully in the marketing of all types of footwear. Stride Rite stores compete in the children' s retail shoe industry with numerous businesses, ranging from large retail chains to single store operators. The chains include The Children' s Place, Gymboree, Dillard' s and Nordstrom. On a wholesale level, Stride Rite competes with many suppliers of footwear. Stride Rite Wholesale' s most significant competitors include Crocs, Nike, Sketchers, Converse, Asics, Brooks, Timberland, Sebago, and Ecco.

## Seasonality

As an international multi-channel provider of footwear and accessories, we have operations that are impacted by certain seasonal factors – some of which are common across segments and channels while others are not. For the most part, our business is characterized by four high-volume seasons: Easter, the arrival of warm weather, back-to-school, and the arrival of cool weather. In preparation for each of these periods, we increase our inventory levels in our retail stores to support the increased demand for our products. For our wholesale business, we increase our inventory levels approximately three months in advance of these periods to support the increased demands from our wholesalers for these products. We offer styles particularly suited for the relevant season such as sandals in the spring and boots during the fall. Our cash position tends to be highest in June as well as September – October, due primarily to the arrival of warm weather and back-to-school, respectively. Our cash position tends to be lowest around February – March when Easter inventories are built-up but not yet sold-through.

### *Payless Domestic*

Payless Domestic retail stores tend to have their highest inventory levels in preparation for the Easter selling season because customers tend to shop our stores for holiday-specific footwear and accessories. This is typically about 1-3 weeks in advance of the holiday. Seasonal sales volumes are typically highest for Payless Domestic in the first quarter, followed closely by the second quarter, and closely again by the third quarter. The arrival of warm weather and back-to-school are meaningful sales catalysts, but typically not quite as strong as Easter. Usually, the Payless Domestic segment has lower sales in the fourth quarter compared to the other three quarters. Footwear customer traffic during the fourth quarter tends to be lower because there are no significant catalysts and footwear tends to be less giftable than other retail alternatives.

### *Payless International*

The Payless International seasonality tends to largely resemble Payless Domestic with one very important difference – a greater share of sales tends to come in December compared to Payless Domestic. In Puerto Rico and Latin America many workers get an incremental paycheck in preparation for the Christmas season and, compared to Payless Domestic, back-to-school and paydays are somewhat more important to Payless International.

### *Stride Rite Retail*

Stride Rite Retail seasonality also tends to create higher volumes in the first half of the year versus the second half. Back-to-school tends not to be nearly as big, proportionally, as it is for the Payless segments because Stride Rite Retail's customer base has traditionally been mostly pre-schoolers.

### *Stride Rite Wholesale*

The Stride Rite Wholesale business is also customarily driven by Easter, warm weather's arrival, back-to-school, and cool weather's arrival. But as a wholesaler, the segment's business is usually about three months earlier than Collective Brands' other three segments which sell primarily at retail. Stride Rite Wholesale tends to have its highest inventory position around January to February and its lowest inventory position around the November to December time frame.

## Supply Chain

We run an integrated supply chain that supports the product life-cycle from concept to liquidation across all reporting segments. In 2007, (for the full year for Payless and for the 24 weeks for which we owned Stride Rite) we sold 183 million pairs of footwear through retail and wholesale combined.

### *Merchandise Planning & Allocation*

We are leveraging merchandise systems across our entire organization. We build and manage total inventory plans, targeted store assortments, and product lifecycles. Our objective is to get the right product to the right store at the right time through accurate distribution utilizing enhanced forecasting and demand planning models. We base our decisions on how to stock our stores using several criteria. We consider the customer profile of our store locations based on demographics, shopping behavior and appetite for fashion. Also, we consider seasonality and climate by geography which impacts the timing of our inventory distribution. In addition, we consider our stores' sales volume, selling history, and the categories of products they tend to sell when deciding how to stock our stores. This results in greater customer connectivity which drives more profitable sales and less liquidation markdowns. Our systems provide perpetual planning and forecasting solutions and support multiple distribution centers. They also provide improved store-level size optimization, initial distribution planning, and case pack configuration information.

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We create meaningful, relevant, and actionable store groupings that allow us to deliver targeted assortments based upon customer profiles of each store. We optimize price throughout a product's life-cycle, as we can price products down to the store level. This helps us manage aged inventory and minimize it as a percentage of the total offering. We flow product consistent with customer shopping patterns. This drives efficiencies across the supply chain and stores. Our use of optimization tools enables store-level price variation which drives gross margin dollars and reduces markdowns.

### *Sourcing*

We procure footwear three different ways – through our direct sourcing organization and by engaging third party agents or vendors to procure products which we cannot or do not want to procure ourselves. Our sourcing team is closely aligned with large factories which serve as our manufacturers. We typically give these factories specifications and performance standards and bid jobs out to multiple factories. Twenty-six core factories accounted for 72% of our footwear purchases. If any one of them was to be unable to supply our needs consistent with prior performance, we might experience disruptions in shoe deliveries. However, we have about 100 factories with whom we do run-over and special approval business, and we believe these factories can fill production voids if necessary.

Our design, product development, and sourcing functions are integrated within our global supply chain organization. In the summer of 2007, we began operating a design office based in New York. This enables us to create trend-right proprietary designs and improves speed to market of new products. We have combined the China-based teams of Payless and Stride Rite to form one organization responsible for product development and sourcing. This team runs our sample creation and quality control processes. It also maintains a materials and costing library to provide greater efficiency and cost control in procuring raw materials. The integration of Payless and Stride Rite is aiding quality, factory loading, cost containment, and manufacturing efficiency. We are negotiating directly with suppliers of raw materials and requiring our factories to use our preferred suppliers much more often now than in the past. In 2007, we employed this process on less than 5% of our materials, relying instead on factories to perform that function. Our long-term goal is to specify preferred suppliers to factories for 80% of our raw materials.

We believe our relationships with our factory base are good. Factories in China are a direct source of approximately 93% of our footwear at cost. We source most of the remaining 7% from Vietnam. Products are manufactured to meet our specifications and standards. We do not purchase “seconds” or “overruns”.

### *Logistics*

We are in the process of capitalizing on areas of opportunity through consolidation of the Payless and Stride Rite distribution networks. These areas include: consolidation of ocean containers, sharing overseas consolidation services, leveraging container cube optimization, reducing transload operating costs, and leveraging inbound carrier rates. The benefits of extending and integrating our network are improved working capital management, stronger in-stock positions, higher inventory turnover, and gross margin improvement. During 2007, we reduced our days from order commitment-to-store (“supply chain days”) by six supply chain days versus the prior year. Through cross functional execution, process enhancements, and optimizing our physical distribution we intend to continue to decrease our supply chain days.

Stores generally receive new merchandise on average twice a week in an effort to maintain a constant flow of fresh and replenished merchandise. We currently use nine distribution facilities worldwide:

1. We own a 850,000 square feet distribution center (“DC”) in Topeka, Kansas which serves approximately 3,500 Payless stores in North America.
2. We lease a 414,000 square feet DC in Redlands, California which serves approximately 1,000 Payless stores in North America.
3. We lease a 602,000 square feet DC in Brookville, Ohio which is planned to begin operation in the spring of 2009.
4. We contract with a third-party in Colon, Panama to operate a distribution facility for our Latin America operations.
5. We own a 520,000 square feet DC in Louisville, Kentucky which serves Stride Rite wholesale operations in the United States.
6. We own a 409,000 square feet DC in Huntington, Indiana which serves the Stride Rite retail stores and wholesale customers.
7. We lease 46,000 square feet of office and warehouse space in Cambridge, Ontario to support Stride Rite Canadian wholesale operations.

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8. We lease 42,000 square feet of warehouse space in Burnaby, British Columbia which serves the Stride Rite Canadian wholesale operations.
9. We lease 16,000 square feet of warehouse space in The Netherlands to support our European operations.

### *Future Changes to Distribution Facilities*

- a. We intend to expand the Ohio facility by approximately 200,000 square feet in 2009.
- b. The Topeka DC will close when the California and Ohio facilities are open and running to our satisfaction, most likely in the spring of 2009.
- c. The British Columbia facility will close in September 2008.
- d. The Indiana facility will close in mid-2009 and inventory will be distributed out of the Ohio and Kentucky facilities.

## **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.

### *Payless Domestic and Payless International*

The trademarks and service marks used in our Payless business include Payless®, Payless ShoeSource®, Payless Kids®, Dyelights®, and various logos used on our Payless ShoeSource store signs and in advertising, including our traditional yellow and orange signage and our new orange and blue circle “P” logos. The domain names include Payless.com®, as well as derivatives of Payless ShoeSource. On May 18, 2006, we acquired from Jimlar Corporation the rights to the trademarks American Eagle™ and AE™ for use on footwear and certain accessories and related domain names. Currently, we have agreements in place regarding the following brands: Champion®, which expires on June 30, 2015; Dexter® which expires on December 31, 2014; Spalding®, which expires on June 1, 2008; and American Ballet Theatre™, which expires on January 31, 2010. In 2006, we entered into agreements with Disney Enterprises, Inc. for use of various Disney properties and characters which expire on December 31, 2010. In March 2008, we entered into an agreement with MTV Networks/Viacom for use of its Nickelodeon property Blue’s Clues™, which expires December 31, 2010. We have agreements for development, licensing, marketing and distribution of Laura Poretzky’s Abaeté for Payless™ line, which expires on May 31, 2009; Lela Rose’s Lela Rose for Payless™ line, which expires on September 30, 2009; Stacey Bendet’s Alice + Olivia for Payless™ line, which expires on September 30, 2008 and Patricia Field’s Patricia Field for Payless™ and/or Red Carpet Collection by Patricia Field™ lines, which expires on December 31, 2008. We also currently have the exclusive right to use the Dunkman® brand. We, through agents, also utilize various character marks from time-to-time.

Collective Licensing owns brand marks including Airwalk®, Vision Street Wear®, Lamar®, Hind®, LTD®, genetic®, Dukes®, Rage®, Ultra-Wheels®, and Skate Attack®. We license the Sims® brand mark. Collective Licensing’s focus is on the growing active sport lifestyle market driven predominantly by the skate- and snowboard-inspired trends. It is positioned with its authentic brand portfolio to reach both the younger consumer with strong ties to board sports, as well as appeal to the broad range of consumers drawn to this established lifestyle and fashion. Payless has been a licensee of the Airwalk brand since 2003 and features the brand on a wide range of footwear and accessories. Payless has helped drive Airwalk to be one of the largest skate footwear brands in America.

### *Stride Rite Retail and Wholesale*

We have license agreements with a number of third parties both domestically and internationally pursuant to which apparel and accessories are designed, manufactured and sold under the Keds®, PRO-Keds®, and Stride Rite® trademarks. We also have domestic and international license agreements for footwear through the Keds®, PRO-Keds®, Saucony®, Sperry Top-Sider® and Champion® trademarks. We continue to pursue new license opportunities.

We have a three-year licensing agreement with an independent third party for the distribution of footwear under the PRO-Keds® brand in the United States, which expires in 2010.

We have an existing trademark license agreement with Tommy Hilfiger Licensing, Inc., pursuant to which we design, market and sell footwear to adults and children. The license agreement for adult footwear expires on December 31, 2008. The license agreement for children’s footwear expires on December 31, 2009. Tommy Hilfiger Licensing, Inc. and its parent company, Tommy Hilfiger Corporation, have been acquired by Apax Partners. In 2008, we announced plans to end our licensing agreement with Tommy Hilfiger for adult footwear, effective January 1, 2009. Our license agreement for Tommy Hilfiger Kids footwear will expire at the end of calendar year 2009 and we do not anticipate that it will be renewed.

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We have a licensing arrangement with H.H. Brown Shoe Company, Inc. to develop, market, and sell an exclusive line of children's footwear under the Børn name. This license agreement runs through May 31, 2010 and covers the United States and Puerto Rico.

In addition, we have entered into license agreements with the entertainer Jessica Simpson for the Jessica Simpson™ trademark which expires on December 31, 2009; and Wham-o, Inc. for the marks Superball®, which expires on December 31, 2008 and Boogie Board®, which expires on December 31, 2010.

### **Backlog**

#### *Stride Rite Wholesale*

As of February 2, 2008 we had a backlog of orders amounting to approximately \$181 million. To a significant extent, the backlog at the end of each fiscal year represents orders for our spring footwear styles. Substantially all of these orders are delivered or canceled during the first quarter of the next fiscal year.

In all of our wholesale businesses, reorders from retail customers are an important source of revenue to supplement the orders taken in advance of the season. Over the years, the importance of reorder activity to a season's success has grown as customers, especially larger retailers, have placed increased reliance on orders during the season. Due to this variability between future orders and reorders, backlog does not necessarily translate directly into sales results.

### **Environmental Liability**

In connection with the Stride Rite acquisition, we acquired a distribution facility with a related environmental liability. The liability as of February 2, 2008 was \$6.5 million, \$1.0 million of which was included as an accrued expense and \$5.5 million of which was included in other long-term liabilities in the accompanying consolidated balance sheet. The assessment of the liability and the associated costs were an estimate based upon available information after consultation with environmental engineers, consultants and attorneys assisting the Company in addressing these environmental issues in the fourth quarter of 2007. As of February 2, 2008, the estimated costs to address these environmental conditions ranged from \$4.4 million to \$8.8 million, including \$0.9 million of costs that have already been paid. Actual costs to address the environmental conditions may change based upon further investigations, the conclusions of regulatory authorities about information gathered in those investigations and due to the inherent uncertainties involved in estimating conditions in the environment and the costs of addressing such conditions. Any changes to the estimated liability will be finalized as necessary, up to one year after the acquisition of Stride Rite's closing date, when information that is known to be available or obtainable is obtained. Any changes to the liability within one year of this acquisition's closing date will impact goodwill for this transaction.

### **Available Information**

We file or furnish our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 with the SEC electronically. Copies of any of these documents will be provided in print to any shareholder who submits a request in writing to Collective Brands, Inc., Attn: Investor Relations, 3231 Southeast Sixth Avenue, Topeka KS 66607 or calls our Investor Relations Department at (785) 559-5321. The public may read or copy any materials we file with the SEC at the Public Reference Room at 100 F Street N.E., Washington, D.C. 20549 on official business days during the hours of 10:00 am and 3:00 pm. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

We maintain an investor relations website at [www.collectivebrands.com](http://www.collectivebrands.com). On our investor relations website, one can access free of charge our reports that are filed with the SEC, the Guidelines for our Board of Directors, and the charters for the Board of Directors, the Audit and Finance Committee and the Compensation, Nominating and Governance Committee. Links are available at [www.collectivebrands.com](http://www.collectivebrands.com) where customers can shop at their convenience. No portion of our website or the information contained in or connected to the website is a part of, or incorporated into, this Annual Report on Form 10-K.

**Directors of the Company**

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

<b>Name</b>	<b>Principal Occupation</b>
<b>Management Director</b>	
Matthew E. Rubel(1*)	Chief Executive Officer and President of the Company
<b>Independent Directors</b>	
Howard R. Fricke(1)(2)(3)	Retired Chairman of the Board of the Security Benefit Group of Companies
Daniel Boggan Jr.(3)	Retired Senior Vice President of the National Collegiate Athletic Association
Judith K. Hofer(4)	Retail Consultant
Mylle H. Mangum(1)(4*)	Chief Executive Officer of IBT Enterprises, LLC
John F. McGovern(1)(3*)	Founder and Partner of Aurora Capital LLC and former Executive Vice President/Chief Financial Officer of Georgia-Pacific Corporation
Robert F. Moran(3)	President and Chief Operating Officer of PetSmart, Inc.
David Scott Olivet(3)	Chief Executive Officer and Director of Oakley, Inc.
Michael A. Weiss(4)	President and Chief Executive Officer of Express LLC
Robert C. Wheeler(4)	Chairman and Chief Executive Officer of Hill's Pet Nutrition, Inc.

(1) Executive Committee Member

(2) Non-Executive Chairman of the Board

(3) Audit and Finance Committee Member

(4) Compensation, Nominating and Governance 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 4, 2008 and offices held by them with the Company.

<b>Name</b>	<b>Age</b>	<b>Position and title</b>
Matthew E. Rubel	50	Chief Executive Officer and President
Darrel J. Pavelka	52	Executive Vice President – Global Supply Chain
Douglas J. Treff	50	Executive Vice President – Chief Administrative Officer
Jay A. Lentz	64	Senior Vice President – Human Resources
Michael J. Massey	43	Senior Vice President – General Counsel and Secretary
Ullrich E. Porzig	62	Senior Vice President – Chief Financial Officer

**Matthew E. Rubel** is 50 years old and has served as Chief Executive Officer and President of the Company 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.

**Darrel J. Pavelka** is 52 years old and has served as Executive Vice President – Global Supply Chain since September 2007. Prior to that he served as Senior Vice President – Merchandise Distribution, Planning and Supply Chain from September 2004 to September 2007. He also served as Senior Vice President – International Operations from March 2003 to September 2004, 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.

**Douglas J. Treff** is 50 years old and has served as the Company's Executive Vice President – Chief Administrative Officer since September 2007. Prior to joining the Company, he served as Executive Vice President – Chief Administrative Officer for Sears Canada, Inc. from 2006 to 2007. From 2000 to 2006 he served as Senior Vice President and Chief Financial Officer for



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Deluxe Corporation and from 1990 to 2000, as Chief Financial Officer and other leadership roles in finance at Wilsons, The Leather Experts, Inc.

**Jay A. Lentz** is 64 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 43 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.

**Ullrich E. Porzig** is 62 years old and has served as Senior Vice President – Chief Financial Officer and Treasurer since February, 1996. 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., and Target Corp.; department stores such as Kohl's, J.C. Penney, Dillard's and Nordstrom; other retailers such as Famous Footwear, The Children's Place, and Gymboree; and wholesalers such as Crocs, Sketchers, and Nike. 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 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 Directly Dependent Upon our Sales Performance. As a result, Declines in our Operating Performance may be Magnified if We are Unable to Reduce Expenses in Response to a Sales Shortfall**

A majority of our operating expenses are fixed costs that are not directly dependent on our sales performance, as opposed to variable costs, which increase as sales volume increases. These fixed costs include the leasing costs of our stores, our debt service expenses and the majority of our labor expenses. If our sales were to decline, we may be unable to reduce or offset these fixed operating expenses in the short term. Accordingly, the effect of any sales decline is magnified because a larger percentage of our earnings are committed to paying these fixed costs. As a result, our net earnings and cash flow could be disproportionately negatively affected as a result of a decline in sales.

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

Our Payless stores have a substantial market presence in all 50 states and the District of Columbia and we currently derive a significant majority 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. We have attempted to capture additional market share through a variety of strategies; however, if we are 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 May Have Unseasonable Weather Where our Stores are Concentrated**

We increase our inventory levels to support the increased demand for our products, as well as to 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 affecting our net sales margins and operating cash flow. Consequently, our results of operations are highly dependent on somewhat predictable 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 results of our wholesale businesses are affected by the buying plans of our customers, which include large department stores, as well as smaller retailers. No customer accounts for 10% or more of our wholesale business. Our wholesale customers may not inform us of changes in their buying plans until it is too late for us to make the necessary adjustments to our product lines and marketing strategies. While we believe that purchasing decisions in many cases are made independently by individual stores or store chains, we are exposed to decisions by the controlling owner of a store chain, to decrease the amount of footwear products purchased from us. In addition, the retail industry periodically experiences consolidation. We face a risk that our wholesale customers may consolidate, restructure, reorganize or realign in ways that could decrease the number of stores or the amount of shelf space that carry our products. We also face a risk that our wholesale customers could develop in-house brands or utilize the private labeling of footwear products, 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 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.

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. 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 increase 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. 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 other countries in which we operate from the People's Republic of China and 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 United States and 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 or interpretation regarding the application timing. Any such changes could adversely affect our ability to import, and/or the cost of, our products and the results of operations of our business or interpretations of these items.

Manufacturers in China are our major suppliers. During 2007, China was a direct source of approximately 93% of our merchandise based on cost. 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 2007, approximately 16% 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;
- inflation;
- exchange controls and currency exchange rates;
- 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 may 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 are not currently entered into any of these agreements.

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

We believe that our trademarks and other intellectual property are important to our business and are generally sufficient to permit us to carry on our business as presently conducted. We cannot, however, know whether we will be able to secure patents or trademark protection for our intellectual property in the future or whether that protection will be adequate for future products. Further, we face the risk of ineffective protection of intellectual property rights in the countries where we source and distribute our products. Finally, we cannot be sure that our activities will not infringe on the proprietary rights of others. If we are compelled to prosecute infringing parties, defend our intellectual property or defend ourselves, we will incur additional costs.

### **We May be Subject to Liability if We Infringe the Trademarks or Other Intellectual Property Rights of Third Parties**

We may be 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. Such payments and injunctions could adversely affect our financial results. 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. Currently, we have agreements in place regarding the following brands, among others: Champion®, which expires on June 30, 2015; Dexter® which expires on December 31, 2014; American Ballet Theatre™, which expires on January 31, 2010; and various Disney properties and characters, which expire on December 31, 2010. 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. 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.

### **Integration Risks of New Distribution Facilities Could Negatively Impact Our Business**

If we are unable to smoothly transition product flow within our new distribution infrastructure, 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 our results of operations.

### **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 impede the further development of our business strategy, reduce our revenue and decrease our operational effectiveness.

### **Prolonged Work Stoppages Could Adversely Affect our Results of Operations**

At the end of 2007, nearly 600 of our employees, including substantially all of our non-management employees at our Topeka distribution center, were covered by collective bargaining agreements. 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.

### **Unstable Credit Markets Could Affect Our Ability to Obtain Financing**

In the event we need additional financing, there can be no assurances that these funds will be available on a timely basis or on reasonable terms. Failure to obtain such financing could constrain our ability to operate or grow the business. In addition, any ratings downgrade of our securities, or any negative impacts on the credit market, generally, could negatively impact the cost or availability of capital. We believe operating cash flows and current credit facilities will be adequate to fund our working capital requirements, scheduled debt repayments, and to support the development of our short-term and long-term operating strategies.

### **There are Risks Associated with Our Acquisitions**

Any acquisitions or mergers by us will be accompanied by the risks commonly encountered in acquisitions of companies. These risks include, among other things, higher than anticipated acquisition costs and expenses, the difficulty and expense of integrating the operations and personnel of the companies and the loss of key employees and customers as a result of changes in management.

In addition, geographic distances may make integration of acquired businesses more difficult. We may not be successful in overcoming these risks or any other problems encountered in connection with any acquisitions.

Our acquisitions may cause large one-time expenses or create goodwill or other intangible assets that could result in significant asset impairment charges in the future. We also make certain estimates and assumptions in order to determine purchase price allocation and estimate the fair value of acquired assets and liabilities. If our estimates or assumptions used to value acquired assets and liabilities are not accurate, we may be exposed to gains or losses that may be material.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Collective Brands owns or leases eight distribution facilities:

1. We own a 850,000 square feet distribution center (DC) in Topeka, Kansas
2. We lease a 414,000 square feet DC in Redlands, California
3. We lease a 602,000 square feet DC in Brookville, Ohio
4. We own a 520,000 square feet DC in Louisville, Kentucky
5. We own a 409,000 square feet DC in Huntington, Indiana
6. We lease 46,000 square feet of office and warehouse space in Cambridge, Ontario
7. We lease 42,000 square feet of warehouse and manufacturing space in Burnaby, British Columbia
8. We lease 16,000 square feet of warehouse space in The Netherlands

In addition, we own a 290,000 square foot headquarters building in Topeka, Kansas. We lease 148,000 square feet of office space at our Stride Rite headquarters building in Lexington, Massachusetts, and we lease approximately 11,000 square feet of office space that serves as our design center in New York, New York. We also contract with a third-party in Colon, Panama to operate a distribution facility for our Latin America operations.

### *Payless Domestic and Payless International*

We lease substantially all of our Payless stores. Our leases typically have an initial term of five or ten years, and either one or two renewal options. During 2008, nearly 1,000 of our leases are due to expire. This includes 246 leases that, as of February 4, 2008, were month-to-month tenancies and 303 lease modifications that are pending execution (of the 303 pending modifications, 126 are currently month-to-month). 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.

### *Stride Rite Retail*

We lease all but one of our Stride Rite stores. Our leases typically have an initial term of 10 years with no renewal options. Leases usually require payment of base rent, applicable real estate taxes, common area expenses and, in some cases, percentage rent based on the store's sales volume.

## 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 are a party or of which any of our property is subject.

On or about February 5, 2004, a complaint was filed against us 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. We have filed an answer. The case is currently assigned to Judge George P. Schiavelli who, on January 14, 2008, set the case for trial on July 8, 2008, with a pretrial conference set for June 2, 2008. On October 12, 2006, we filed a suit against St. Paul Fire and Marine Insurance Company ("St. Paul"), in Kansas state court seeking damages and a declaratory judgment that St. Paul is obligated to provide coverage in connection with the underlying lawsuit brought by K-Swiss. On October 18, 2006, St. Paul filed a separate declaratory judgment action in the U.S. District Court for the Central District of California seeking a declaration that there is no coverage for the underlying lawsuit. We have moved to dismiss the California action filed by St. Paul, which was granted on February 12, 2007. On November 2, 2006, St. Paul removed the action from state court to the U.S. District Court for the District of Kansas. Also, on November 2, 2006, St. Paul moved to transfer the Kansas action to the U.S. District Court for the Central District of California, which was denied on January 10, 2007. On January 23, 2007, St. Paul filed a motion to stay the Kansas Action until the underlying lawsuit is resolved, which was granted on March 2,

2007. We believe we have meritorious defenses to the claims asserted in the underlying lawsuit. An estimate of the possible loss, if any, or the range of the loss cannot be made and therefore we have

not accrued a loss contingency related to this matter. However, the ultimate resolution of this matter could have a material adverse effect on our financial position, results of operations and cash flows.

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 have filed an answer and a motion for summary judgment which the court granted in part. On June 18, 2004, the plaintiff appealed the District Court's ruling on the motion for summary judgment. On January 5, 2006, the 9th Circuit Court of Appeals entered an order reversing the District Court's partial summary judgment order. We requested a rehearing en banc, which was denied by the 9th Circuit Court of Appeals. On June 29, 2006, we filed a petition for writ of certiorari to the United States Supreme Court, which was denied on October 2, 2006. By Order dated July 9, 2007, the case was assigned to a new judge for trial who subsequently set the pretrial conference for April 1, 2008 and a 14-day trial beginning April 8, 2008. On December 21, 2007, the District Court entered an Order granting, in part, adidas' summary judgment motion and dismissing several of our affirmative defenses including laches, waiver and estoppel. In that same order, the District Court denied several of our summary judgment motions, although the judge did dismiss adidas' state law trademark dilution claims. On February 4, 2008, we filed (with the Court's permission) a motion to reconsider the District Court's summary judgment rulings dismissing our laches, waiver and estoppel defenses. The District Court requested additional briefing on our motion and will decide the motion without a hearing. We believe we have meritorious defenses to claims asserted in the lawsuit. An estimate of the possible loss, if any, or the range of loss cannot be made and therefore we have not accrued a loss contingency related to this matter. However, the ultimate resolution of this matter could have a material adverse effect on our financial position, results of operations and cash flows.

On or about April 3, 2006, Crocs Inc. filed two companion actions against several manufacturers of foam clog footwear asserting claims for patent infringement, trade dress infringement, and unfair competition. One complaint was filed before the United States International Trade Commission ("ITC") in Washington D.C. The other complaint was filed in federal district court in Colorado. The Company's wholly-owned subsidiary, Collective Licensing International LLC ("Collective Licensing"), was named as a Respondent in the ITC investigation, and as a Defendant in the Colorado federal court action. The ITC published notice in the Federal Register on May 8, 2006, announcing that it is commencing an investigation into the allegations contained in Crocs' complaint. In accordance with federal law, the Colorado federal court action will be stayed pending the outcome of the ITC investigation. A motion to stay the Colorado federal court action was filed on May 12, 2006. In the ITC investigation, Crocs seeks an order and injunction prohibiting any of the respondents from importing or selling any imported shoes that infringe on Crocs' patent and trade dress rights. In the federal court action, which, as noted above, will be stayed, Crocs seeks damages and injunctive relief prohibiting the defendants from infringing on Crocs' intellectual property rights. On November 7, 2006, the Administrative Law Judge in the ITC action entered an order granting summary judgment of non-infringement of design patent No. D517,589 in favor of Collective Licensing and the other remaining respondents. Further, because Crocs' expert and fact witnesses admitted that the recent versions of the shoes of all respondents did not infringe the separate utility patent at issue, Crocs proposed that the trial, which was to commence on November 13, 2006, be continued pending review. All respondents agreed not to oppose Crocs' request to continue the trial and on November 8, 2006, the Administrative Law Judge entered an order on Crocs' motion postponing the trial indefinitely pending review of the summary judgment motion by the ITC. On December 21, 2006, the ITC decided to review, in part, the initial determination granting summary determination of non-infringement of design patent No. D517,589. On February 15, 2007, the ITC vacated the initial determination and remanded for further proceedings. On February 22, 2007, the Administrative Law Judge entered an order extending the date for completion of the investigation to August 11, 2008; affirming his previous narrow claim construction of design patent No. D517,789; and rejecting the claim construction proposed by Crocs. A hearing was held before the Administrative Law Judge from September 7-14, 2007, and all post-hearing briefings have been completed. The deadline for an initial determination by the Administrative Law Judge is April 11, 2008, while the target date for completion of the investigation is August 11, 2008. We believe we have meritorious defenses to the claims asserted in the lawsuits and have filed an answer. An estimate of the possible loss, if any, or the range of loss cannot be made and therefore we have not accrued a loss contingency related to this matter. However, the ultimate resolution of this matter could have a material adverse effect on our financial position, results of operations and cash flows.

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of security holders during the 13 weeks ended February 2, 2008.



## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

There were approximately 9,800 registered holders of the Company's Common Stock as of February 2, 2008, compared to approximately 12,100 registered holders as of February 3, 2007.

#### 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 2007 and 2006 were:

Fiscal Quarter	2007		2006	
	High	Low	High	Low
First	\$35.36	\$29.40	\$24.39	\$20.64
Second	37.20	24.42	27.80	20.36
Third	26.43	16.69	28.80	22.07
Fourth	20.95	13.64	35.14	25.76
Year	\$37.20	\$13.64	\$35.14	\$20.36

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, the Indenture governing our 8.25% Senior Subordinated Notes and our term loan which restrict our ability to pay dividends. We do not currently plan to pay any cash dividends.

#### Recent Sales of Unregistered Securities

On May 25, 2006, and May 24, 2007, 5,865 shares, and 5,888 shares, respectively, were credited to an account under the Company's Restricted Stock Plan for Non-Management Directors as the annual restricted stock grant portion of their director's fees. In addition, the following directors received a prorated director's fee based on their date of election as a director during the year: Mr. Olivet received 1,340 shares on September 21, 2006; and Mr. Moran received 412 shares on March 1, 2007. Each director is permitted to defer receipt of a portion of their compensation including their annual restricted stock grant pursuant to the Company's Deferred Compensation Plan for Non-Management Directors. In the past three years, non-management directors have deferred an aggregate of 44,247 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 February 2, 2008, of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased <sup>(1)</sup> (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)
11/04/07 – 12/01/07	5	\$16.83	–	\$ 231.7
12/02/07 – 01/05/08	196	15.74	190	228.8
01/06/08 – 02/02/08	1,592	15.12	1,587	204.8
Total	1,793	\$15.19	1,777	\$ 204.8 (2)

- (1) Includes an aggregate of approximately sixteen thousand shares of our common stock that was repurchased in connection with our employee stock purchase and stock incentive plans.





- (2) On March 2, 2007, our Board of Directors authorized an aggregate of \$250 million of share repurchases. The timing and amount of share repurchases, if any, are limited by the terms of our Credit Agreement and Senior Subordinated Notes.

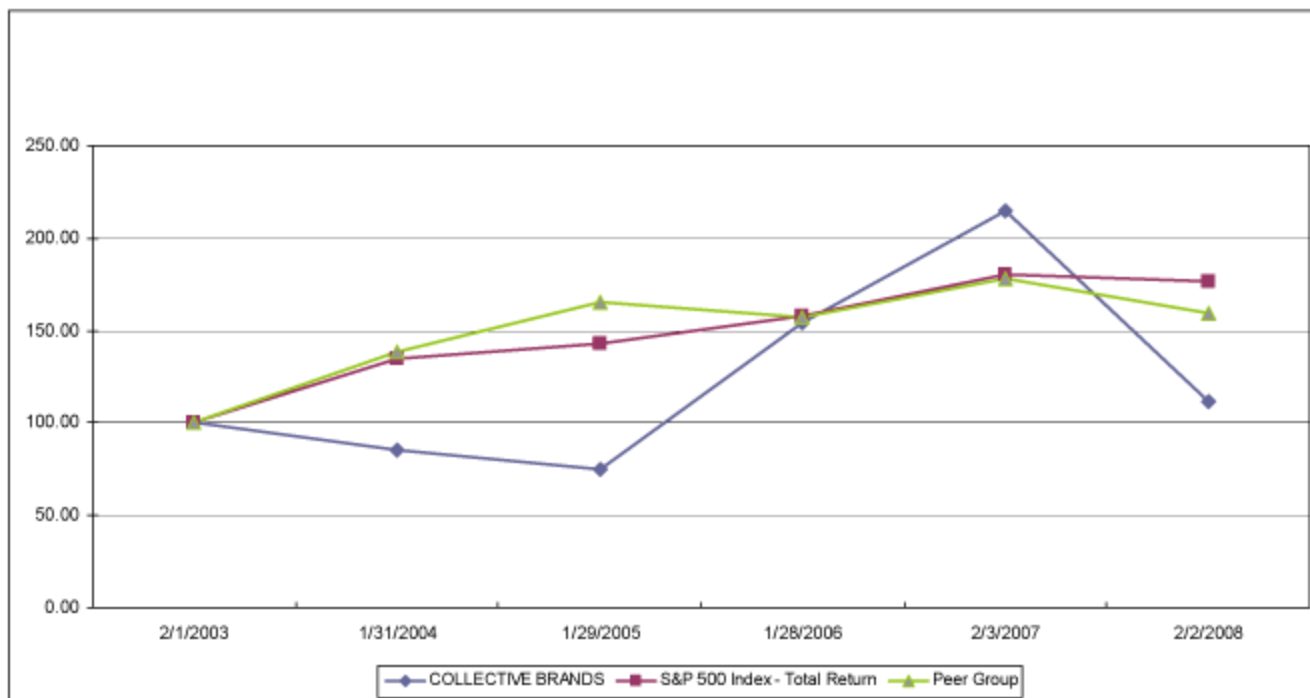
#### **New York Stock Exchange Corporate Governance Matters**

As a listed Company with the NYSE, the Company is subject to certain Corporate Governance standards as required by the NYSE 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 NYSE on June 21, 2006. 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.

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The graph below compares the cumulative total stockholder return on Collective Brands Stock against the cumulative returns of the Standard and Poor's Corporation Composite Index (the "S&P 500 Index"), and the Peer Group, some of which are competitors and many of which were used in determining bonuses under the Company's performance based incentive plans.

### **Comparison of Five Fiscal Year Cumulative Returns of the Company, the S&P 500 Index and Peer Group**



Investment Value at End of Fiscal Year:

	2002	2003	2004	2005	2006	2007
Collective Brands	100.00	85.16	74.83	154.36	215.13	111.67
S&P 500	100.00	134.57	142.93	157.75	180.63	176.46
Peer Group	100.00	138.12	165.52	156.89	178.02	159.25

The graph assumes \$100 was invested on February 1, 2003, (the end of fiscal 2002) in Payless Common Stock, in the S&P 500 Index, and the Peer Group and assumes the reinvestment of dividends.

Companies comprising the Peer Group are: The Gap, Inc., Limited Brands, Inc., Ross Stores, Inc., The TJX Companies, Inc., Brown Shoe Company, Inc., Footstar, Inc., Genesco Inc., Shoe Carnival, Inc., The Finish Line, Inc., and Foot Locker, Inc.

## 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)				
	2007(9)(10)	2006(8)	2005	2004	2003
<b>Statements of Earnings (Loss) Data:</b>					
Net sales	\$3,035.4	\$2,796.7	\$2,665.7	\$2,656.2	\$2,662.4
Cost of sales	2,044.5	1,821.0	1,777.1	1,836.5	1,920.9
Gross margin	990.9	975.7	888.6	819.7	741.5
Selling, general and administrative expenses	899.4	808.5	767.1	730.0	715.7
Restructuring charges (benefits)(2)	0.2	0.8	3.8	24.9	(0.2 )
Operating profit from continuing operations	91.3	166.4	117.7	64.8	26.0
Interest expense	46.7	19.2	19.7	22.1	20.7
Interest income	(14.4 )	(22.7 )	(12.3 )	(5.3 )	(3.9 )
Earnings from continuing operations before income taxes and minority interest	59.0	169.9	110.3	48.0	9.2
Provision (benefit) for income taxes	8.6	39.9	30.8	13.2	(4.0 )
Earnings from continuing operations before minority interest	50.4	130.0	79.5	34.8	13.2
Minority interest, net of income taxes	(7.7 )	(4.6 )	(3.0 )	2.3	3.7
Net earnings from continuing operations	42.7	125.4	76.5	37.1	16.9
Loss from discontinued operations, net of income taxes and minority interest(2)(3)	–	(3.4 )	(6.0 )	(39.1 )	(17.0 )
Net earnings (loss) before cumulative effect of change in accounting principle	42.7	122.0	70.5	(2.0 )	(0.1 )
Cumulative effect of change in accounting principle, net of income taxes and minority interest(4)	–	–	(4.1 )	–	–
Net earnings (loss)	\$42.7	\$122.0	\$66.4	\$(2.0 )	\$(0.1 )
<b>Diluted earnings (loss) per share:</b>					
Earnings from continuing operations	\$0.65	\$1.87	\$1.13	\$0.55	\$0.25
Loss from discontinued operations, net of income taxes and minority interest	–	(0.05 )	(0.09 )	(0.58 )	(0.25 )
Diluted earnings (loss) per share before cumulative effect of change in accounting principle	0.65	1.82	1.04	(0.03 )	–
Cumulative effect of change in accounting principle	–	–	(0.06 )	–	–
Diluted earnings (loss) per share	\$0.65	\$1.82	\$0.98	\$(0.03 )	\$–
Average shares outstanding – diluted	65,387	66,974	67,854	68,020	68,031
<b>Balance Sheet Data:</b>					
Working capital	\$525.1	\$526.3	\$516.0	\$391.6	\$367.9
Property and equipment, net	551.0	421.2	385.1	421.2	423.5
Total assets	2,415.2	1,427.4	1,314.5	1,239.8	1,204.3
Total long-term debt(5)	922.3	202.1	204.6	204.6	203.7
Total equity(6)	702.9	700.1	652.0	595.0	604.4
<b>Other Financial Data:</b>					
Capital expenditures	\$167.4	\$118.6	\$64.3	\$102.0	\$107.7
Present value of operating leases	1,023.5	1,011.9	945.7	1,018.2	979.8
Net sales growth, continuing operations	8.5 %	4.9 %	0.4 %	(0.2 )%	(2.7 )%
Same-store sales growth, continuing operations(7)	(2.0 )%	3.5 %	2.4 %	(0.8 )%	(3.3 )%
Return on equity, including discontinued operations	6.1 %	18.7 %	11.2 %	(0.3 )%	– %
Return on net assets, including discontinued operations	8.0 %	12.3 %	9.9 %	4.4 %	4.4 %
Return on invested capital, continuing operations	6.2 %	14.5 %	10.3 %	5.8 %	4.6 %

Stores open (at year-end)	<b>4,892</b>	4,572	4,605	4,640	5,042
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- (1) All years include 52 weeks, except 2006, which includes 53 weeks. During 2003, we changed the reporting for our operations in the Central and South American Regions to use a December 31 year-end.

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- (2) In 2006, 2005 and 2004, the restructuring charges and discontinued operations relate 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, the restructuring activity relates to changes in estimated net costs associated with the restructuring charge recorded in 2001 in connection with our decision to close certain domestic division offices, as well as approximately 100 Payless and Parade stores.
- (3) During 2006, we exited retail operations in Japan and closed its one store location. The financial results for retail operations in Japan have been reflected as discontinued operations for all periods presented. In addition, as a result of the 2004 restructuring, the results of operations for Parade, Peru, Chile and 26 Payless closed stores are classified as discontinued operations for all periods presented.
- (4) 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.
- (5) Excluded from total long-term debt for 2003-2006 are demand notes payable entered into to finance our subsidiaries in the Central American Region. During 2003-2006, we maintained certificates of deposit, in amounts equal to those demand notes, as compensating balances to collateralize those notes payable. The certificates of deposit are reflected as restricted cash for those periods in our consolidated balance sheets found elsewhere in this Form 10-K. These demand notes payable were paid in 2007.
- (6) During 2003, 2004, 2005, 2006 and 2007, we repurchased \$1.7 million (117 thousand shares), \$11.4 million (938 thousand shares), \$71.2 million (3.3 million shares), \$129.3 million (5.0 million shares), and \$48.4 million (2.4 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.
- (7) Same-store sales are presented on a 52 week fiscal basis for all years. 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. Stride Rite stores are excluded in this calculation as the Stride Rite stores were not owned by the Company in the prior year. The same-store sales calculation excludes the South American and Central American Regions.
- (8) During 2006, we adopted the fair value recognition provisions of SFAS No 123(R), “Share-Based Payment.” See Note 3 “Share-Based Compensation” under the Notes to Consolidated Financial Statements included in Item 8, “Financial Statements and Supplementary Data” of this Form 10-K.
- (9) During 2007, we adopted the provisions of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109”. See Note 9 “Income Taxes” under the Notes to Consolidated Financial Statements included in Item 8, “Financial Statements and Supplementary Data” of this Form 10-K.
- (10) Results for 2007 include the effects of the acquisitions of The Stride Rite Corporation (acquired August 17, 2007) and Collective Licensing, Inc. (acquired March 30, 2007) as of the date of those acquisitions.

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

### Overview

The following Management' s Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand Collective Brands, Inc., our operations and our present business environment. MD&A is provided as a supplement to - and should be read in connection with - our consolidated financial statements and the accompanying notes thereto contained in Item 8 of this report. MD&A includes the following sections:

Our Business - a general description of our business, our history and our strategy.

Consolidated Review of Operations - an analysis of our consolidated results of operations for the three years presented in our consolidated financial statements.

Reporting Segment Review of Operations - an analysis of our results of operations for the three years presented in our consolidated financial statements for our four reporting segments: Payless Domestic, Payless International, Stride Rite Retail and Stride Rite Wholesale.

Liquidity and Capital Resources - an analysis of cash flows, aggregate financial commitments and certain financial condition ratios.

Critical Accounting Policies - a discussion of our critical accounting policies that involve a higher degree of judgment or complexity. This section also includes the impact of new accounting standards.

### Our Business

Collective Brands, Inc. is the holding company of Payless ShoeSource, Inc. ("Payless"), The Stride Rite Corporation ("Stride Rite"), and a licensing business known as Collective International, LP ("Collective Licensing"). We operate using a hybrid business model which includes retail, wholesale and licensing. Payless is one of the largest footwear retailers in the Western Hemisphere. It is dedicated to democratizing fashion and design in footwear and accessories and inspiring fun, fashion possibilities for the family at a great value. Stride Rite markets the leading brand of high-quality children' s shoes in the United States. Stride Rite also markets products for children and adults under well-known brand names, including Keds®, Sperry Top-Sider®, and Saucony®. Collective Licensing is a youth lifestyle marketing and global licensing business within the Payless Domestic segment.

Our mission is to become the leader in bringing compelling lifestyle, performance and fashion brands for footwear and accessories to consumers worldwide. Our strategy has four strategic themes: consumer connections; powerful brands; operational excellence; and dynamic growth.

We strive to create meaningful connections with consumers and meet their varied desires for style, performance, quality and value. We do so by building and leveraging deep consumer insights that will allow us to continually anticipate trends and increase our relevance to our consumers' lifestyles. In addition, we strive to create outstanding experiences at each touch point with consumers - online, in our stores and through our customers.

We are building a diverse portfolio of leadership brands that forge emotional connections with target consumers. Each of our brands is infused with unique qualities to meet the lifestyle and aspirational needs of our consumers. Our messaging communicates each brand' s essence and helps create the connection between our brands and their target consumers.

We are committed to executing core processes at a best-in-class level. These core processes include: consumer insight, product creation, branding, supply chain and logistics, and talent development. We also leverage new technologies to streamline and enable new business processes. We strive to consistently deliver effective and efficient solutions to serve our customers and consumers.

We plan to fully extend our brand platforms across global markets, expand our brands into other relevant categories from a traditional base in footwear, and build out all relevant delivery channels for all of our brands - wholesale, retail, licensing and e-commerce/direct-to-consumer. In addition, we plan to continue to grow our portfolio of brands through internal development, licensing and acquisition.

Fiscal year 2007 was highlighted by the acquisitions of Collective Licensing and Stride Rite. These acquisitions, as well as the existing Payless ShoeSource operations will help us reach an expanded customer base with leading, well-recognized brands,

superior quality and on-trend footwear, and accessory products offered through multiple channels. As a result of these acquisitions, we are more diverse with respect to breadth of brands, price points and customer segments. Adding wholesale businesses allows us to add additional revenues without significant capital resources. We are also able to use cash flow generated by our mature businesses to fund higher margins and higher return opportunities. We will continue to seek out ways to leverage core competencies across the organization in areas such as product design and development, global sourcing, distribution, inventory management, and various corporate functions.

On March 30, 2007, we acquired 100% of the partnership interests of Collective Licensing for \$91.1 million, net of cash acquired of \$1.1 million, including transaction costs. We acquired Collective Licensing, a brand development and licensing company, to further develop our “House of Brands” strategy.

On August 17, 2007, we completed the acquisition of 100% of the equity of Stride Rite. The purchase price was approximately \$786.6 million, net of cash acquired of \$22.7 million. The acquisition was financed with cash-on-hand and the net proceeds from a \$725 million term loan. Assets acquired and liabilities assumed were recorded at their estimated fair values, and operating results are included in the Stride Rite Retail and Stride Rite Wholesale segments from the date of acquisition. The purchase price was allocated on a preliminary basis using information currently available. As a result of the Stride Rite acquisition, we have incurred certain employee severance costs and have terminated certain contracts as a result of identified synergies. As of February 2, 2008, these costs were included in the purchase price and include employee severance costs of \$14.5 million and contract termination and other costs of \$1.2 million. As of February 2, 2008, the Company has paid \$1.7 million of these costs. These costs include employee severance for certain Stride Rite Corporate employees as well as employee severance, contract termination and other costs related to the Company’s plan to close the Burnaby and Huntington distribution centers.

We are still in the process of integrating Stride Rite and may have additional costs associated with this integration including costs related to employee severance, asset valuation and contract termination. The allocation of the purchase price to the assets and liabilities acquired will be finalized as necessary, up to one year after the acquisition closing date, when information that is known to be available or obtainable is obtained.

We anticipate that the challenging economic conditions in the United States will continue into 2008. We plan to stay true to our successful merchandising strategies and maintain the right balance of our opening price point offerings while communicating to customers through refined direct marketing. Additionally, we will continue to build a more diverse portfolio of brands to position ourselves in the mass and premium markets. Finally, we will build on our success in international markets to help mitigate the challenging economic conditions in the United States.

#### *Payless ShoeSource*

Payless ShoeSource operates over 4,500 retail stores in 15 countries and territories in North America, the Caribbean, Central America, and South America. Payless sells 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. Payless stores offer fashionable, quality, branded and private label footwear and accessories for women, men and children at affordable prices in a self-selection shopping format. Stores sell footwear under brand names including Airwalk®, American Eagle™, Champion® and Dexter®. Select stores also sell exclusive designer lines of footwear and accessories under the names Abaete for Payless, Lela Rose for Payless, and alicia + olivia for Payless. Payless seeks to compete effectively by bringing to market differentiated, trend-right merchandise before mass-market discounters and at the same time as department and specialty retailers but at a more compelling value.

Payless is comprised of two operating segments, Payless Domestic and Payless International. The Payless strategy focuses on four key elements: on-trend, targeted product; effective brand marketing; a great shopping experience; and efficient operations.

By offering on-trend targeted product, we successfully build a connection with our customers. We interpret fashion trends timely and translate this into on-trend product in our stores through an extensive due diligence process. Beginning about a year in advance, we review key fashion markets worldwide. We employ trend services and examine the industry’s ready-to-wear forecasts; then, we test product. By doing so, we gain valuable intelligence well in advance of the seasons’ arrival. We refine our ideas, commit to a product assortment, and display that assortment in our stores at about the same time as other fashion-oriented higher-priced competitors. Customers demand on-trend products, but have different definitions of what that means. Importantly, we believe merchandise can be on-trend at a great value. Customers will always find tiered pricing at Payless with good-better-best price points. Through elements of promotion and pricing tiers, we strive to maintain market share with budget-oriented shoppers while driving the opportunity to increase market share with expressive customers.

The next component of the Payless strategy is brand marketing effectiveness, and the development of a “House of Brands” architecture. We are building, licensing and buying appropriate authentic and aspirational brands to appeal to 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 the average selling price per unit. The Dexter line is our newest branded program and addresses the traditional and updated customer in both men's and women's. The results of our branded programs validate our strategy and demonstrate that we have additional expansion opportunities ahead.

We are also creating a great shopping experience through improved store operations execution. Our passionate and skilled store teams offer friendly helpful service. In addition, a new store design improves our ability to showcase our merchandise, improve the in-store experience for our customers, and further support the Payless brand identity. Our new design, known as Hot Zone, features attractive gondolas and tables with product featured by style in the front of the store, while maintaining the traditional shopping experience by size in the back of the store. About 10% of the chain has been refreshed with some iteration of our new design. Hot Zone will be the design for our remodels, new stores, and relocations as we move forward. We try to inspire our customers with of-the-moment trend stories with the displays. Customer satisfaction, conversion rates, and financial returns have trended higher in our latest Hot Zone stores compared to the Payless average.

The last major component of our Payless strategy is improving the efficiency of our operations. Our new distribution center model allows us to service our customer base in the United States, which is located predominately on the nation's coasts and borders, better than operating our distribution center located in Topeka, Kansas. The distribution center investments are intended to improve speed-to-market and replenishment of product for our stores. The distribution center initiative will also reduce our disaster recovery and business interruption risk. We opened our West Coast distribution center in California in the second quarter of 2007, and plan to open another distribution center in Ohio in the spring of 2009. Once both new distribution centers are operating satisfactorily, we plan to close our current facility in Topeka, Kansas. In addition, we plan on incorporating some of Stride Rite's operations into Payless' distribution network by shifting distribution from Stride Rite's Burnaby, British Columbia and Huntington, Indiana distribution centers to our Brookville, Ohio distribution center. Investing in our business will remain a top priority and will take place on a variety of levels. We intend to invest in all elements of our business that impact the customer experience, while ensuring that an efficient supporting infrastructure is in place.

### *Stride Rite*

Stride Rite is the leading marketer of high quality men's, women's and children's footwear in the United States and across the globe. Stride Rite was founded on the strength of the Stride Rite® children's brand, but today includes a portfolio of brands addressing different markets within the footwear industry. Stride Rite is predominantly a wholesaler of footwear, selling its products mostly in North America in a wide variety of retail formats including premier department stores, independent shoe stores, value retailers and specialty stores. Stride Rite markets products in countries outside North America through owned operations, independent distributors and licensees. Stride Rite also markets its products directly to consumers by selling children's footwear through its Stride Rite retail stores and by selling all of its brands through Stride Rite outlet stores and through ecommerce. In total, Stride Rite operates over 300 retail locations.

Stride Rite is comprised of two operating segments, Stride Rite Retail and Stride Rite Wholesale. We intend to build upon Stride Rite's position as the premier brand in children's footwear. We also expect to build Sperry Top-Sider® and Keds® into a nautical lifestyle and athletic lifestyle brands, respectively, and to leverage Saucony's authentic running heritage to build a greater global athletic and lifestyle footwear and apparel business. Each major brand has certain key strategic priorities.

The Stride Rite retail stores are one of the largest premium retailers of children's non-athletic shoes. Stride Rite has over 80 years of expertise in the development of children's shoes. Most of the Stride Rite brand's sales come from its 300-plus retail stores, which account for approximately 500 thousand square feet of retail space. The rest of the brand's sales come from a variety of channels including department stores and licensed dealers. Stride Rite is currently merchandised and marketed at premium price points primarily for consumers up to six years of age. One of the elements of our Stride Rite brand strategy is to expand our market to older children.

Sperry Top-Sider® ("Sperry") is a brand with a powerful heritage in the boat shoe category. Our strategy for the Sperry brand is centered primarily on expanding beyond boat shoes, driving its women's business and expanding internationally. We have created new footwear products in the rugged and casual market, which is larger than the boat shoe market, according to a 2007 study performed by the NPD Group. We are also building upon our early success in women's - a larger footwear market than our core men's target market. New women's products are multi-generational, year-round, and distributed at a broad array of retail channels. International growth trends are to be strengthened by focusing on specific markets with the best opportunities, adding resources to our international infrastructure, and leveraging U.S. marketing and imagery.

The Saucony® brand strategy is focused on creating and delivering authentic technical running products; growing share in new and existing wholesale channels; and re-establishing a product line known as Saucony Originals. We are driving business with those who shop the specialty running channel by evolving and improving our designs. We offer an array of award winning products specifically engineered with emphasis on stability, cushioning, and motion control. Our Saucony products



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are expected to be more compelling due to improved technical design, aesthetic design, and broader pricing. In addition, we are re-establishing the Saucony Originals line to focus on fashion and youth lifestyles, and we have launched an apparel line focused on the specialty running channel.

The Keds® brand position is an iconic American brand. The strategy to grow this brand is predicated upon executing opportunities related to Keds' consumer, product, distribution, and operations. The Keds target consumer is a woman up to 24 years old. We believe twenty-four years old is an age that many potential and existing Keds consumers aspire to be in their lifestyles. We are also broadening the appeal of the Keds products beyond just canvas and vulcanized styles into women's casual and dress casual.

## Consolidated Review of Operations

The following discussion summarizes the significant factors affecting consolidated operating results for the fiscal years ended February 2, 2008 (2007), February 3, 2007 (2006) and January 28, 2006 (2005). Fiscal year 2006 contains 53 weeks of operating results compared to fiscal years 2007 and 2005 which contain 52 weeks. References to years relate to fiscal years rather than calendar years unless otherwise designated. Results for the past three years were as follows:

(dollars in millions, except per share)	52 Weeks Ended 2007		53 Weeks Ended 2006		52 Weeks Ended 2005	
		% of Sales		% of Sales		% of Sales
Net sales	\$3,035.4	100.0 %	\$2,796.7	100.0 %	\$2,665.7	100.0 %
Cost of sales	2,044.5	67.4	1,821.0	65.1	1,777.1	66.7
Gross margin	990.9	32.6	975.7	34.9	888.6	33.3
Selling, general and administrative expenses	899.4	29.6	808.5	28.9	767.1	28.8
Restructuring charges	0.2	—	0.8	—	3.8	0.1
Operating profit from continuing operations	91.3	3.0	166.4	6.0	117.7	4.4
Interest expense	46.7	1.5	19.2	0.7	19.7	0.7
Interest income	(14.4 )	(0.5 )	(22.7 )	(0.8 )	(12.3 )	(0.4 )
Earnings from continuing operations before income taxes and minority interest	59.0	2.0	169.9	6.1	110.3	4.1
Provision for income taxes <sup>(1)</sup>	8.6	14.6	39.9	23.5	30.8	27.9
Earnings from continuing operations before minority interest	50.4	1.7	130.0	4.6	79.5	3.0
Minority interest, net of income taxes	(7.7 )	(0.3 )	(4.6 )	(0.1 )	(3.0 )	(0.1 )
Net earnings from continuing operations	42.7	1.4	125.4	4.5	76.5	2.9
Loss from discontinued operations, net of income taxes and minority interest	—	—	(3.4 )	(0.1 )	(6.0 )	(0.3 )
Net earnings before cumulative effect of change in accounting principle	42.7	1.4	122.0	4.4	70.5	2.6
Cumulative effect of change in accounting principle, net of income taxes and minority interest	—	—	—	—	(4.1 )	(0.2 )
Net earnings	<u>\$42.7</u>	<u>1.4 %</u>	<u>\$122.0</u>	<u>4.4 %</u>	<u>\$66.4</u>	<u>2.4 %</u>

### Basic earnings per share:

Earnings from continuing operations	\$0.66	\$1.90	\$1.13
Loss from discontinued operations	—	(0.05 )	(0.09 )
Basic earnings per share before cumulative effect of change in accounting principle	0.66	1.85	1.04
Cumulative effect of change in accounting principle	—	—	(0.06 )
Basic earnings per share	<u>\$0.66</u>	<u>\$1.85</u>	<u>\$0.98</u>

### Diluted earnings per share:

Earnings from continuing operations	\$0.65	\$1.87	\$1.13
Loss from discontinued operations	—	(0.05 )	(0.09 )
Diluted earnings per share before cumulative effect of change in accounting principle	0.65	1.82	1.04

Cumulative effect of change in accounting principle	–		–		(0.06 )
Diluted earnings per share	<b>\$0.65</b>		<b>\$1.82</b>		<b>\$0.98</b>
Return on sales from continuing operations	<b>1.4</b>	<b>%</b>	<b>4.5</b>	<b>%</b>	<b>2.9</b> <b>%</b>
Return on equity, including discontinued operations(2)	<b>6.1</b>	<b>%</b>	<b>18.7</b>	<b>%</b>	<b>11.2</b> <b>%</b>
Return on net assets, including discontinued operations(3)	<b>8.0</b>	<b>%</b>	<b>12.3</b>	<b>%</b>	<b>9.9</b> <b>%</b>
Return on invested capital, continuing operations(4)	<b>6.2</b>	<b>%</b>	<b>14.5</b>	<b>%</b>	<b>10.3</b> <b>%</b>

- (1) Percent of sales columns for the provision for income taxes represents effective income tax rates.  
Return on equity is computed as net earnings, including discontinued operations, divided by beginning shareowners' equity and
- (2) measures our ability to invest shareowners' funds profitably. The decrease in return on net assets from 2006 to 2007 is primarily due to a decrease in net earnings. The increase in return on net assets from 2005 to 2006 is primarily due to an increase in net earnings.  
Return on net assets is computed as pre-tax net earnings, 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
- (3) represents performance independent of capital structure. The decrease in return on net assets from 2006 to 2007 is primarily due to a decrease in net earnings. The increase in return on net assets from 2005 to 2006 is primarily due to an increase in net earnings.  
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 decrease in return on invested capital from
- (4) 2006 to 2007 is primarily due to a decrease in net earnings and an increase in long-term debt. The increase in return on invested capital from 2005 to 2006 is primarily due to an increase in net earnings.

### Net Earnings

For 2007 net earnings were \$42.7 million, or \$0.65 per diluted share compared to 2006 net earnings of \$122.0 million, or \$1.82 per diluted share. Results for 2007 include incremental costs resulting from the flow through of acquired inventory recorded at fair value and depreciation and amortization of certain other assets purchased in the Stride Rite acquisition totaling \$57.6 million pre-tax. We currently expect to incur approximately \$22 million pre-tax of additional purchase accounting expense in 2008, approximately \$9 million of which is expected to be incurred in the first quarter of 2008. Results for 2006 include the impact of operating results of a 53rd week vs. 2007 which had 52 weeks.

For 2006 net earnings were \$122.0 million, or \$1.82 per diluted share, up 83.7% versus 2005 net earnings of \$66.4 million, or \$0.98 per diluted share. Results for 2006 include the impact of operating results of a 53rd week vs. 2005 which had 52 weeks.

### Net Sales

Net sales at our retail stores are recognized at the time the sale is made to the customer; they are net of estimated returns and current promotional discounts and exclude sales tax. Net sales for wholesale and e-commerce transactions are recognized when title passes and the risks or rewards of ownership have transferred to the customer, based on the shipping terms. Sales are net of estimated returns and current promotional discounts and exclude sales tax.

The table below summarizes net sales information for each of the last three fiscal years. 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 last two years being compared, its sales are included in the same-store sales calculation for the week. Except for net sales, all metrics below exclude information from our Stride Rite Retail and Stride Rite Wholesale segments as those segments were not present until the acquisition date of August 17, 2007.

Sales percent increases (decreases) are as follows:

	2007	2006	2005
Net sales	8.5 %	4.9 %	0.4 %
Same-store sales	(2.0 )	3.5	2.4
Average selling price per unit	4.8	9.4	7.6
Unit volume	(8.2 )	(4.1 )	(6.3 )
Footwear average selling price per unit	4.6	8.8	4.6
Footwear unit volume	(7.6 )	(2.4 )	(2.9 )
Non-footwear average selling price per unit	3.1	2.9	12.2
Non-footwear unit volume	(11.1)	(10.3)	(17.2)

For the fiscal year 2007, total sales increased 8.5% or \$238.7 million, to \$3,035.4 million, over the prior year. The increase in net sales was driven by the acquisition of Stride Rite during 2007. During 2007, net sales included in the Stride Rite Retail reporting segment were \$94.9 million and net sales in our Stride Rite Wholesale reporting segment were \$215.1 million. There were no comparable sales for 2006 for these segments as we acquired them in 2007. Sales also increased in our Payless International reporting segment by 6.4% or \$25.5 million to \$427.0 million over the prior year. These increases were offset by a decrease in sales from our Payless Domestic reporting segment of 4.0% or \$96.8 million. Sales in the 53rd week of 2006 were \$36.4 million, and they are included in the 2006 results of our Payless Domestic and Payless International reporting segments.

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For the fiscal year 2006, total sales increased 4.9% or \$131.0 million, to \$2,796.7 million, over the prior year. The increase in sales in 2006 was driven by the increase in sales of our Payless Domestic segment of 3.9% or \$89.2 million (\$34.2 million of which was due to the 53rd week) and an increase in sales of our Payless International segment of 11.6% or \$41.8 million.

### *Cost of Sales*

Cost of sales includes cost of merchandise sold and our buying, occupancy, warehousing and product movement costs, as well as depreciation of stores and distribution centers. Cost of sales was \$2,044.5 million in 2007, up 12.3% from \$1,821.0 million in 2006. The increase in cost of sales from 2006 to 2007 is primarily due to incremental sales due to the acquisition of Stride Rite and higher distribution center expenses.

In 2007, the Company's Board of Directors approved a plan to shift to a dual distribution center model for Payless domestic operations. As part of the plan, the Company intends to open a new distribution center in Brookville, Ohio, which will begin operation in the spring of 2009. This distribution center will be in addition to the Company's Redlands, California distribution center that commenced operations in the second quarter of 2007. Once both new distribution centers are operating satisfactorily, the Company plans to close its current distribution center in Topeka, Kansas. Total exit costs are currently estimated to be approximately \$13 million, consisting of approximately \$3 million of non-cash accelerated depreciation expenses, approximately \$8 million for employee severance expenses, and approximately \$2 million related to contract termination and other exit costs. The exit costs are recorded as costs of sales within the Payless Domestic segment in the consolidated statement of earnings. Actual results could vary from these estimates.

The significant components of the exit costs incurred as of February 2, 2008, are summarized as follows:

(dollars in millions)	Costs Incurred 52 Weeks Ended February 2, 2008	Cash Payments 52 Weeks Ended February 2, 2008	Accrual Balance as of February 2, 2008
Employee severance costs	\$ 5.9	\$ (0.7 )	\$ 5.2
Contract termination	0.8	(0.8 )	\$ -
Accelerated depreciation	2.4		
	<u>\$ 9.1</u>	<u>\$ (1.5 )</u>	<u>\$ 5.2</u>

Cost of sales was \$1,821.0 million in 2006, up 2.5% from \$1,777.1 million in 2005. As a percent of net sales, cost of sales was 65.1% in 2006, compared with 66.7% in 2005. The increase in cost of sales of \$43.9 million from 2005 to 2006 was primarily due to increased occupancy expenses.

### *Gross Margin*

Gross margin rate for 2007 was 32.6%, compared to a gross margin rate of 34.9% for 2006. The decrease in gross margin rate is primarily due to the impact of purchase accounting resulting from the flow through of inventory recorded at fair value and depreciation and amortization of certain other assets purchased in the Stride Rite acquisition totaling \$57.6 million, the de-leveraging of fixed costs such as rent and other occupancy costs for our Payless Domestic and Payless International Segments as a result of lower sales, and higher distribution center expenses. These items were partially offset by more favorable initial mark-ons relative to 2006. Gross margin rate for 2006 was 34.9%, compared to a gross margin rate of 33.3% in 2005. The gross margin rate increased in 2006 due primarily to more favorable initial mark-ons relative to 2005.

### *Selling, General and Administrative Expenses*

In 2007, selling, general and administrative expenses were \$899.4 million, an increase of 11.2% from \$808.5 million in the 2006 period. Selling, general and administrative expenses as a percentage of net sales were 29.6% in 2007 compared with 28.9% in 2006. The increase of 0.7% as a percentage of net sales is primarily due to lower comparable Payless Domestic store sales (0.8%) and \$6.4 million of integration related expenses incurred in 2007 (0.2%) partially offset by Payless expense reductions primarily due to lower employee incentive programs (0.2%) and the incremental impact of Stride Rite's lower selling, general and administrative expense rate (0.1%).

In 2006, selling, general and administrative expenses were \$808.5 million, an increase of 5.4% from \$767.1 million in the 2005 period. Selling, general and administrative expenses as a percentage of net sales were 28.9% in 2006 compared with 28.8% in 2005. The increase of 0.1% as a percentage of net sales primarily reflects the result of 0.5% of additional costs for employee incentive programs (including a 0.3% increase related to the incremental impact of SFAS No. 123(R)), partially offset by a 0.5% reduction in payroll and related costs driven primarily by 2005 management transition costs that did not repeat in 2006.

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### *Interest (Income) Expense*

Interest income and expense components were:

(dollars in millions)	2007	2006	2005
Interest expense	<b>\$46.7</b>	\$19.2	\$19.7
Interest income	<b>(14.4 )</b>	(22.7 )	(12.3 )
Interest expense (income), net	<b><u>\$32.3</u></b>	<b><u>\$(3.5 )</u></b>	<b><u>\$7.4</u></b>

The increase in interest expense in 2007 is due primarily to the increased borrowings of \$725 million used to fund the Stride Rite acquisition. The decline in interest income is a result of the decrease in invested balances due to cash used to fund the Stride Rite and Collective Licensing acquisitions.

The interest expense decrease in 2006 is due primarily to a reduction of debt. Interest income increased in 2006 due primarily to an increase in invested balances and increased yield.

### *Income Taxes*

The effective tax rate from continuing operations was 14.6% in 2007 versus 23.5% in 2006. The favorable difference in the overall effective tax rate for 2007 compared to 2006 is due primarily to the acquisition of Stride Rite and the related purchase accounting impact and incremental interest expense, which reduced income in relatively high tax rate jurisdictions. In addition, income in lower tax rate jurisdictions has increased during 2007.

Our effective tax rates have differed from the U.S. statutory rate principally due to the impact of our operations conducted in jurisdictions with rates lower than the U.S. statutory rate, the benefit of jurisdictional and employment tax credits, favorable adjustments to our 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. See Note 9 of our Consolidated Financial Statements for more information detailing the relative impact of these items on our tax rate on a comparative basis.

We adopted the provisions of Financial Accounting Standards Board, ("FASB") interpretation No 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), on February 4, 2007. FIN 48 prescribes a recognition threshold and a measurement standard for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. The recognition and measurement of tax benefits is often highly judgmental. Determinations regarding the recognition and measurement of a tax benefit can change as additional developments occur relative to the issue. Accordingly, our future results may include favorable or unfavorable adjustments to our unrecognized tax benefits.

At February 2, 2008, deferred tax assets for state and foreign net operating loss carryforwards are \$6.8 million, less a valuation allowance of \$0.5 million. The net operating losses related to recorded assets will expire as follows: \$1.5 million in 2010 through 2011, and \$4.8 million by 2026. Federal foreign tax credit carryforwards are \$1.6 million and state income tax credit carryforwards are \$9.2 million, less a valuation allowance of \$5.1 million. The remaining \$0.2 million of our total valuation allowance of \$5.8 million relates to other deferred tax assets in a Latin American country that does not have a history of earnings. The tax credit carryforwards related to the recorded assets expire as follows: \$1.3 million by 2013, \$1.6 million in 2017 and \$2.8 million may be carried forward indefinitely.

The American Jobs Creation Act of 2004, enacted on October 22, 2004 (the "Jobs Act"), provided 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, our Chief Executive Officer established domestic reinvestment plans which were approved by the Board of Directors. Pursuant to the plans, we repatriated \$85.0 million from foreign subsidiaries during 2005. The repatriation resulted in recognition of \$1.4 million of income tax expense in 2005. At the close of 2007, we have not provided tax on our cumulative undistributed earnings of foreign subsidiaries of approximately \$32 million, because it is our 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, we would be subject to U.S. taxes and withholding taxes payable to various foreign governments. Based on the facts and circumstances at that time, we would determine whether a credit for foreign taxes already paid would be available to reduce or offset the U.S. tax liability. We anticipate that earnings would not be repatriated unless it was tax efficient to do so.

### *Impact of Inflation*

Inflation did not have a material impact on our net sales growth or net earnings for the three years in the period ended February 2, 2008.

In fiscal year 2008, we expect inflationary pressures exacerbated by the weak dollar from China, where a majority of our product is made. We are looking for ways to control costs by working with our factory partners on opportunities for production further inland and north in China as well as other countries such as Indonesia and India, as well as expanding our existing presence in Vietnam. We believe we will be able to manage cost by using a number of initiatives such as more direct sourcing, the consolidation of raw material suppliers, and the consolidation of factories.

### *Minority Interest, Net of Income Taxes*

Minority interest represents our joint venture partners' share of net earnings or losses on applicable international operations. The increase in minority interest expense from 2006 to 2007 and 2005 to 2006 is due to increased earnings from our joint ventures.

### *Discontinued Operations*

Discontinued operations include Parade, Chile and Peru Stores as well as 26 Payless stores in North America and Japan retail operations. There was no income or loss from discontinued operations in 2007. The loss from discontinued operations of \$3.4 million, net of income taxes and minority interest, during 2006 primarily relates to operating performance and disposal costs associated with our retail operations in Japan. The loss from discontinued operations of \$6.0 million, net of income taxes and minority interest, during 2005 primarily relates to disposal costs associated with our discontinued Parade, Chile and Peru Stores and well as 26 stores in North America.

### *Environmental Liability*

In connection with the Stride Rite acquisition, we acquired a distribution facility with a related environmental liability. The liability as of February 2, 2008 was \$6.5 million; \$1.0 million of which was included as an accrued expense and \$5.5 million of which was included in other long-term liabilities in the accompanying consolidated balance sheet. The assessment of the liability and the associated costs were an estimate based upon available information after consultation with environmental engineers, consultants and attorneys assisting the Company in addressing these environmental issues in the fourth quarter of 2007. As of February 2, 2008, the estimated costs to address these environmental conditions ranged from \$4.4 million to \$8.8 million, including \$0.9 million of costs that have already been paid. Actual costs to address the environmental conditions may change based upon further investigations, the conclusions of regulatory authorities about information gathered in those investigations, the inherent uncertainties involved in estimating conditions in the environment, and the costs of addressing such conditions. Any changes to the estimated liability will be finalized as necessary, up to one year after the acquisition of Stride Rite's closing date, when information that is known to be available or obtainable is obtained. Any changes to the liability within one year of this acquisition's closing date will impact goodwill for this transaction.

### **Reporting Segment Review of Operations**

We operate our business using four reporting segments: Payless Domestic, Payless International, Stride Rite Retail and Stride Rite Wholesale. We evaluate the performance of our reporting segments based on segment revenues from external customers and segment operating profit from continuing operations as a measure of overall performance of the Company. The following table reconciles reporting segment revenues from external customers to net sales and operating profit from continuing operations to our consolidated operating profit from continuing operations for the three years presented in our consolidated financial statements:



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(in millions)	2007	2006	2005
Revenues from external customers:			
Payless Domestic	\$2,298.4	\$2,395.2	\$2,306.0
Payless International	427.0	401.5	359.7
Stride Rite Wholesale	215.1	—	—
Stride Rite Retail	94.9	—	—
Consolidated Net Sales	<u>\$3,035.4</u>	<u>\$2,796.7</u>	<u>\$2,665.7</u>
Operating profit from continuing operations:			
Payless Domestic	\$82.2	\$115.9	\$83.4
Payless International	52.0	50.5	34.3
Stride Rite Wholesale	(27.5 )	—	—
Stride Rite Retail	(15.4 )	—	—
Operating profit from continuing operations	<u>\$91.3</u>	<u>\$166.4</u>	<u>\$117.7</u>

The following table presents the change in store count during 2007 and 2006 by reporting segment. We consider a store relocation to be both a store opening and a store closing. The stores acquired as a result of the Stride Rite acquisition are denoted in the stores acquired line.

	Payless Domestic	Payless International	Stride Rite Retail	Total
<b>Fiscal year ended February 2, 2008</b>				
Beginning store count	3,986	586	—	4,572
Stores acquired	—	—	330	330
Stores opened	113	23	15	151
Stores closed	(145 )	(11 )	(5 )	(161 )
Ending store count	<u>3,954</u>	<u>598</u>	<u>340</u>	<u>4,892</u>
<b>Fiscal year ended February 3, 2007</b>				
Beginning store count	4,027	578	—	4,605
Stores opened	150	19	—	169
Stores closed	(191 )	(11 )	—	(202 )
Ending store count	<u>3,986</u>	<u>586</u>	<u>—</u>	<u>4,572</u>

For the Payless Domestic Segment, our store activity plan for fiscal year 2008 includes a net decrease of approximately 50 stores under the Payless ShoeSource name. This includes approximately 100 new stores and 150 store closings. For the Payless International Segment, our store activity plan for fiscal year 2008 includes a net increase of approximately 25 stores under the Payless ShoeSource name. This includes approximately 40 new stores and 15 store closings. For the Stride Rite Retail Segment, our store activity plan for fiscal year 2008 includes a net increase of approximately 20 stores under the Stride Rite name. The current plan for 2008 through 2010 will not materially increase or decrease the net number of either Payless ShoeSource or Stride Rite stores. We review our store activity plan at least on an annual basis.

### *Payless Domestic Segment Operating Results*

The Payless Domestic operating segment is comprised primarily of operations from the domestic retail stores under the Payless ShoeSource name, the Company's sourcing operations and Collective Licensing. The following table presents selected financial data for our Payless Domestic segment for each of the past three fiscal years:

(dollars in millions)	2007	2006	2005	Percent increase (decrease)	
				2006 to 2007	2005 to 2006
Revenues from external customers	\$ 2,298.4	\$ 2,395.2	\$ 2,306.0	(4.0 )%	3.9 %
Operating profit from continuing operations	\$ 82.2	\$ 115.9	\$ 83.4	(29.1)%	39.0%
Operating profit from continuing operations as % of revenues from external customers	3.6 %	4.8 %	3.6 %		

For the fiscal year 2007, revenues from external customers for the Payless Domestic reporting segment decreased 4.0% or \$96.8 million, to \$2,298.4 million, from 2006. The decrease in sales from 2006 to 2007 is due to lower traffic and lower unit sales across all product categories as well as the impact of \$34.2 million of net sales in the 2006 53rd week, partially offset by increases in average selling prices per unit across all product categories.





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For the fiscal year 2006, revenues from external customers for the Payless Domestic reporting segment increased 3.9% or \$89.2 million, to \$2,395.2 million, over 2005. The increase in sales from 2005 to 2006 was due to positive sales performance across all segments of the women' s category and girl' s shoes as well as the additional week of sales in 2006 due to the 53rd week of \$34.2 million, partially offset by weaker performance in accessories, boy' s shoes, men' s boots and men' s athletics.

As a percentage of revenues from external customers, operating profit from continuing operations decreased to 3.6% for 2007 compared to 4.8% in the 2006. The percentage decrease is primarily due to negative leverage on SG&A expenses due to lower net sales.

As a percentage of revenues from external customers, operating profit from continuing operations increased to 4.8% for 2006 compared to 3.6% in the 2005. The percentage increase is primarily due to higher initial mark-on in 2006 relative to 2005.

### *Payless International Segment Operating Results*

Our Payless International operating segment includes retail operations under the Payless ShoeSource name in Canada, the Central and South American Regions, Puerto Rico and the U.S. Virgin Islands.

(dollars in millions)	2007	2006	2005	Percent increase (decrease)	
				2006 to 2007	2005 to 2006
Revenues from external customers	\$ 427.0	\$ 401.5	\$ 359.7	6.4%	11.6%
Operating profit from continuing operations	\$ 52.0	\$ 50.5	\$ 34.3	3.0%	47.2%
Operating profit from continuing operations as % of revenues from external customers	12.2 %	12.6 %	9.5 %		

In general, gross margin percentages in our Payless International segment exceed those in the Payless Domestic segment. Also, as a percent of net sales, our selling, general and administrative expenses in the Payless International segment are lower than in the Payless Domestic segment primarily due to lower payroll-related expenses. Therefore, as a percentage of net sales, operating profits in our Payless International segment exceed those in our Payless Domestic segment.

For the fiscal year 2007, revenues from external customers for the Payless International reporting segment increased 6.4% or \$25.5 million, to \$427.0 million, over 2006. The increase in sales was driven by increased sales in Central and South America offset by the impact of \$2.2 million of net sales in the 2006 53rd week.

For the fiscal year 2006, revenues from external customers for the Payless International reporting segment increased 11.6% or \$41.8 million, to \$401.5 million, over 2005. The increase in sales was driven by increased sales in Canada and Central America, offset by decreased sales in Puerto Rico. The increase in sales in Canada was impacted by additional sales of \$2.2 million in the 2006 53rd week.

As a percentage of revenues from external customers, operating profit from continuing operations decreased to 12.2% for 2007 compared to 12.6% in the 2006. The percentage decrease is primarily due to higher expenses in Canada, partially offset by improved gross margin rates in Central America.

As a percentage of revenues from external customers, operating profit from continuing operations increased to 12.6% for 2006 compared to 9.5% in the 2005. The percentage increase is primarily due to higher gross margin rates in Canada, partially offset by higher expenses in Puerto Rico.

### *Stride Rite Wholesale Segment Operating Results*

The Stride Rite Wholesale operating segment is comprised of Stride Rite' s wholesale operations, which includes sales from the Stride Rite, Robeez, Sperry, Saucony, Keds and Tommy Hilfiger brands.

The sales from external customers for the Stride Rite Wholesale segment were \$215.1 million for 2007. We did not have sales for this segment prior to 2007 as Stride Rite was acquired on August 17, 2007. Sales in this segment were driven primarily by strong sales of the Sperry and Saucony brands, along with strong sales of certain brands in international markets. Keds sales were soft in the mid-tier channel, and sales for the Stride Rite and Tommy Hilfiger brands experienced soft sales in several channels.

The Stride Rite Wholesale segment operating loss of \$27.5 million was primarily driven by incremental costs related to the flow through of the acquired inventory write-up to fair value and depreciation and amortization of certain other assets. Partially offsetting the impact of purchase accounting were strong net sales in Saucony, Sperry and international markets.

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In 2008, we announced plans to end our licensing agreement with Tommy Hilfiger for our men's and women's brands, effective January 1, 2009. Our license for Tommy Hilfiger Kids footwear licensing agreement will expire at the end of calendar year 2009 and we do not anticipate that it will be renewed.

### *Stride Rite Retail Segment Operating Results*

The Stride Rite Retail operating segment is comprised of operations from Stride Rite's retail stores and outlet stores. As of February 2, 2008, we operated 238 Stride Rite retail stores and 102 Stride Rite outlet stores.

The sales from external customers for the Stride Rite Retail segment were \$94.9 million for 2007. We did not have sales for this segment prior to 2007 as Stride Rite was acquired on August 17, 2007. Sales in this segment were affected by the difficult economic and retail environment.

The Stride Rite Retail segment operating loss was \$15.4 million for 2007. The flow through of the acquired inventory write-up to fair value and depreciation and amortization of certain other assets offset the sales and corresponding gross profit generated during the period.

### **Liquidity and Capital Resources**

We ended 2007 with a cash and cash equivalents balance of \$232.5 million, a decrease of \$138.9 million from 2006, and no short-term investments, a decrease of \$90.0 million from 2006. Any materially adverse change in customer demand, fashion trends, competitive market forces or customer acceptance of our merchandise mix and retail locations, uncertainties related to the effect of competitive products and pricing, risks associated with foreign global sourcing or economic conditions worldwide could affect our ability to continue to fund our needs from business operations. We believe internally generated cash flow from operations has been our primary source of cash and we believe operating cash flows and current credit facilities will be adequate to fund our working capital requirements, scheduled debt repayments, and to support the development of our short-term and long-term operating strategies. We usually finance our real estate through operating leases. Significant sources and (uses) of cash are summarized below:

(dollars in millions)	2007	2006	2005
Net earnings	\$42.7	\$122.0	\$66.4
Working capital decreases (increases)	(2.9 )	(17.5 )	30.0
Other operating activities	35.7	35.6	38.9
Depreciation and amortization	117.3	89.6	91.6
Cash flow provided by operating activities	192.8	229.7	226.9
Payments for capital expenditures	(167.4 )	(118.6 )	(64.3 )
Net sales (purchases) of investments	90.6	(27.4 )	(36.4 )
Acquisition of businesses, net of cash acquired	(877.7 )	—	—
Other investing activities	4.3	(10.9 )	2.1
Cash flow used in investing activities	(950.2 )	(156.9 )	(98.6 )
Net purchases of common stock	(39.7 )	(82.2 )	(21.6 )
Payments of debt and deferred financing costs	(70.0 )	(3.0 )	(2.5 )
Distributions to minority owners	(2.4 )	(1.5 )	—
Issuance of debt	725.0	—	1.2
Other financing activities	2.4	9.2	0.9
Cash flow provided by (used in) financing activities	615.3	(77.5 )	(22.0 )
Effect of exchange rate changes on cash	3.2	(2.1 )	0.9
(Decrease) increase in cash and cash equivalents	<u>\$ (138.9 )</u>	<u>\$ (6.8 )</u>	<u>\$ 107.2</u>

As of February 2, 2008, of the \$232.5 million in cash and cash equivalents, our foreign subsidiaries and joint ventures had \$155.5 million in cash located in financial institutions outside of the United States. A portion of this cash represents undistributed earnings of our foreign subsidiaries, which are indefinitely reinvested. In the event of a distribution to the United States, those earnings could be subject to United States federal and state income taxes, net of foreign tax credits.

### *Cash Flow Provided by Operating Activities*

Cash flow from operating activities was \$192.8 million in 2007 compared with \$229.7 million in 2006 and \$226.9 million in 2005. The significant changes in cash flow from operations from 2007 compared with 2006 are due to decreases in net earnings, offset by a change in inventory. Compared to 2006, we have reduced inventory levels in response to lower sales.

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Also, due to changes in our sourcing process we no longer take possession of significant amounts of raw materials. The significant changes in cash flow from operations in 2006 as compared to 2005 were due to increases in net earnings, offset by a change in inventory.

### *Cash Flow Used in Investing Activities*

In 2007, our capital expenditures totaled \$167.4 million which included \$162.8 million for our Payless Domestic and Payless International segments and \$4.6 million for our Stride Rite Retail and Stride Rite Wholesale segments. For our Payless Domestic and Payless International Segments, capital expenditures for new and relocated stores were \$49.0 million, capital expenditures to remodel existing stores were \$36.6 million, capital expenditures for information technology hardware and systems development were \$18.9 million, capital expenditure for supply chain of \$36.8 million and capital expenditures for other necessary improvements including corporate expenditures were \$21.5 million. In the 2007 first quarter, we acquired Collective Licensing for \$91.1 million, net of cash acquired, including transaction costs. In the 2007 third quarter, we acquired Stride Rite for \$786.6 million, net of cash acquired, including transaction costs. We expect that cash paid for capital expenditures during 2008 will be approximately \$145 million. We intend to use internal cash flow and available financing from our \$350 million revolving credit agreement to finance all of these expenditures.

### *Cash Flow Provided By(Used in) Financing Activities*

The Company has made the following common stock repurchases:

(dollars in millions, shares in thousands)	2007		2006		2005	
	Dollars	Shares	Dollars	Shares	Dollars	Shares
Stock repurchase program	<b>\$47.1</b>	<b>2,387</b>	\$128.4	4,960	\$70.4	3,234
Employee stock purchase, deferred compensation and stock incentive plans	<b>1.3</b>	<b>51</b>	0.9	34	0.8	45
	<b><u>\$48.4</u></b>	<b><u>2,438</u></b>	<b><u>\$129.3</u></b>	<b><u>4,994</u></b>	<b><u>\$71.2</u></b>	<b><u>3,279</u></b>

As of February 2, 2008, we had approximately \$204.8 million of remaining common stock repurchase authorization from our Board of Directors. Under the indenture governing our 8.25% Senior Subordinated Notes, we are restricted on the amount of common stock we may repurchase. This limit may increase or decrease on a quarterly basis based upon our net earnings.

On August 17, 2007, we entered into a \$725 million term loan (the "Term Loan Facility") and a \$350 million Amended and Restated Loan and Guaranty Agreement (the "Revolving Loan Facility" and collectively with the Term Loan Facility, the "Loan Facilities"). The Loan Facilities rank *pari passu* in right of payment and have the lien priorities specified in an intercreditor agreement executed by the administrative agent to the Term Loan Facility and the administrative agent to the Revolving Loan Facility. The Loan Facilities are senior secured loans guaranteed by substantially all of the assets of the borrower and the guarantors, with the Revolving Facility having first priority in accounts receivable, inventory and certain related assets and the Term Loan Facility having first priority in substantially all of the borrower's and the guarantors' remaining assets, including intellectual property, the capital stock of each domestic subsidiary, any intercompany notes owned by the Borrower and the guarantors, and 66% of the stock of non-U.S. subsidiaries directly owned by borrower or a guarantor.

The Revolving Loan Facility will mature on August 17, 2012. The Revolving Loan Facility bears interest at the LIBOR, plus a variable margin of 0.875% to 1.5%, or the base rate as defined in the agreement governing the Revolving Loan Facility, based upon certain borrowing levels and commitment fee payable on the unborrowed balance of 0.25%. The Revolving Loan Facility contains a total leverage ratio covenant and other 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 February 2, 2008, we were in compliance with all covenants. The facility will be available as needed for general corporate purposes. The variable interest rate including the applicable variable margin at February 2, 2008, was 3.97%. No amounts were drawn on the Revolving Loan Facility as of February 2, 2008. Based on our current borrowing base, we may borrow up to \$296.2 million under our Revolving Loan Facility, less \$25.8 million in outstanding letters of credit as of February 2, 2008.

The Term Loan Facility will mature on August 17, 2014. The Term Loan Facility will amortize quarterly in annual amounts of 1.0% of the original amount, with the final installment payable on the maturity date. The Term Loan Agreement provides for customary mandatory prepayments, subject to certain exceptions and limitations and in certain instances, reinvestment rights, from (a) the net cash proceeds of certain asset sales, insurance recovery events and debt issuances, each as defined in the Term Loan Agreement, and (b) 25% of excess cash flow, as defined in the Term Loan Agreement, subject to reduction so long as the total leverage ratio, as defined in the Term Loan Agreement, is less than 2.0:1.0. Loans under the Term Loan Facility will bear interest at the Borrower's option, at either (a) the Base Rate as defined in the Term Loan Facility agreement plus 1.75% per annum or (b) the Eurodollar (LIBOR-indexed) Rate plus 2.75% per annum, with such margin to be agreed for any incremental term loans. The Term Loan Facility contains a total leverage ratio covenant and other various covenants including those that

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may limit our ability to pay dividends, repurchase stock, accelerate the retirement of other subordinated debt or make certain investments. As of February 2, 2008, we were in compliance with all covenants.

On August 24, 2007, we entered into an interest rate swap arrangement for \$540 million to hedge a portion of our variable rate Term Loan Facility. The interest rate swap provides for a fixed interest rate of approximately 7.75%, portions of which mature on a series of dates over the next five years. This derivative instrument is designated as a cash flow hedge for accounting purposes.

On August 17, 2007, as part of the Stride Rite acquisition, we acquired and immediately repaid \$46.0 million in Stride Rite debt.

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. 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 February 2, 2008, we were in compliance with all covenants. As of February 2, 2008, the fair value of the Notes was \$188.3 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%

### *Financial Commitments*

As of February 2, 2008, no amounts were drawn against the \$296.2 million borrowing base available under the \$350.0 million Facility. However, to determine the amount that we may borrow, the \$296.2 million borrowing base available under the Facility is reduced by \$25.8 million in outstanding letters of credit.

Our financial commitments as of February 2, 2008, are described below:

(dollars in millions)	Cash Payments Due by Fiscal Year				
	Total	Less than One Year	1-3 Years	3-5 Years	More than Five Years
Senior subordinated notes (including unamortized discount)	\$200.0	\$—	\$—	\$—	\$200.0
Term Loan	723.2	7.3	14.6	14.6	686.7
Capital lease obligations (including interest)	1.3	0.1	0.2	0.2	0.8
Operating lease obligations	1,467.6	295.9	483.6	329.4	358.7
Interest on notes payable and long-term debt	420.1	48.3	128.8	140.5	102.5
Royalty obligations	101.8	7.2	15.0	13.0	66.6
Pension obligations	79.1	5.7	18.4	14.1	40.9
Intangible asset obligations	7.0	3.0	4.0	—	—
Service agreement obligations	10.3	6.9	3.4	—	—
Employment agreement obligations	12.5	12.5	—	—	—
Employee severance	16.3	12.8	3.5	—	—
Total	<u>\$3,039.2</u>	<u>\$399.7</u>	<u>\$671.5</u>	<u>\$511.8</u>	<u>\$1,456.2</u>

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 pension obligations consist of projected pension payments related to our pension plans. Our intangible asset obligations include payments for trademarks we have purchased. 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 integration initiatives.

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Amounts not reflected in the table above:

We issue cancelable purchase orders to various vendors for the purchase of our merchandise. As of February 2, 2008, we had merchandise purchase obligations in the amount of approximately \$208.8 million for which we will likely take delivery.

In conjunction with the adoption of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FAS 109, Accounting for Income Taxes" ("FIN 48"), our liability for unrecognized tax benefits, excluding interest and penalties, is \$49.8 million as of February 2, 2008. With the exception of a reduction in the unrecognized tax benefit of \$0.9 million related to a recent ruling from a taxing authority, the Company does not expect resolution of these matters to result in significant changes to the liability during the next twelve months. We are unable to make a reasonably reliable estimate of the amount and period of related future payments on the remaining balance.

### *Financial Condition Ratios*

A summary of key financial information for the periods indicated is as follows:

	2007	2006	2005
Debt-capitalization Ratio*	56.7%	22.6%	24.0%

\* Debt-to-capitalization has been computed by dividing total debt by capitalization. Total debt is defined as 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 as debt and as capitalization, was 73.5%, 63.5% and 63.8%, respectively, for the periods referred to above.

The increase of the debt-capitalization ratio as of February 2, 2008 is due to the additional debt incurred to finance the Stride Rite acquisition.

### **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 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.

Wholesale inventories are valued at the lower of cost or market using the FIFO method.

The fashion oriented nature of our business, along with the potential for changes in customer preferences and the extended product development lead times, leave us vulnerable to the risk of inventory obsolescence both at our own stores and within our wholesale inventories. We are also exposed to the risk of inventory markdowns for excess or obsolete products, both at retail stores and from independent retailers. We make ongoing estimates relating to the net realizable value of inventories,



based upon our assumptions about future demand and market conditions. If we estimate that the net realizable value of our inventory is less than the cost of the inventory recorded on our books, we record a reserve equal to the difference between the cost of the inventory and the estimated net realizable value. If changes in market conditions result in reductions in the estimated net realizable value of our inventory below our previous estimate, we would increase our reserve in the period in which we made such a determination. We have continually managed these risks in the past and believe we can successfully manage them in the future. However, our revenues and operating margins may suffer if we are unable to effectively manage these risks.

#### *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 into service.

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 on a store-by-store basis are used to determine if impairment exists. The underlying estimates of cash flows include estimates of future revenues, gross margin rates and store expenses and are based upon the stores' past and expected future performance. To the extent our estimates for revenue growth and gross margin rates are not realized, assessments of collectibility could result in impairment charges.

#### *Defined Benefit Plan*

The Company has defined benefit pension plans. One of the plans is frozen and no longer accrues future retirement benefits. Major assumptions used in the accounting for this employee benefit plan include the discount rate, expected return on plan assets and rate of increase in employee compensation levels. Assumptions are determined based on our data and appropriate market indicators, and are evaluated each year as of the plan's measurement date. A change in any of these assumptions would have an effect on net periodic pension and post-retirement benefit costs reported in the consolidated financial statements.

We use a cash flow matching approach for determining the appropriate discount rate for the defined benefit pension plan. The approach is derived from U.S. Treasury rates, plus an option-adjusted spread varying by maturity, to derive hypothetical "Aa" corporate bond rates. The calculation of pension expense is dependent on the determination of the assumptions used. A 25 basis point change in the discount rate will change expense by approximately \$0.4 million. A 25 basis point change in the expected long-term return on assets will result in an approximate change of \$0.1 million in the expense.

#### *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 including historical claims experience, demographic factors and severity factors to estimate the frequency and severity of losses as well as the patterns surrounding the emergence, development and settlement of claims.

#### *Accounting for Taxes*

We adopted the provisions of Financial Accounting Standards Board, ("FASB") interpretation No 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"), on February 4, 2007. FIN 48 prescribes a recognition threshold and a measurement standard for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. The recognition and measurement of tax benefits is often highly judgmental. Determinations regarding the recognition and measurement of a tax benefit can change as additional developments occur relative to the issue. Accordingly, our future results may include favorable or unfavorable adjustments to our unrecognized tax benefits.

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, including average store closing costs, inflation rates, labor costs and asset re-use rates. 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.

#### *Environmental Reserves*

We accrue for costs associated with environmental obligations when such costs are probable and reasonably estimable in accordance with the American Institute of Certified Public Accountant’s Statement of Position (“SOP 96-1”), “Environmental Remediation Liabilities (Including Auditing Guidance)”. Accruals to address estimated costs for environmental obligations generally are recognized no later than the date when we learn what cleanup measures, if any, are likely to occur to address the environmental conditions at issue. In accordance with SOP 96-1, included in such obligations are the estimated direct costs to investigate and address the conditions on our property and the associated engineering, legal and consulting costs. Such accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value.

#### *Share-based Compensation*

We account for share-based awards in accordance with SFAS No. 123(R), “Share-Based Payment” (“SFAS No. 123(R)”). As required by SFAS No. 123(R), share-based compensation is estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using a binomial model. The binomial model requires various highly judgmental assumptions including the expected life, stock price volatility and the forfeiture rate. If any of the assumptions used in the model change significantly, share-based compensation expense may differ materially in the future from that recorded in the current period.

#### *Accounting for Business Combinations*

In accordance with accounting for business combinations under SFAS No. 141 “Business Combinations,” we allocate the purchase price of an acquired business to its identifiable assets and liabilities based on estimated fair values. The excess of the purchase price over the amount allocated to the assets and liabilities, if any, is recorded as goodwill.

We use all available information to estimate fair values including the fair value determination of identifiable intangible assets such as tradenames, and any other significant assets or liabilities. We adjust the preliminary purchase price allocation, as necessary, up to one year after the acquisition closing date when information that is known to be available or obtainable is obtained.

Our purchase price allocation methodology contains uncertainties because it requires management to make assumptions and to apply judgment to estimate the fair value of acquired assets and



liabilities. Management estimates the fair value of assets and liabilities based upon quoted market prices, the carrying value of the acquired assets and widely accepted valuation techniques, including discounted cash flows. Unanticipated events or circumstances may occur which could affect the accuracy of our fair value estimates, including assumptions regarding industry economic factors and business strategies.

#### *Accounting for Goodwill*

We assess goodwill, which is not subject to amortization, for impairment on an annual basis and also at any other date when events or changes in circumstances indicate that the carrying value of these assets may exceed their fair value. This assessment is performed at a reporting unit level. A reporting unit is a component of a segment that constitutes a business, for which discrete financial information is available, and for which the operating results are regularly reviewed by management. We develop an estimate of the fair value of each reporting unit using both a market approach and an income approach. If potential for impairment exists, the fair value of the reporting unit is subsequently measured against the fair value of its underlying assets and liabilities, excluding goodwill, to estimate an implied fair value of the reporting unit's goodwill.

A change in events or circumstances, including a decision to hold an asset or group of assets for sale, a change in strategic direction, or a change in the competitive environment could adversely affect the fair value of one or more reporting units. Given the decline in our market value during 2007, we updated our impairment analysis and concluded there was no impairment as of February 2, 2008. However, if our market value continues to decline we may have a resulting impairment charge.

The estimate of fair value is highly subjective and requires significant judgment related to the estimate of the magnitude and timing of future reporting unit cash flows. If we determine that the estimated fair value of any reporting unit is less than the reporting unit's carrying value, then we will recognize an impairment charge. If goodwill on our consolidated balance sheet becomes impaired during a future period, the resulting impairment charge could have a material impact on our results of operations and financial condition. Our recognized goodwill totaled \$321.0 million as of February 2, 2008.

#### *Accounting for Intangible Assets*

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, certain trademarks and other intangible assets with finite lives are amortized over their useful lives using the straight-line method. Customer relationships are amortized using an economic patterning technique based on when the benefits of the asset are expected to be used.

Each period we evaluate whether events and circumstances warrant a revision to the remaining estimated useful life of each intangible asset. If we were to determine that events and circumstances warrant a change to the estimate of an intangible asset's remaining useful life, then the remaining carrying amount of the intangible asset would be amortized prospectively over that revised remaining useful life.

Additionally, events and circumstances may indicate that the carrying value of one or more intangible assets is not recoverable and its fair value is less than the intangible asset's carrying value, resulting in recognition of an impairment charge.

A change in the estimate of the remaining life of one or more intangible assets or the impairment of one or more intangible assets could have a material impact on our results of operations and financial condition. Our intangible assets' carrying value, net of amortization, was \$559.5 million as of February 2, 2008.

#### *Accounting for Derivatives*

We participate in interest rate related derivative instruments to manage our exposure on our debt instruments. We record all derivative instruments on the balance sheet as either assets or liabilities measured at fair value under the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended. The calculation of the fair value of the interest rate related derivative instruments is based on estimates of future interest rates, which may change based on economic or other factors. Changes in the fair value of these derivative instruments are recorded either through current earnings or as other comprehensive income, depending on the type of hedge designation. Gains and losses on derivative instruments designated as cash flow hedges are reported in other comprehensive income and reclassified into earnings in the periods in which earnings are impacted by the hedged item. As of February 2, 2008, a 100 basis point increase in LIBOR on the unhedged portion of the Company's debt would impact pretax interest expense by approximately \$1.9 million annually or approximately \$0.5 million per quarter.

### *New Accounting Standards*

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies whenever other standards require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position No. FAS 157-1 ("FSP 157-1"), "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13". FSP 157-1 amends SFAS No. 157 to exclude from its scope SFAS No. 13 and other pronouncements that address fair value measurements for purposes of lease classification or measurement. The scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value (including assets and liabilities not related to leases). In February 2008, FASB issued Staff Position 157-2, "Effective Date of FASB Statement No. 157", (FSP 157-2) which delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We are evaluating the impact the adoption of SFAS No. 157 will have on our Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities." This statement permits entities to choose to measure many financial instruments and certain other items at fair value. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We do not believe the impact the adoption of SFAS No. 159 will have a material effect on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations". SFAS No. 141(R) requires the acquiring entity in a business combination to record all assets acquired and liabilities assumed at their respective acquisition-date fair values, changes the recognition of assets acquired and liabilities assumed arising from contingencies, changes the recognition and measurement of contingent consideration, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141(R) also requires additional disclosure of information surrounding a business combination, such that users of the entity's financial statements can fully understand the nature and financial impact of the business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The provisions of SFAS No. 141(R) will only impact us if we are party to a business combination after the pronouncement has been adopted.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51". SFAS No. 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. In addition this statement establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. SFAS No. 160 becomes effective for fiscal periods beginning after December 15, 2008. We are currently evaluating the impact of the adoption of SFAS No. 160 will have 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 0.875% to 1.5%, or the base rate, as defined in the credit agreement. There are no outstanding borrowings on the revolving line of credit at February 2, 2008; however, if we were to borrow against our revolving line of credit, borrowing costs may fluctuate depending upon the volatility of LIBOR. On August 24, 2007, we entered into an interest rate swap arrangement for \$540 million to hedge a portion of our variable rate Term Loan Facility. The interest rate swap provides for a fixed interest rate of approximately 7.75%, portions of which mature on a series of dates over the next five years. The unhedged portion of the Term Loan Facility is subject to interest rate risk depending on the volatility of LIBOR. As of February 2, 2008, a 100 basis point increase in LIBOR on the unhedged portion of the Company's debt would impact pretax interest expense by approximately \$1.9 million annually or approximately \$0.5 million per quarter.

## Foreign Currency Risk

We have 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 February 2, 2008, February 3, 2007 and January 28, 2006, 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.

A significant percentage of our footwear is 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, during 2005, the PRC's government revalued the Yuan 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 0.5% 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 February 1, 2008, the last day of trading in our fiscal year, the exchange rate was 7.19 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 by the independent registered public accounting firm and reports prepared by the 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 five outside directors all of whom have accounting or financial management expertise. The members of the Committee are Daniel Boggan Jr., Howard R. Fricke, Robert F. Moran, John F. McGovern and David Scott Olivet. 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 Collective Brands, 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 February 2, 2008. As permitted by the rules of the SEC, the Company has excluded The Stride Rite Corporation (acquired August 17, 2007) from its annual assessment of the effectiveness on internal control over financial reporting for the year ending February 2, 2008, the year of acquisition. As of February 2, 2008, The Stride Rite Corporation's financial statements constitute approximately \$88 million and \$1,123 million of net and total assets, respectively, \$310 million of revenues, and a net loss of \$27 million of the consolidated financial statement amounts as of and for the year ended February 2, 2008.

Collective Brands, Inc.'s independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report dated March 31, 2008 on our internal control over financial reporting which report is included on page 45.

/s/ Matthew E. Rubel

Chief Executive Officer and President

/s/ Ullrich E. Porzig

Senior Vice President – Chief Financial Officer and Treasurer



## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareowners of  
Collective Brands, Inc.  
Topeka, Kansas

We have audited the internal control over financial reporting of Collective Brands, Inc. and subsidiaries (the “Company”) as of February 2, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management’s Annual Report on Internal Control over Financial Reporting, management excluded from its assessment the internal control over financial reporting at The Stride Rite Corporation, which was acquired on August 17, 2007 and whose financial statements constitute approximately \$88 million and \$1,123 million of net and total assets, respectively, \$310 million of revenues, and a net loss of \$27 million of the consolidated financial statement amounts as of and for the year ended February 2, 2008. Accordingly, our audit did not include the internal control over financial reporting at The Stride Rite Corporation. 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, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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, the Company maintained, in all material respects, effective internal control over financial reporting as of February 2, 2008, 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 financial statement schedule as of and for the year ended February 2, 2008 of the Company and our report dated March 31, 2008 expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding the change in method of accounting for uncertainty in income taxes upon the adoption of Financial Accounting Standards Board Interpretation No. 48, “*Accounting for Uncertainty in Income Taxes*.”

/s/ DELOITTE & TOUCHE LLP

Kansas City, Missouri  
March 31, 2008



**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareowners of  
Collective Brands, Inc.  
Topeka, Kansas

We have audited the accompanying consolidated balance sheets of Collective Brands, Inc. and subsidiaries (the “Company”) as of February 2, 2008 and February 3, 2007, and the related consolidated statements of earnings, shareowners’ equity and comprehensive income, and cash flows for each of the three fiscal years in the period ended February 2, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and 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 Collective Brands, Inc. and subsidiaries as of February 2, 2008 and February 3, 2007, and the results of their operations and their cash flows for each of the three fiscal years in the period ended February 2, 2008, 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.

As discussed in the notes to the consolidated financial statements, the Company adopted Financial Accounting Standards Board (“FASB”) Interpretation No. 48, “*Accounting for Uncertainty in Income Taxes*” in 2007, FASB Statement No. 123(R), “*Share-Based Payment*” and FASB Statement No. 158, “*Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*” in 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of February 2, 2008, 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 31, 2008 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ *DELOITTE & TOUCHE LLP*

Kansas City, Missouri  
March 31, 2008



**COLLECTIVE BRANDS, INC. AND SUBSIDIARIES**  
(Formerly Payless ShoeSource, Inc.)

**CONSOLIDATED STATEMENTS OF EARNINGS**  
(dollars in millions, except per share)

	52 Weeks Ended February 2, 2008	53 Weeks Ended February 3, 2007	52 Weeks Ended January 28, 2006
Net sales	\$ 3,035.4	\$ 2,796.7	\$ 2,665.7
Cost of sales	2,044.5	1,821.0	1,777.1
Gross margin	990.9	975.7	888.6
Selling, general and administrative expenses	899.4	808.5	767.1
Restructuring charges	0.2	0.8	3.8
Operating profit from continuing operations	91.3	166.4	117.7
Interest expense	46.7	19.2	19.7
Interest income	(14.4 )	(22.7 )	(12.3 )
Earnings from continuing operations before income taxes and minority interest	59.0	169.9	110.3
Provision for income taxes	8.6	39.9	30.8
Earnings from continuing operations before minority interest	50.4	130.0	79.5
Minority interest, net of income taxes	(7.7 )	(4.6 )	(3.0 )
Net earnings from continuing operations	42.7	125.4	76.5
Loss from discontinued operations, net of income taxes and minority interest	-	(3.4 )	(6.0 )
Net earnings before cumulative effect of change in accounting principle	42.7	122.0	70.5
Cumulative effect of change in accounting principle, net of income taxes and minority interest	-	-	(4.1 )
Net earnings	<u>\$ 42.7</u>	<u>\$ 122.0</u>	<u>\$ 66.4</u>
Basic earnings per share:			
Earnings from continuing operations	\$ 0.66	\$ 1.90	\$ 1.13
Loss from discontinued operations	-	(0.05 )	(0.09 )
Basic earnings per share before cumulative effect of change in accounting principle	0.66	1.85	1.04
Cumulative effect of change in accounting principle	-	-	(0.06 )
Basic earnings per share	<u>\$ 0.66</u>	<u>\$ 1.85</u>	<u>\$ 0.98</u>
Diluted earnings per share:			
Earnings from continuing operations	\$ 0.65	\$ 1.87	\$ 1.13
Loss from discontinued operations	-	(0.05 )	(0.09 )
Diluted earnings per share before cumulative effect of change in accounting principle	0.65	1.82	1.04
Cumulative effect of change in accounting principle	-	-	(0.06 )
Diluted earnings per share	<u>\$ 0.65</u>	<u>\$ 1.82</u>	<u>\$ 0.98</u>

See Notes to Consolidated Financial Statements

**COLLECTIVE BRANDS, INC. AND SUBSIDIARIES**  
(Formerly Payless ShoeSource, Inc.)

**CONSOLIDATED BALANCE SHEETS**  
(dollars in millions)

	February 2, 2008	February 3, 2007
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 232.5	\$ 371.4
Short-term investments	–	90.0
Restricted cash	–	2.0
Accounts receivable, net of allowance for doubtful accounts and returns reserve as of February 2, 2008 of \$3.4	86.1	3.8
Inventories	470.1	361.9
Current deferred income taxes	23.8	15.6
Prepaid expenses	93.4	46.5
Other current assets	31.5	14.3
Current assets of discontinued operations	0.8	1.1
Total current assets	<u>938.2</u>	<u>906.6</u>
Property and Equipment:		
Land	9.3	6.6
Property, buildings and equipment	1,440.1	1,245.1
Accumulated depreciation and amortization	(898.4 )	(830.5 )
Property and equipment, net	551.0	421.2
Intangible assets, net	559.5	39.6
Goodwill	321.0	5.9
Deferred income taxes	1.5	37.7
Other assets	44.0	16.4
Total Assets	<u>\$ 2,415.2</u>	<u>\$ 1,427.4</u>
<b>LIABILITIES AND SHAREOWNERS' EQUITY</b>		
Current Liabilities:		
Current maturities of long-term debt	\$ 7.4	\$ 0.4
Notes payable	–	2.0
Accounts payable	200.9	185.6
Accrued expenses	203.5	190.2
Current liabilities of discontinued operations	1.3	2.1
Total current liabilities	413.1	380.3
Long-term debt	914.9	201.7
Deferred income taxes	112.9	0.2
Other liabilities	254.2	132.4
Minority interest	17.2	12.7
Commitments and contingencies (Note 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; 63,752,674 and 64,996,287 shares outstanding in 2007 and 2006, respectively	0.9	0.9
Treasury stock, \$.01 par value; 24,378,200 and 23,134,587 shares in 2007 and 2006, respectively	(0.2 )	(0.2 )
Additional paid-in-capital	–	0.7
Retained earnings	708.1	698.1
Accumulated other comprehensive (loss) income, net of income taxes	(5.9 )	0.6
Total shareowners' equity	<u>702.9</u>	<u>700.1</u>

See Notes to Consolidated Financial Statements

**COLLECTIVE BRANDS, INC. AND SUBSIDIARIES**  
(Formerly Payless ShoeSource, Inc.)

**CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY  
AND COMPREHENSIVE INCOME**  
(dollars in millions, shares in thousands)

	Outstanding Common Stock		Additional Paid-in Capital	Unearned Nonvested Shares	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareowners' Equity	Comprehensive Income
	Shares	Dollars						
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 exercise	—	—	6.5	—	—	—	6.5	
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	
Net earnings	—	—	—	—	122.0	—	122.0	122.0
Translation adjustments	—	—	—	—	—	(3.0 )	(3.0 )	(3.0 )
Minimum pension liability adjustment, net of taxes of \$2.0	—	—	—	—	—	(3.6 )	(3.6 )	(3.6 )
Adoption of SFAS No. 158 as restated (Note 8), net of taxes of \$4.5	—	—	—	—	—	(4.7 )	(4.7 )	
Reclassification of unearned nonvested shares related to the adoption of SFAS No. 123(R) (Note 3)	—	—	(4.3 )	4.3	—	—	—	
Issuances of common stock under stock plans	2,698	—	47.1	—	—	—	47.1	
Purchases of common stock	(4,994 )	—	(77.0 )	—	(52.3 )	—	(129.3 )	
Amortization of unearned nonvested shares	—	—	2.2	—	—	—	2.2	
Income tax benefit of stock option exercise	—	—	8.6	—	—	—	8.6	
Stock option expense	—	—	8.8	—	—	—	8.8	
Restricted stock cancellation	(14 )	—	—	—	—	—	—	
Comprehensive income								115.4
Balance at February 3, 2007	64,996	0.7	0.7	—	698.1	0.6	700.1	
Net earnings	—	—	—	—	42.7	—	42.7	42.7
Translation adjustments	—	—	—	—	—	14.3	14.3	14.3
Net change in fair value of derivative, net of taxes of \$9.2 (Note 17)	—	—	—	—	—	(14.3 )	(14.3 )	(14.3 )
Changes in unrecognized amounts of pension benefits, net of taxes of \$4.5 (Note 8)	—	—	—	—	—	(6.5 )	(6.5 )	(6.5 )

Issuances of common stock under stock plans	1,291	–	8.7	–	–	–	8.7
Purchases of common stock	(2,438 )	–	(26.9 )	–	(21.5 )	–	(48.4 )
Amortization of unearned nonvested shares	–	–	4.9	–	–	–	4.9
Income tax benefit of stock option exercise	–	–	2.6	–	–	–	2.6
Stock option expense	–	–	10.0	–	–	–	10.0
Restricted stock cancellation	(96 )	–	–	–	–	–	–
Adoption of FIN 48 (Note 9)	–	–	–	–	(11.2 )	–	(11.2 )
Comprehensive income							–
							\$ 36.2
Balance at February 2, 2008	63,753	\$0.7	\$–	\$–	\$708.1	\$ (5.9 )	\$ 702.9

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Outstanding common stock is net of shares held in treasury and is presented net of \$0.2 million of treasury stock in 2007, 2006 and 2005, respectively. Treasury stock is accounted for using the par value method. Treasury share activity for the last three years is summarized below:

(shares in thousands)	2007	2006	2005
Balance, beginning of year	23,135	20,825	20,939
Issuances of common stock:			
Stock options	(504 )	(2,617 )	(3,145 )
Deferred compensation plan	(8 )	(7 )	(6 )
Net restricted stock grants	(683 )	(60 )	(242 )
	<u>(1,195 )</u>	<u>(2,684 )</u>	<u>(3,393 )</u>
Purchases of common stock	<u>2,438</u>	<u>4,994</u>	<u>3,279</u>
Balance, end of year	<u>24,378</u>	<u>23,135</u>	<u>20,825</u>

See Notes to Consolidated Financial Statements

**COLLECTIVE BRANDS, INC. AND SUBSIDIARIES**  
(Formerly Payless ShoeSource, Inc.)

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(dollars in millions)

	52 Weeks Ended February 2, 2008	53 Weeks Ended February 3, 2007	52 Weeks Ended January 28, 2006
<b>Operating Activities:</b>			
Net earnings	\$ 42.7	\$ 122.0	\$ 66.4
Loss from discontinued operations, net of income taxes and minority interest	–	3.4	6.0
Adjustments for non-cash items included in net earnings:			
Cumulative effect of change in accounting principle, net of income taxes and minority interest	–	–	4.1
Loss on impairment of and disposal of assets	7.2	10.3	9.8
Depreciation and amortization	117.3	89.6	91.6
Provision for losses on accounts receivable	1.5	–	–
Share-based compensation expense	14.6	12.2	1.3
Deferred income taxes	(25.1 )	9.1	13.7
Minority interest, net of income taxes	7.7	4.6	3.0
Income tax benefit from share-based compensation	2.6	8.6	6.5
Excess tax benefit from share-based compensation	(2.4 )	(8.0 )	–
Interest income on held-to-maturity investments	(0.6 )	(3.6 )	(1.3 )
<b>Changes in working capital, exclusive of the effects of acquisitions:</b>			
Accounts receivable	12.7	–	(0.4 )
Inventories	80.6	(29.8 )	13.5
Prepaid expenses and other current assets	(23.5 )	(9.0 )	(1.6 )
Accounts payable	(42.0 )	15.6	9.0
Accrued expenses	(30.7 )	5.7	9.5
Changes in other assets and liabilities, net	30.7	3.0	6.4
Net cash used in discontinued operations	(0.5 )	(4.0 )	(10.6 )
<b>Cash flow provided by operating activities</b>	<b>192.8</b>	<b>229.7</b>	<b>226.9</b>
<b>Investing Activities:</b>			
Capital expenditures	(167.4 )	(118.6 )	(64.3 )
Restricted cash	2.0	–	1.0
Proceeds from sale of property and equipment	2.9	4.6	1.2
Intangible asset additions	(0.6 )	(15.5 )	–
Purchases of investments	(6.1 )	(215.6 )	(146.4 )
Sales and maturities of investments	96.7	188.2	110.0
Acquisition of businesses, net of cash acquired	(877.7 )	–	–
Net cash used in discontinued operations	–	–	(0.1 )
<b>Cash flow used in investing activities</b>	<b>(950.2 )</b>	<b>(156.9 )</b>	<b>(98.6 )</b>
<b>Financing Activities:</b>			
Repayment of notes payable	(2.0 )	–	(1.0 )
Issuance of debt	725.0	–	1.2
Repayment of debt	(55.3 )	(2.8 )	(1.5 )
Payment of deferred financing costs	(12.7 )	(0.2 )	–
Issuances of common stock	8.7	47.1	49.6
Purchases of common stock	(48.4 )	(129.3 )	(71.2 )
Excess tax benefit from share-based compensation	2.4	8.0	–
Distributions to minority owners	(2.4 )	(1.5 )	–
Net cash provided by discontinued operations	–	1.2	0.9
<b>Cash flow provided by (used in) financing activities</b>	<b>615.3</b>	<b>(77.5 )</b>	<b>(22.0 )</b>
<b>Effect of exchange rate changes on cash</b>	<b>3.2</b>	<b>(2.1 )</b>	<b>0.9</b>

(Decrease) increase in cash and cash equivalents	(138.9 )	(6.8 )	107.2
Cash and cash equivalents, beginning of year	371.4	378.2	271.0
Cash and cash equivalents, end of year	<u>\$ 232.5</u>	<u>\$ 371.4</u>	<u>\$ 378.2</u>

See Notes to Consolidated Financial Statements



**COLLECTIVE BRANDS, INC. AND SUBSIDIARIES**  
**(Formerly Payless ShoeSource, Inc.)**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 – Summary of Significant Accounting Policies**

*Description of Business and Basis of Presentation*

Collective Brands, Inc. (the “Company”) is the holding company of Payless ShoeSource, Inc. (“Payless”), The Stride Rite Corporation (“Stride Rite”), and a licensing business known as Collective International, LP (“Collective Licensing”). Payless is dedicated to democratizing fashion and design in footwear and accessories and inspiring fun, fashion possibilities for the family at a great value. Stride Rite markets the leading brand of high-quality children’s shoes in the United States. Stride Rite also markets products for children and adults under well-known brand names, including Keds, Sperry Top-Sider, and Saucony. Collective Licensing is a youth lifestyle marketing and global licensing business within the Payless Domestic segment.

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. The Company’s Central American and South American Regions 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. All intercompany amounts have been eliminated.

As a result of the 2004 restructuring, as discussed in Note 5 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. In addition, during 2006 the Company exited retail operations in Japan, closing its one store location. The financial information for Japan retail operations 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.

Certain prior year amounts have been reclassified, based on the aggregation rules contained in the Security and Exchange Commission’s Regulation S-X, Rule 5-02, to conform to the current year presentation.

*Fiscal Year*

The Company’s fiscal year ends on the Saturday closest to January 31. Fiscal years 2007, 2006 and 2005 ended on February 2, 2008, February 3, 2007, and January 28, 2006, respectively. Fiscal years 2007 and 2005 contain 52 weeks of results compared to fiscal year 2006 which contains 53 weeks. References to years in these financial statements and notes relate to fiscal years rather than calendar years.

*Use of Estimates*

Management makes estimates and assumptions that affect the amounts reported within the Consolidated Financial Statements. Actual results could differ from these estimates.

*Net Sales*

Net sales (“sales”) for transactions at the Company’s retail stores are recognized at the time the sale is made to the customer, are net of estimated returns and current markdowns and exclude sales tax. Net sales for wholesale and e-commerce transactions are recognized when title passes and the risks or rewards of ownership have transferred to the customer, the price is fixed and determinable, and collectibility is reasonable assured, based on the shipping terms. Sales are net of estimated returns and current promotional discounts and exclude sales tax.

The Company has established an allowance for merchandise returns and markdowns based on historical experience, product sell-through performance by product and customer, current and historical trends in the footwear industry and changes in demand for our products, in accordance with Statement of Financial Accounting Standards (SFAS) No. 48, “Revenue Recognition When Right of Return Exists”. The returns allowance is recorded as a reduction to revenues for the estimated sales value of the projected merchandise returns and as a reduction in cost of products for the corresponding cost amount. Allowances for markdowns are recorded as a reduction of revenue based on historical experience. From time to time actual results will vary from the estimates that were previously established. Due to the existence of monitoring systems, the Company’s visibility into its wholesale customers’ inventory levels and ongoing communication with its wholesale customers, the Company is able to identify and reflect in its financial statements in a timely manner variances from estimates previously established.

### *Shipping and Handling*

Products are sold Free On Board (“FOB”) shipping point for wholesale customers. Any shipping charges that we pay are recorded as cost of sales and any reimbursement is recorded as revenue.

### *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, occupancy, warehousing and product movement costs, as well as depreciation of stores and the distribution centers.

### *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 \$131.8 million, \$112.7 million and \$106.7 million in 2007, 2006 and 2005, respectively.

### *Co-operative Advertising*

The Company engages in co-op advertising programs with some of its wholesale customers. Co-op advertising funds are available to all wholesale customers in good standing. Wholesale customers receive reimbursement under this program if they meet established advertising guidelines and trademark requirements. Costs are accrued on the basis of sales to qualifying customers and accounted for as an operating expense if the Company receives, or will receive, an identifiable benefit in exchange for the consideration and the Company can reasonably estimate the fair value of the benefit identified.

### *Income Taxes*

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

In determining our provision for income taxes, the Company uses an annual effective income tax rate based on annual income, permanent differences between book and tax income, and statutory income tax rates. The effective income tax rate also reflects the Company’s assessment of the ultimate outcome of tax audits. The Company adjusts its annual effective income tax rate as additional information on outcomes or events becomes available. Discrete events such as audit settlements or changes in tax laws are recognized in the period in which they occur.

The Company has adopted Financial Accounting Standards Board (“FASB”) Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109” (“FIN 48”) which addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax

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position will be sustained on examination by the taxing authorities, based on the technical merits of the position. We include our reserve for unrecognized tax benefits, as well as related accrued penalties and interest, in other long term liabilities on our consolidated balance sheets and in provision for income taxes in our consolidated statements of earnings.

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.

### *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 \$17.0 million and \$15.3 million for the settlement of credit card transactions are included in cash and cash equivalents as of February 2, 2008, and February 3, 2007, respectively, as they are generally collected within three business days. Cash equivalents are stated at cost, which approximates fair value.

### *Short-Term Investments*

Short-term investments consisted of the following:

(dollars in millions)	February 3, 2007
Held-to-maturity securities:	
Commercial paper	\$90.0
Total held-to-maturity securities	\$90.0

Held-to-maturity securities are accounted for in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are carried at amortized cost, which approximates their fair value. As of February 3, 2007, the estimated fair value of each investment approximated its amortized cost and, therefore, there were no significant unrecognized holding gains or losses. As of February 2, 2008, the Company did not have any short-term investments.

### *Reserve for Uncollectible Accounts Receivable*

The Company makes ongoing estimates relating to the collectibility of its accounts receivable and maintains a reserve for estimated losses resulting from the inability of our customers to make required payments. In determining the amount of the reserve, the Company considers its historical level of credit losses and makes judgments about the creditworthiness of significant customers based on ongoing credit evaluations. These evaluations include, but are not limited to, analyzing our customer's financial statements, maintaining a credit watch list to monitor accounts receivable exposure and reviewing the customer's prior payment history.

### *Inventories*

Merchandise inventories in the Company's 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. 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 approximates a traditional FIFO cost basis.

Wholesale inventories are valued at the lower of cost or market using the FIFO method.

The Company makes ongoing estimates relating to the net realizable value of inventories, based upon our assumptions about future demand and market conditions. If the Company's estimate of the net realizable value of our inventory is less than the cost of the inventory recorded on our books, a reserve is recorded equal to the difference between the cost of the inventory and the estimated net realizable value. If changes in market conditions result in reductions in the estimated net realizable value of

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the Company's inventory below the previous estimate, the Company increases its reserve in the period in which it made such a determination.

Raw materials are included in inventories and accounted for under the FIFO basis. Raw materials of \$1.9 million and \$29.5 million are included in inventories in the consolidated balance sheet at February 2, 2008, and February 3, 2007, 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	2 to 10 years
Property under capital lease	10 to 30 years

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

(dollars in millions)	2007	2006
Buildings and leasehold improvements	\$718.5	\$633.0
Furniture, fixtures and equipment	638.3	532.5
Property under capital leases	3.5	0.9
Projects in progress	79.8	78.7
	<u>\$1,440.1</u>	<u>\$1,245.1</u>

Depreciation expense for 2007, 2006, and 2005 was \$102.5 million, \$85.3 million, and \$87.0 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. Undiscounted estimated future cash flows are used to determine if impairment exists. If impairment exists, we use discounted cash flows to calculate impairment. The Company uses current operating results and historical performance to estimate future cash flows on a store-by-store basis. Excluding exit costs as discussed in Note 4, total impairment charges related to assets held and used were \$1.9 million, \$1.7 million, and \$2.4 million in 2007, 2006 and 2005, respectively. These charges are included in cost of sales.

### *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 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 2007, 2006 and 2005, cumulative translation adjustments included in accumulated other comprehensive income (loss) were \$23.7 million, \$9.4 million and \$12.4 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. Transaction adjustments are included in the determination of net earnings.

### *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 statements of earnings.

The Company adopted FIN 47 in the fourth quarter of 2005. Please refer to Note 22 for further discussion regarding this change in accounting principle. 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, labor costs and asset re-use rates.

The following table summarizes the Company's ARO liability included on its consolidated balance sheets.

(in millions)	2007	2006
Beginning asset retirement obligation	<b>\$8.5</b>	\$8.5
Liabilities incurred during year	<b>0.2</b>	0.1
Liabilities settled during year	<b>(0.3 )</b>	(0.4 )
Accretion expense	–	0.3
Ending asset retirement obligation	<b><u>\$8.4</u></b>	<b><u>\$8.5</u></b>

### *Business Combinations*

In accordance with accounting for business combinations under SFAS No. 141 "Business Combinations," the Company allocates the purchase price of an acquired business to its identifiable assets and liabilities based on estimated fair values. The excess of the purchase price over the amount allocated to the assets and liabilities, if any, is recorded as goodwill.

The Company uses all available information to estimate fair values including the fair value determination of identifiable intangible assets such as tradenames, and any other significant assets or liabilities. The Company adjusts the preliminary purchase price allocation, as necessary, up to one year after the acquisition closing date when information that is known to be available or obtainable is obtained.

The Company's purchase price allocation methodology contains uncertainties because it requires management to make assumptions and to apply judgment to estimate the fair value of acquired assets and liabilities. Management estimates the fair value of assets and liabilities based upon quoted market prices, the carrying value of the acquired assets and widely accepted valuation techniques, including discounted cash flows.

### *Accounting for Goodwill*

The Company assesses goodwill, which is not subject to amortization, for impairment on an annual basis and also at any other date when events or changes in circumstances indicate that the carrying value of these assets may exceed their fair value. This assessment is performed at a reporting unit level. A reporting unit is a component of a segment that constitutes a business, for which discrete financial information is available, and for which the operating results are regularly reviewed by management. The Company develops an estimate of the fair value of each reporting unit using both a market approach and an income approach. If potential for impairment exists, the fair value of the reporting unit is subsequently measured against the fair value of its underlying assets and liabilities, excluding goodwill, to estimate an implied fair value of the reporting unit's goodwill.

The Company performed the required annual impairment testing using a test date of September 1, 2007 and no impairment losses were necessary.

A change in events or circumstances, including a decision to hold an asset or group of assets for sale, a change in strategic direction, or a change in the competitive environment could adversely affect the fair value of one or more reporting units. Given the decline in the Company's market value during 2007, the Company updated its impairment analysis and concluded there was no impairment as of February 2, 2008. However, if the Company's market value continues to decline we may have a resulting impairment charge.

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The estimate of fair value is highly subjective and requires significant judgment related to the estimate of the magnitude and timing of future reporting unit cash flows. If the Company determines that the estimated fair value of any reporting unit is less than the reporting unit's carrying value, then it will recognize an impairment charge. If goodwill on the Company's consolidated balance sheet becomes impaired during a future period, the resulting impairment charge could have a material impact on its results of operations and financial condition. The Company's recognized goodwill totaled \$321.0 million as of February 2, 2008.

### *Accounting for Intangible Assets*

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, certain trademarks and other intangible assets with finite lives are amortized over their useful lives using the straight-line method. Customer relationships are amortized using an economic patterning technique based on when the benefits of the asset are expected to be used.

Each period, the Company evaluates whether events and circumstances warrant a revision to the remaining estimated useful life of each intangible asset. If the Company were to determine that events and circumstances warrant a change to the estimate of an intangible asset's remaining useful life, then the remaining carrying amount of the intangible asset would be amortized prospectively over that revised remaining useful life.

Additionally, other events and circumstances may indicate that the carrying value of one or more intangible assets is not recoverable and its fair value is less than the intangible asset's carrying value, resulting in the recognition of an impairment charge.

A change in the estimate of the remaining life of one or more intangible assets or the impairment of one or more intangible assets could have a material impact on the Company's results of operations and financial condition. The Company's intangible assets' carrying value, net of amortization, was \$559.5 million as of February 2, 2008.

### *Derivatives*

The Company participates in an interest rate related derivative instrument to manage its exposure on debt instruments. The Company records all derivative instruments on the balance sheet as either assets or liabilities measured at fair value under the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended. Changes in the fair value of these derivative instruments are recorded either through current earnings or as other comprehensive income, depending on the type of hedge designation. Gains and losses on derivative instruments designated as cash flow hedges are reported in other comprehensive income and reclassified into earnings in the periods in which earnings are impacted by the hedged item.

### *Environmental Costs*

The Company accrues for costs associated with environmental obligations when such costs are probable and reasonably estimable in accordance with the American Institute of Certified Public Accountant's Statement of Position ("SOP 96-1"), "Environmental Remediation Liabilities (Including Auditing Guidance)". Accruals to address estimated costs for environmental obligations generally are recognized no later than the date when the Company learns what cleanup measures, if any, are likely to occur to address the environmental conditions at issue. In accordance with SOP 96-1, included in such obligations are the estimated direct costs to investigate and address the conditions on Company property and the associated engineering, legal and consulting costs. Such accruals are adjusted as further information develops or circumstances change. Cost of future expenditures for environmental remediation obligations are not discounted to their present value.

*Supplemental Cash Flow Information*

(dollars in millions)	52 Weeks Ended February 2, 2008	53 Weeks Ended February 3, 2007	52 Weeks Ended January 28, 2006
Interest paid	\$ 34.5	\$ 28.5	\$ 20.8
Income taxes paid	\$ 13.1	\$ 29.4	\$ 14.9
Non-cash investing and financing activities:			
Accrued capital additions	\$ 25.3	\$ 23.0	\$ 9.4
Capital lease additions	\$ 1.2	\$ –	\$ –
Accrued intangible asset additions	\$ –	\$ 10.0	\$ –



## Note 2 - Acquisitions

### Stride Rite

On August 17, 2007, the Company completed the acquisition of 100% of the equity of Stride Rite. The purchase price of Stride Rite was approximately \$786.6 million, net of cash acquired of \$22.7 million, including transaction costs. The Stride Rite acquisition was financed with cash-on-hand and the net proceeds from a \$725 million term loan. The Acquisition was accounted for using the purchase method in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations." Accordingly, net assets were recorded at their estimated fair values, and operating results are included from the date of acquisition. The purchase price was allocated on a preliminary basis using information currently available. The Company is still in the process of integrating Stride Rite and may have additional costs associated with this integration including costs related to employee severance, environmental liability valuation and contract termination. The allocation of the purchase price to the assets and liabilities acquired will be finalized as necessary, up to one year after the acquisition closing date, when information that is known to be available or obtainable is obtained. As the purchase price exceeded the fair value of the assets and liabilities assumed, including identified intangible assets, goodwill associated with this transaction was recorded in the consolidated balance sheet. The purchase price in excess of the value of Stride Rite's net assets reflects the strategic value the Company placed on Stride Rite's wholesale and retail businesses. The Company believes it will benefit from synergies as Stride Rite's operations are integrated with the Company's existing operations. Of the \$280.8 million of goodwill associated with this transaction, \$42.0 million is included in the Stride Rite Retail segment and \$238.8 million is included in the Stride Rite Wholesale segment. None of the goodwill associated with this acquisition is deductible for tax purposes.

The preliminary purchase price allocation, net of cash acquired, was as follows:

(In millions)	
Receivables	\$91.1
Inventories	184.6
Other current assets	34.7
Total current assets	310.4
Property and equipment	68.0
Goodwill	280.8
Indefinite lived trademarks	391.1
Finite lived intangible assets*	83.7
Other assets	10.6
Total assets acquired	1,144.6
Accounts payable	(53.4 )
Accrued expenses and other current liabilities	(59.0 )
Total current liabilities	(112.4 )
Long-term debt	(46.0 )
Long-term deferred tax liabilities	(179.2 )
Other long-term liabilities	(20.4 )
Total liabilities acquired	(358.0 )
Net assets acquired	<u>\$786.6</u>

\* Finite lived intangible assets will be amortized as follows:

Type	Fair Value (in millions)	Weighted Average Useful Life
Trademarks	\$ 7.2	8 Years
Customer relationships	66.6	8 Years
Customer backlog	2.2	0.75 Years
Other intangibles	7.7	5 Years
	<u>\$ 83.7</u>	



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Identification and allocation of value assigned to the identified intangible assets is based on the provisions of SFAS No. 141. The fair value was estimated by performing three generally accepted valuation approaches (as applicable): the income approach, the market approach and the cost approach. Under the income approach, valuations include a forecast of direct revenues and costs associated with the respective intangible assets and charges for economic returns on tangible and intangible assets utilized in cash flow generation. Net cash flows attributable to the identified intangible assets are discounted to their present value using a rate that is commensurate with the perceived risk. Under the market approach, the fair value of a business or asset reflects the price at which comparable businesses or assets are purchased under similar circumstances. Under the cost approach, the value of an asset is estimated using the current cost to purchase or replace the asset. The projected cash flow assumptions included considerations for contractual relationships, customer attrition, and market competition.

As part of the purchase price allocation, the Company incurred exit costs as a result of the Stride Rite acquisition. As of February 2, 2008, these costs include employee severance costs of \$14.5 million and contract termination and other costs of \$1.2 million. As of February 2, 2008, the Company has paid \$1.7 million of these costs. These costs include employee severance for certain Stride Rite corporate employees as well as employee severance, contract termination and other costs related to the Company's plan to close the Stride Rite's Burnaby and Huntington distribution centers.

### *Collective Licensing*

Effective March 30, 2007, the Company acquired 100% of the partnership interest of Collective Licensing for \$91.1 million, net of cash acquired of \$1.1 million, including transaction costs. Collective Licensing is a brand development, management and licensing company that had previously licensed the Airwalk brand to the Company. The acquisition was accounted for using the purchase method in accordance with SFAS No. 141. Accordingly, net assets were recorded at their estimated fair values, and operating results are included in the Payless Domestic segment from the date of acquisition. As the purchase price exceeded the fair value of the assets and liabilities assumed, goodwill associated with this transaction was recorded in the consolidated balance sheet. The purchase price in excess of the value of Collective Licensing's net assets reflects the strategic value the Company placed on Collective Licensing's business. All goodwill is included in the Payless Domestic segment and is deductible for tax purposes.

The purchase price allocation, net of cash acquired, was as follows:

(In millions)	
Current assets	\$4.6
Goodwill	34.3
Indefinite lived trademarks	40.6
Finite lived intangible assets*	16.5
Total assets acquired	96.0
Current liabilities	(4.9 )
Total liabilities acquired	(4.9 )
Net assets acquired	<u>\$91.1</u>

\* Finite lived intangible assets will be amortized as follows:

Type	Fair Value (in millions)	Weighted Average Useful Life
Trademarks	\$ 7.1	10 Years
Customer relationships	9.2	7 Years
Non-compete contracts	0.2	3 Years
	<u>\$ 16.5</u>	

Identification and allocation of value assigned to the identified intangible assets is based on the provisions of SFAS No. 141. The fair value was estimated by performing a discounted cash flow analysis using the "income" approach. This method includes a forecast of direct revenues and costs associated with the respective intangible assets and charges for economic returns on tangible and intangible assets utilized in cash flow generation. Net cash flows attributable to the identified intangible assets are discounted to their present value using a rate that is commensurate with the perceived risk. The projected cash flow assumptions included considerations for contractual relationships, customer attrition, and market competition.

*Pro forma Financial Information*

The following pro forma combined results of operations for the acquisitions of Stride Rite and Collective Licensing have been provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that will be achieved by the combined company in the future. The pro forma combined results of operations assume that the acquisitions of Stride Rite and Collective Licensing occurred at the beginning of each fiscal year. The results have been prepared by adjusting the historical results of the Company to include the historical results of Stride Rite and Collective Licensing, the incremental interest expense and the impact of the preliminary purchase price allocations discussed above. The pro forma combined results of operations do not include any cost savings that may result from the combination of the Company and Stride Rite and Collective Licensing or any estimated costs that will be incurred by the Company to integrate the businesses.

(dollars in millions, except per share)	52 Weeks Ended February 2, 2008	53 Weeks Ended February 3, 2007
Net sales	\$ 3,495.3	\$ 3,506.9
Net earnings	37.6	72.9
Basic earnings per share	\$ 0.58	\$ 1.11
Diluted earnings per share	\$ 0.58	\$ 1.09

**Note 3 - Share-Based Compensation**

Effective January 29, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment", using the modified prospective transition method and therefore has not retroactively adjusted results from prior periods. Under this transition method, compensation cost associated with share-based awards recognized in fiscal years 2006 and 2007 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested, as of January 29, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", and (b) compensation cost for all share-based payments granted subsequent to January 29, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R).

The Company elected to adopt the alternative transition method to account for the tax effects of share-based payment awards as provided in FASB Staff Position FAS 123(R)-3: "Transition Election Related to Accounting for the Tax effects of Share-Based Payment Awards" ("FSP 123(R)-3") during the second quarter of 2006.

Prior to the adoption of SFAS No. 123(R), the Company followed the disclosure provisions of SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." The Statement required 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. Prior to fiscal year 2006, the Company accounted for stock compensation awards under the intrinsic value method of Accounting Principles Board ("APB") Opinion No. 25. APB Opinion No. 25 required 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 the Company's plans were granted with an exercise price equal to the fair market value on the date of the grant.

SFAS No. 123 established a fair value based method of accounting for employee stock options or similar equity instruments. In order to calculate fair value under SFAS No. 123, the Company used the Black-Scholes option pricing model to estimate the grant date fair value of options granted in fiscal years 1996 through 2005. The fair value was recognized over the option vesting period using tranche specific expense attribution as discussed in FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans - An Interpretation of APB Opinions No. 15 and 25."

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The following table presents the effect on net earnings and earnings per share had share-based compensation expense been recorded for the 52 weeks ended January 28, 2006, based on the fair-value method under SFAS No. 123.

(dollars in millions, except per share amounts)

January 28, 2006

<b>Net earnings:</b>	
As reported	\$ 66.4
Add: Total stock-based employee compensation expense included in net earnings as reported, net of related income taxes	3.2
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related income taxes	6.8
Pro forma	<u>\$ 62.8</u>
<b>Basic earnings per share:</b>	
As reported	\$ 0.98
Pro forma	\$ 0.93
<b>Diluted earnings per share:</b>	
As reported	\$ 0.98
Pro forma	\$ 0.93

### *Equity Incentive Plans*

Under its equity incentive plans, the Company currently grants share appreciation vehicles consisting of stock options, stock-settled stock appreciation rights ("stock-settled SAR's") and cash-settled stock appreciation rights ("cash-settled SAR's"), as well as full value vehicles consisting of nonvested shares and phantom stock units. Appreciation vehicles granted under the 1996 and 2006 Stock Incentive Plans are granted at the fair market value on the date of grant and may be exercised only after stated vesting dates or other vesting criteria, as applicable, has been achieved. Generally, vesting of appreciation vehicles is conditioned upon continued employment with the Company, although appreciation vehicles may be exercised during certain periods following retirement, disability or death. Historically, the Company has used treasury shares for settlement of share-based compensation.

Under the 1996 Stock Incentive Plan, which expired in April 2006, the Company was authorized to grant a maximum of 15,600,000 shares, of which no more than 1,200,000 could be issued pursuant to nonvested share grants. Appreciation vehicles granted under the plan had a maximum term of 10 years and could vest on a graded schedule or a cliff basis. The exercise prices of appreciation vehicles equaled the average of the high and low trading prices of the Company's stock on the grant date. Nonvested shares granted under the plan could 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. Associates who received nonvested shares paid no monetary consideration.

On May 25, 2006, the Company's shareowners approved the 2006 Stock Incentive Plan. On May 24, 2007, the 2006 Stock Incentive Plan was amended to allow the Company to grant a maximum of 4,300,000 shares. Appreciation vehicles to be granted under the plan have a maximum term of seven years and can vest on a graded schedule, a cliff basis or based on performance. The exercise price of an appreciation vehicle may not be less than the average of the high and low trading prices of the Company's stock on the grant date. Associates who receive full value vehicles pay no monetary consideration. Awards under the 2006 Stock Incentive Plan can be granted with or without performance restrictions. Restrictions, including performance restrictions, lapse over periods of up to seven years, as determined at the date of grant.

On May 25, 2006, the Company's shareowners approved amendments to and restatement of the Stock Plan for Non-Management Directors (the "Director Plan"). Under the Company's amended and restated Director Plan, each Director who is not an officer of the Company is eligible to receive share-based compensation in the form of non-qualified stock options and/or stock awards, including, but not limited to, restricted and unrestricted stock awards. All shares of common stock issued under the Director Plan are subject to restrictions on transferability and to forfeiture during a specified restricted period. The Director Plan provides for the issuance of not more than 350,000 shares of common stock, subject to adjustment for changes in the Company's capital structure. The Company may not, without stockholder approval, amend the Director Plan in a manner that would increase the number of shares of common stock available for awards, decrease the exercise price of any award, or otherwise materially increase benefits or modify eligibility requirements. The material differences between the amended and prior Director Plans are: (1) participants may, if certain conditions are met, transfer or otherwise dispose of shares of stock received pursuant to the amended plan prior to their termination from the board, and (2) the maximum number of shares of common stock available for issuance under the Director Plan was reduced from 900,000 to 350,000 shares.

Under the Company's Amended Stock Ownership Plan, a maximum of 6,000,000 shares of the Company's common stock may be purchased by employees at a 5% discount. The current terms of the Stock Ownership plan are such that the plan is non-compensatory. As a result, the purchase of shares by employees does not give rise to compensation cost.

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### *Stock Options*

During 2007, the Company did not grant any stock options.

Transactions for stock options for the fiscal year 2007 were as follows:

(units in thousands)	52 Weeks Ended February 2, 2008	
	Options	Weighted Average Exercise Price
Outstanding at beginning of period	3,395	\$ 19
Granted	—	—
Exercised	(461 )	17
Forfeited or expired	(115 )	20
Outstanding at end of period	2,819	19
Vested and expected to vest at end of period	2,779	19
Exercisable at end of period	1,814	18

The following table summarizes information about stock options outstanding, options vested or expected to vest, and exercisable at February 2, 2008:

Options Outstanding				
Range of Exercise Prices	Number of Outstanding (in thousands)	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price
\$13 - 15	78	5	\$ 250	\$ 14
16 - 18	1,462	4	1,557	17
19 - 24	1,279	4	—	22

Options Vested and Expected to Vest				
Range of Exercise Prices	Number Vested and Expected to Vest (in thousands)	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price
\$13 - 15	78	5	\$ 250	\$ 14
16 - 18	1,443	4	1,544	17
19 - 24	1,258	4	—	22

Options Exercisable				
Range of Exercise Prices	Number Exercisable (in thousands)	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price
\$13 - 15	78	5	\$ 250	\$ 14
16 - 18	1,192	3	1,362	16
19 - 24	544	4	—	22

The aggregate intrinsic value was calculated using the difference between the current market price and the grant price for only those awards that have a grant price that is less than the current market price.

The total intrinsic value of options exercised during 2007, 2006 and 2005 was \$6.5 million, \$24.0 million and \$17.9 million, respectively. Cash received from option exercises for 2007, 2006 and 2005 was \$8.2 million, \$46.6 million and \$48.9 million, respectively, excluding cash received from the Company's employee stock purchase and deferred compensation plans. The tax benefit realized for the deductions from options exercised during 2007, 2006 and 2005 was \$2.6 million, \$8.6 million and \$6.5 million, respectively. The weighted average fair value of units granted per unit for 2006 and 2005 was \$10 and \$7, respectively.

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### *Stock-settled SAR's*

During 2007, the Company granted 1,697,889 stock-settled SAR's under the 2006 Stock Incentive Plan. Of this amount, 1,389,829 are subject to a three-year graded vesting schedule and 308,060 are subject to a three-year cliff vesting schedule. None of the vesting requirements are based on any performance conditions.

Upon exercise of a stock-settled SAR, employees will receive a number of shares of common stock equal in value to the appreciation in the fair market value of the underlying common stock from the grant date to the exercise date of the stock-settled SAR. All of the stock-settled SAR's issued by the Company to-date contain an appreciation cap, which limits the appreciation for which shares of common stock will be granted to 200% of the fair market value of the underlying common stock on the grant date of the stock-settled SAR. As a result of the appreciation cap, a maximum of 2/3 of a share of common stock may be issued for each stock-settled SAR granted.

Transactions for stock-settled SAR's for the fiscal year 2007 were as follows:

(units in thousands)	52 Weeks Ended February 2, 2008	
	Stock-Settled SAR's	Weighted Average Exercise Price
Outstanding at beginning of period	889	\$ 23
Granted	1,698	27
Exercised	(50 )	23
Forfeited or expired	(166 )	26
Outstanding at end of period	2,371	26
Vested and expected to vest at end of period	2,228	26
Exercisable at end of period	216	23

Weighted average fair value of units granted (per unit) \$ 12

The following table summarizes information about stock-settled SAR's outstanding, vested or expected to vest and exercisable at February 2, 2008:

Stock-Settled SAR's Outstanding				
Range of Exercise Prices	Number of Outstanding (in thousands)	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price
\$18-23	1,567	6	\$ —	\$ 23
24-30	60	5	—	27
30-37	744	6	—	33

Stock-Settled SAR's Vested and Expected to Vest				
Range of Exercise Prices	Number Vested and Expected to Vest (in thousands)	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price
\$18-23	1,477	6	\$ —	\$ 23
24-30	57	5	—	27
30-37	694	6	—	33

Stock-Settled SAR's Exercisable				
Range of Exercise Prices	Number Exercisable (in thousands)	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price
\$18-23	198	5	\$ —	\$ 23
24-30	8	4	—	27
30-37	10	6	—	32

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The aggregate intrinsic value was calculated using the difference between the current market price and the grant price for only those awards that have a grant price that is less than the current market price.

The total intrinsic value of stock-settled SAR' s exercised during 2007 was \$0.6 million. There were no stock-settled SAR' s exercised during 2006. The tax benefit realized for the deductions from stock-settled SAR' s exercised during 2007 was \$0.2 million. There was no such tax benefit realized in 2006. The weighted average fair value of units granted per unit for 2007 and 2006 was \$12 and \$9, respectively.

### *Nonvested Shares and Share Units*

During 2007, the Company granted 762,818 nonvested shares, of which 292,641 were related to a performance grant under the 2006 Stock Incentive Plan. The remaining 470,177 nonvested shares are subject to a three-year cliff vesting schedule, which is not based on any performance vesting conditions. The performance condition for 144,008 shares was not met for 2007 and, as such, none of the related nonvested shares will vest. The performance condition for 148,633 shares will not be known until the spring of 2008.

During 2007, the Company granted 271,113 nonvested share units with market based performance conditions under the 2006 Stock Incentive Plan. These shares are subject to a market appreciation condition and a three-year cliff vesting schedule. If either condition is not met, the shares will not vest. The Company also granted 16,735 nonvested share units subject to a three-year graded vesting schedule, which is not based on any performance vesting conditions, and 8,595 nonvested share units subject to a performance vesting condition.

During 2007, the Company granted 7,360 nonvested shares under the Director Plan. These shares will vest on May 1, 2008. In addition, pursuant to the provisions of the Director Plan, Directors elected to defer compensation into 10,232 share units that will be issued as common stock subsequent to the Directors' resignation from the Board. These share units will vest on May 1, 2008. Deferral does not affect vesting. Deferred share units are excluded from the summary table of nonvested shares.

On July 18, 2005, the Company granted its Chief Executive Officer and President 214,250 nonvested shares. The nonvested shares will cliff vest on the third anniversary of the grant.

Excluding deferred shares under the Director Plan, transactions for nonvested shares and share units for the fiscal year 2007 were as follows:

(shares in thousands)	52 Weeks Ended February 2, 2008	
	Nonvested Shares and Share Units	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	318	\$ 21
Granted	1,059	26
Vested	(45 )	19
Forfeited or expired	(86 )	24
Nonvested at end of period	<u>1,246</u>	25

The weighted average grant date fair value of nonvested shares granted in 2007, 2006 and 2005 was \$26, \$23 and \$20, respectively.

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### *Cash-settled SAR's*

During 2007, the Company issued 84,611 cash-settled SAR's on 84,611 shares. Of this amount, 70,611 are subject to a three-year graded vesting schedule and 14,000 are subject to a three-year cliff vesting schedule. None of the vesting requirements are based on any performance conditions.

Transactions for cash-settled SAR's for the fiscal year 2007 were as follows:

(shares in thousands)	52 Weeks Ended February 2, 2008	
	Cash-Settled SAR's	Weighted Average Exercise Price
Outstanding at beginning of period	119	\$ 20
Granted	85	\$ 27
Vested	(32 )	\$ 16
Forfeited or expired	(2 )	\$ 15
Outstanding at end of period	170	\$ 25
Exercisable or convertible at end of period	30	\$ 21
Weighted average fair value of units granted (per unit)	\$ 12	

### *Fair Value*

Effective January 29, 2006, grants under the Company's equity incentive plans are accounted for as provided by SFAS No. 123(R). Compensation expense for appreciation vehicles is based on the fair market value as of the grant date. For nonvested share grants, compensation expense is based upon the grant date fair value (i.e., the average of the high and low trading prices of the Company's stock on the grant date.)

Beginning in fiscal year 2006, the Company changed its method of determining the fair value of share-based awards from the Black-Scholes model to a binomial model. The binomial model considers a range of assumptions relative to volatility, risk-free interest rates and employee exercise behavior, which more accurately models actual employee behaviors. The Company believes the binomial model provides a fair value that is more representative of actual and future experience.

The fair value of options and stock-settled SAR's granted were calculated using the following assumptions:

	52 Weeks Ended February 2, 2008	53 Weeks Ended February 3, 2007	52 Weeks Ended January 28, 2006
Risk-free interest rate	4.6%	4.9%	3.9%
Expected dividend yield	– %	– %	– %
Expected appreciation vehicle life (in years)	5	6	5
Weighted-average expected volatility	38 %	35 %	34 %

**Risk-free interest rate** – The rate is based on zero-coupon U.S. Treasury yields in effect at the date of grant, utilizing separate rates for each whole year up to the contractual term of the appreciation vehicle and interpolating for time periods between those not listed.

**Expected dividend yield** – the Company has not historically paid dividends and has no immediate plans to do so; as a result, the dividend yield is assumed to be zero.

**Expected appreciation vehicle life** – The expected life is derived from the output of the binomial lattice model and represents the period of time that the appreciation vehicles are expected to be outstanding. This model incorporates time-based early exercise assumptions based on an analysis of historical exercise patterns.

**Expected Volatility** – The rate used in the binomial model is based on an analysis of historical prices of the Company's stock. The Company currently believes that historical volatility is a good indicator of future volatility.

The total fair value of shares vested during 2007, 2006 and 2005 was \$8.8 million, \$5.5 million and \$8.9 million, respectively.

### *Compensation Expense*

SFAS No. 123(R) requires compensation expense associated with share-based awards to be recognized over the requisite service period, which for the Company is the period between the grant date and the award's stated vesting term.



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The Company used the tranche specific attribution method for stock option and nonvested share awards with graded vesting issued prior to the adoption of SFAS No. 123(R). Share-based awards issued after the adoption of SFAS No. 123(R) are expensed under the straight-line attribution method, with the exception of performance-based stock-settled SAR's that are expensed under the tranche specific attribution method.

The amount of share-based compensation recognized during a period is based on the value of the portion of the awards that are expected to vest. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. This analysis is evaluated quarterly and the forfeiture rate is adjusted as necessary. For performance-based stock-settled SAR's, compensation expense is recorded over the vesting period based on estimates of achieving the performance goal. Ultimately, the actual expense recognized over the vesting period will be based on only those shares that vest.

Total share-based compensation expense of \$14.6 million before tax has been included in the Company's consolidated statements of earnings for the 52 weeks ended February 2, 2008. No amount of share-based compensation has been capitalized. Total share-based compensation expense is summarized as follows:

(dollars in millions, except per share amounts)	52 Weeks Ended February 2, 2008	53 Weeks Ended February 3, 2007	52 Weeks Ended January 28, 2006
Cost of sales	\$ 3.8	\$ 4.1	\$ –
Selling, general and administrative expenses	10.8	8.1	5.0
Share-based compensation expense before income taxes	14.6	12.2	5.0
Tax benefit	(5.5)	(4.4)	(1.8)
Share-based compensation expense after income taxes	\$ 9.1	\$ 7.8	\$ 3.2

Effect on:

Basic earnings per share	\$ 0.14	\$ 0.12	\$ 0.05
Diluted earnings per share	\$ 0.14	\$ 0.12	\$ 0.05

As of February 2, 2008, the Company had unrecognized compensation expense related to nonvested awards of approximately \$37.0 million, which is expected to be recognized over a weighted average period of 1.2 years.

### Note 4 – Exit Costs

During the first quarter of 2007, the Company's Board of Directors approved a plan to shift to a new distribution model. As part of the plan, the Company intends to open a new distribution center in Brookville, Ohio, which will begin operation in the spring of 2009. This distribution center will be in addition to the Company's Redlands, California distribution center that commenced operations in the second quarter of 2007. Once both new distribution centers are operating satisfactorily, the Company plans to close its current distribution center in Topeka, Kansas. Total exit costs are currently estimated to be approximately \$13 million, consisting of approximately \$3 million of non-cash accelerated depreciation expenses, approximately \$8 million for employee severance expenses, and approximately \$2 million related to contract termination and other exit costs. The exit costs are recorded as costs of sales in the consolidated statements of earnings and are included in the Payless Domestic segment. Actual results could vary from these estimates.

The significant components of the exit costs incurred as of February 2, 2008 are summarized as follows:

(dollars in millions)	Costs Incurred 52 Weeks Ended February 2, 2008	Cash Payments 52 Weeks Ended February 2, 2008	Accrual Balance as of February 2, 2008
Employee severance costs	\$ 5.9	\$ (0.7)	\$ 5.2
Contract termination	0.8	(0.8)	\$ –
Accelerated depreciation	2.4		
	\$ 9.1	\$ (1.5)	\$ 5.2

The majority of the remaining exit costs will be recognized over the period until the Topeka distribution center is closed, which is expected to be in spring of 2009.



## **Note 5 – Discontinued Operations**

### *Payless Domestic*

In accordance with the provisions of Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”), the results of operations for the 52 weeks ended February 2, 2008, the 53 weeks ended February 3, 2007, and the 52 weeks ended January 28, 2006, for Parade and 26 Payless stores closed in connection with the 2004 restructuring plan are classified as discontinued operations within the Payless Domestic segment. 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. Losses from discontinued operations net of income taxes for the 53 weeks ended February 3, 2007 and 52 weeks ended January 28, 2006 were \$0.5 million and \$3.7 million, respectively. There was no impact on net earnings related to discontinued operations for the 52 weeks ended February 2, 2008. Additionally, the consolidated balance sheets include the assets of Parade and the 26 Payless closed stores presented as discontinued operations. As of February 2, 2008, current assets of discontinued operations were \$0.8 million and current liabilities of discontinued operations were \$1.3 million. As of February 3, 2007, current assets of discontinued operations were \$1.0 million and current liabilities of discontinued operations were \$2.1 million, respectively.

### *Payless International*

During 2006, the Company exited its retail operations in Japan and closed its one store location. In 2004, the Company closed all stores in Peru and Chile. Losses from discontinued operations net of minority interest for the 53 weeks ended February 3, 2007, and 52 weeks ended January 28, 2006, were \$2.9 million and \$2.3 million, respectively. There was no impact related to discontinued operations on net earnings for the 52 weeks ended February 2, 2008. Additionally, the consolidated balance sheets include the assets of Parade and the 26 Payless closed stores presented as discontinued operations. As of February 3, 2007, current assets of discontinued operations were \$0.1 million.

## Note 6 – 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)					
2007					
Quarter	First	Second	Third(2)(3)	Fourth (3)	Year
Net sales	\$728.6	\$699.3	\$830.7	\$776.8	\$3,035.4
Gross margin	268.9	240.6	267.2	214.2	990.9
Net earnings (loss) from continuing operations	39.0	24.7	25.6	(46.6 )	42.7
Earnings (loss) from discontinued operations, net of income taxes and minority interest	(0.1 )	0.2	(0.1 )	–	–
Net earnings (loss)	<u>\$38.9</u>	<u>\$24.9</u>	<u>\$25.5</u>	<u>\$(46.6 )</u>	<u>\$42.7</u>
Basic earnings (loss) per share:(1)					
Earnings (loss) from continuing operations	\$0.60	\$0.38	\$0.40	\$(0.73 )	\$0.66
Earnings from discontinued operations	–	0.01	–	–	–
Basic earnings (loss) per share	<u>\$0.60</u>	<u>\$0.39</u>	<u>\$0.40</u>	<u>\$(0.73 )</u>	<u>\$0.66</u>
Diluted earnings (loss) per share:(1)					
Earnings (loss) from continuing operations	\$0.59	\$0.37	\$0.39	\$(0.73 )	\$0.65
Earnings from discontinued operations	–	0.01	–	–	–
Diluted earnings (loss) per share	<u>\$0.59</u>	<u>\$0.38</u>	<u>\$0.39</u>	<u>\$(0.73 )</u>	<u>\$0.65</u>

(dollars in millions, except per share)					
2006					
Quarter	First	Second	Third	Fourth	Year
Net sales	\$694.5	\$706.1	\$703.4	\$692.7	\$2,796.7
Gross margin	255.8	244.0	241.3	234.6	975.7
Net earnings from continuing operations	36.8	33.0	30.6	25.0	125.4
Loss from discontinued operations, net of income taxes and minority interest	(0.8 )	(0.5 )	(1.7 )	(0.4 )	(3.4 )
Net earnings	<u>\$36.0</u>	<u>\$32.5</u>	<u>\$28.9</u>	<u>\$24.6</u>	<u>122.0</u>
Basic earnings per share:(1)					
Earnings from continuing operations	\$0.55	\$0.50	\$0.47	\$0.38	\$1.90
Loss from discontinued operations	(0.01 )	(0.01 )	(0.03 )	–	(0.05 )
Basic earnings per share	<u>\$0.54</u>	<u>\$0.49</u>	<u>\$0.44</u>	<u>\$0.38</u>	<u>\$1.85</u>
Diluted earnings per share:(1)					
Earnings from continuing operations	\$0.54	\$0.49	\$0.46	\$0.38	\$1.87
Loss from discontinued operations	(0.01 )	(0.01 )	(0.03 )	(0.01 )	(0.05 )
Diluted earnings per share	<u>\$0.53</u>	<u>\$0.48</u>	<u>\$0.43</u>	<u>\$0.37</u>	<u>\$1.82</u>

- (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) The company recognized an income tax benefit in the 13 week period ended November 3, 2007 as a result of adjusting the Company's year-to-date tax provision to reflect the reduced effective tax rate for the year.
- (3) Financial information since August 17, 2007 contains Stride Rite operating results and the related impact of purchase accounting.

## Note 7 – Defined Contribution Plans

The Company has two qualified profit sharing plans offered by Payless ShoeSource ("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 at the discretion of the Board of Directors. The Company funds at least a minimum guaranteed Company matching contribution of \$0.25 per \$1.00 contributed by associates. Associate contributions up to 5% of their pay are eligible for the match. The Company has historically contributed 2.5% of Payless pre-tax earnings from continuing operations as defined by the plans. At the discretion of the Board of Directors, the 2007 contribution was determined to be 2.5% of Payless pre-tax earnings from continuing operations excluding 2007 interest expense on debt incurred for the purchase of Stride Rite. Associates may voluntarily contribute to the Company's profit sharing plans on both a pre-tax and

after-tax basis. For 2007, 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 six months, if full-time, or one year, if part-time, as of

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December 31. Total profit sharing contributions for 2007, 2006 and 2005 were \$3.0 million, \$4.2 million and \$2.7 million, respectively.

Stride Rite also provides a qualified defined contribution plan for its associates. This qualified defined contribution plan enables eligible associates to defer a portion of their salary to be held by the trustees of the plan. The Company makes an additional contribution to the plan equal to a maximum of 100% of the first 6% of salary deferred by each participant. During 2007, the contribution to the plan was \$1.1 million.

### **Note 8 – Pension Plans**

The Company has a pension plan that covers a select group of Payless management employees (“Payless Plan”) and a pension plan that covers certain Stride Rite employees (“Stride Rite Plan”).

#### *Payless Plan*

The Payless Plan is a nonqualified, supplementary defined benefit plan for a select group of management employees. The plan is an unfunded, noncontributory plan.

Effective January 1, 2008, the Company amended the Payless Plan. The amendment provided the select group of management employees a transition benefit and changed the plan’s benefit formula. The change in the benefit plan did not trigger the recognition of the plan’s unrecognized expense.

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 by management for reasonableness. The measurement date used for the 2007 actuarial valuation was January 31, 2008.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans – An Amendment of FASB Statements No. 87, 88, 106, and 132(R).” This statement requires companies to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income (“AOCI”) to report the funded status of defined benefit pension and other postretirement benefit plans. The adjustment to AOCI at adoption represents the net unrecognized actuarial losses and unrecognized prior service costs. These amounts will be subsequently recognized as net periodic pension cost subject to the Company’s historical accounting policy for amortizing such amounts. Additional minimum pension liabilities (“AML”) and related intangible assets are also derecognized upon adoption of the new standard. The statement requires prospective application, and the recognition and disclosure requirements are effective for companies with fiscal years ending after December 15, 2006. The Company adopted SFAS No. 158 as of February 3, 2007. The following table summarizes the incremental effect of adopting the provisions of SFAS No. 158 on the Company’s consolidated balance sheets.

(dollars in millions)	Prior to AML Adjustment and Adoption of SFAS 158	AML Adjustment	Effect of Adopting SFAS 158	As Reported at February 3, 2007
Other assets	\$ 17.8	\$ 1.8	\$ (3.2)	\$ 16.4
Accrued expenses	188.7	–	1.5	190.2
Other liabilities	120.8	6.9	4.7	132.4
Accumulated other comprehensive income, net of income taxes	\$ 8.4	\$ (3.1)	\$ (4.7)	\$ 0.6

The Company incorrectly presented the \$4.7 million effect of the transition adjustment as a reduction of 2006 comprehensive income on its Consolidated Statements of Shareowners’ Equity for the year ended February 3, 2007. Subsequently, the Company became aware that the transition provisions of SFAS No. 158 required that this transition adjustment be presented as a direct adjustment to accumulated other comprehensive income rather than as part of comprehensive income for the period. The effect of removing the adoption of SFAS No. 158 from comprehensive income changes reported comprehensive income for 2006 from \$110.7 million to \$115.4 million. The Company has reflected the restatement of 2006 comprehensive income in the consolidated statement of shareowners’ equity.

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Included in accumulated other comprehensive income are the following amounts that have not yet been recognized in net periodic pension cost:

(dollars in millions)	Unrecognized Prior Service Cost	Unrecognized Losses/(Gains)	Total AOCI
Reconciliation of accumulated other comprehensive income:			
Amount at February 3, 2007	\$ 3.2	\$ 10.3	\$ 13.5
Amortization recognized	(0.5 )	(0.6 )	(1.1 )
New amounts recognized	9.1	(0.5 )	8.6
Amount at February 2, 2008	<u>\$ 11.8</u>	<u>\$ 9.2</u>	<u>\$ 21.0</u>

The unrecognized loss and prior service cost included in accumulated other comprehensive income and expected to be recognized in net periodic pension cost during fiscal year 2008 is \$0.7 million and \$1.6 million, respectively.

The following information provides a summary of the funded status of the plan, amounts recognized in the consolidated balance sheets, and major assumptions used to determine these amounts:

(dollars in millions)	2007	2006
Change in projected benefit obligation:		
Obligation at beginning of year	\$31.1	\$21.5
Service cost	1.0	0.8
Interest cost	1.8	1.3
Plan amendments	9.1	2.3
Actuarial loss (gain)	(0.5 )	6.4
Benefits paid	(1.5 )	(1.2 )
Obligation at end of year	<u>\$41.0</u>	<u>\$31.1</u>
Assumptions:		
Discount rate	6.00 %	5.75 %
Salary increases	4.0 %	3.0 %

As the plan is unfunded, the total benefit obligation at the end of each fiscal year is recognized as a liability on the consolidated balance sheet. Of the \$41.0 million liability recognized as of February 2, 2008, \$2.8 million is recorded in accrued expenses and \$38.2 million is recorded in other liabilities. The accumulated benefit obligation as of February 2, 2008 and February 3, 2007 were \$37.8 million and \$26.4 million, respectively.

Employer contributions and employer benefits paid were \$1.5 million in the current year.

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

(dollars in millions)	2007	2006
Components of pension expense:		
Service cost	\$1.0	\$0.8
Interest cost	1.8	1.3
Amortization of prior service cost	0.5	0.4
Amortization of actuarial loss	0.6	0.2
Total	<u>\$3.9</u>	<u>\$2.7</u>
Assumptions:		
Discount rate	6.00 %	5.75 %
Salary increases	4.0 %	3.0 %

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

(dollars in millions)

2008	\$ 2.8
2009	3.1
2010	9.1
2011	3.6
2012	3.7
2013-2017	20.3

### *Stride Rite Plan*

In connection with the Stride Rite acquisition, the Company acquired a non-contributory defined benefit pension plan covering certain eligible Stride Rite associates. Effective December 31, 2006, Stride Rite stopped the accrual of future benefits for this plan. All retirement benefits that employees earned as of December 31, 2006 were preserved. Certain salaried, management, sales and non-production hourly associates accrued pension benefits based on the associate's service and compensation. Prior to the freezing of the plan, production associates accrued pension benefits at a fixed unit rate based on service. The prior measurement date of this plan, August 17, 2007, was the date the Company acquired Stride Rite.

Included in accumulated other comprehensive income are the following amounts that have not yet been recognized in net periodic pension cost:

(dollars in millions)

	2007
Net transition obligation	\$—
Net prior service cost	—
Net loss	3.5
Accumulated other comprehensive loss recognized	<u>\$3.5</u>

The following tables present information about benefit obligations, plan assets, annual expense, assumptions and other information about Stride Rite's defined benefit pension plan. The defined benefit plan is valued using a January 31, 2008 measurement date:

(dollars in millions)

	2007
Change in projected benefit obligation:	
Obligation at prior measurement date	\$68.1
Service cost	—
Interest cost	2.0
Plan amendments	—
Actuarial loss	0.1
Benefits paid	(1.1 )
Obligation at end of year	<u>\$69.1</u>
Assumptions:	
Discount rate	6.50 %
Salary increases	n/a

The following table summarizes the change in plan assets:

(dollars in millions)

	2007
Fair value of plan assets at prior measurement date	\$58.5
Actual return on plan assets	(1.2 )
Employer contributions	0.8
Benefits paid	(1.1 )
Fair value of plan assets at end of year	<u>\$57.0</u>
Funded (underfunded) status at end of year	<u>\$(12.1 )</u>

The \$12.1 million liability recognized as of February 2, 2008 is included in other long-term liabilities on the Consolidated Balance Sheet.



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

(dollars in millions)	2007
Service cost	\$-
Interest cost	2.0
Expected return on assets	(2.2 )
Net periodic benefit cost (income)	<u><u>\$(0.2 )</u></u>

### Assumptions:

Discount rate	6.50 %
Expected long-term return on plan assets	8.25 %
Salary increases	n/a

The accumulated benefit obligation for the plan was:

(dollars in millions)	2007
Projected benefit obligation	\$ 69.1
Accumulated benefit obligation	69.1
Fair value of plan assets	57.0

The Company does not expect any amounts of net loss and prior service cost included in accumulated other comprehensive income to be recognized in net periodic pension cost during fiscal year 2008.

In selecting the expected long-term rate of return on assets, the Company considers the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of this plan. This includes considering the plan's asset allocation and the expected returns likely to be earned over the life of the plan. This basis is consistent with the prior year. The calculation of pension expense is dependent on the determination of the assumptions used. A 25 basis point change in the discount rate will change expense by approximately \$0.4 million. A 25 basis point change in the expected long-term return on assets will result in an approximate change of \$0.1 million in the expense. As the result of stopping the accrual of future benefits, a salary growth assumption is no longer applicable.

The long term annualized time-weighted rate of return calculated on the basis of a three year rolling average using market values is expected to be at least 1% higher than the composite benchmark for the plan. Investment managers are evaluated semi-annually against commonly accepted benchmarks to ensure adherence to the stated strategy and that the risk posture assumed is commensurate with the given investment style and objectives.

The Company's written investment policy for the Stride Rite Plan establishes investment principles and guidelines and defines the procedures that will be used to control, evaluate and monitor the investment practices for the plan. An administrative committee designated by the Board of Directors provides investment oversight for the plan. Stated investment objectives are:

Maintain a portfolio of secure assets of appropriate liquidity and diversification that will generate investment returns, combined with expected future contributions, that should be sufficient to maintain the plan's funded state or improve the funding level of the plan if it is in deficit.

To control the long-term costs of the plan by maximizing return on the assets subject to meeting the objectives above.

The plan's target allocation per the investment policy and weighted average asset allocations by asset category are:

	Target Allocation	2007
Domestic equity securities	50% - 56%	49 %
International equity securities	10% - 14%	13 %
Domestic fixed income securities	32% - 38%	38 %
		<u>100%</u>

The portfolio is designed to achieve a balanced return of current income and modest growth of capital, while achieving returns in excess of the rate of inflation over the investment horizon in order to preserve purchasing power of plan assets. All plan assets are required to be invested in liquid securities. While the Company is outside of its target range as of January 31, 2008, it is still within its allowable allocation range set forth by the investment policy.

The Company plans to contribute \$6.2 million to this pension plan during the 2008 fiscal year.



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

(dollars in millions)

2008	\$ 2.9
2009	3.1
2010	3.1
2011	3.3
2012	3.5
2013 - 2017	20.6

### Note 9 – Income Taxes

Earnings from continuing operations before income taxes and minority interest include the following components:

(dollars in millions)

	2007	2006	2005
Domestic	<b>\$(39.8 )</b>	\$78.5	\$42.1
Foreign	<b>98.8</b>	91.4	68.2
Total	<b><u>\$59.0</u></b>	<b><u>\$169.9</u></b>	<b><u>\$110.3</u></b>

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

(dollars in millions)

	2007	2006	2005
Federal	<b>\$11.0</b>	\$21.2	\$6.7
State and local	<b>4.3</b>	3.1	0.7
Foreign	<b>18.4</b>	6.5	9.7
Current tax provision	<b><u>33.7</u></b>	<u>30.8</u>	<u>17.1</u>
Federal	<b>(14.7 )</b>	0.8	10.2
State and local	<b>(6.1 )</b>	(0.1 )	0.8
Foreign	<b>(4.3 )</b>	8.4	2.7
Deferred tax provision (benefit)	<b><u>(25.1 )</u></b>	<u>9.1</u>	<u>13.7</u>
Total provision	<b><u>\$8.6</u></b>	<b><u>\$39.9</u></b>	<b><u>\$30.8</u></b>

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

(dollars in millions)

	2007		2006		2005	
Statutory federal income tax rate	<b>35.0 %</b>	<b>\$20.6</b>	35.0 %	\$59.4	35.0 %	\$38.6
State and local income taxes, net of federal tax benefit	<b>(1.9 )</b>	<b>(1.1 )</b>	1.8	3.0	1.4	1.5
Rate differential on foreign earnings, net of valuation allowance	<b>(17.1 )</b>	<b>(10.1 )</b>	(5.6 )	(9.4 )	(2.5 )	(2.8 )
Repatriation of foreign earnings	–	–	–	–	1.3	1.4
Decrease in excess tax reserves	–	–	(8.7 )	(14.7 )	(5.3 )	(5.9 )
Federal employment tax credits	<b>(3.1 )</b>	<b>(1.8 )</b>	(0.8 )	(1.3 )	(1.0 )	(1.1 )
Nondeductible executive compensation	<b>2.9</b>	<b>1.7</b>	–	–	–	–
Other, net	<b>(1.2 )</b>	<b>(0.7 )</b>	1.8	2.9	(1.0 )	(0.9 )
Effective income tax rate	<b><u>14.6 %</u></b>	<b><u>\$8.6</u></b>	<b><u>23.5 %</u></b>	<b><u>\$39.9</u></b>	<b><u>27.9 %</u></b>	<b><u>\$30.8</u></b>

The Company's effective tax rates have differed from the U.S. statutory rate principally due to the impact of its operations conducted in jurisdictions with rates lower than the U.S. statutory rate, the benefit of jurisdictional and employment tax credits, favorable adjustments to its 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 Company adopted the provisions of Financial Accounting Standards Board, ("FASB") interpretation No 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"), on February 4, 2007. In accordance with the recognition standards established by FIN 48, the Company performed a comprehensive review of potential uncertain tax positions in each jurisdiction in which the Company operates. As a result of the Company's review, the Company adjusted the carrying amount of the liability for unrecognized tax benefits resulting in a reduction to retained



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earnings of \$11.2 million. Upon adoption, the Company also recorded an increase to deferred tax assets of \$4.2 million, an increase to other liabilities of \$34.2 million, a reduction to accrued expenses of \$18.0 million, and a reduction to minority interest of \$0.9 million.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows (in millions):

Gross unrecognized tax benefits at February 4, 2007	<b>\$29.7</b>
Increases in tax positions for prior years	<b>4.2</b>
Increases in tax positions for current year	<b>17.0</b>
Settlements	<b>(0.6 )</b>
Lapse in statute of limitations	<b>(0.5 )</b>
Gross unrecognized tax benefits at February 2, 2008	<b><u>\$49.8</u></b>

As of February 4, 2007, the gross liabilities for unrecognized tax benefits and the related interest and penalties total \$34.8 million.

The portion of the unrecognized tax benefits which will favorably impact the effective tax rate if recognized is \$37.8 million. The portion of the unrecognized tax benefits which will reduce the carrying amount of goodwill if recognized is \$3.8 million.

Interest and penalties related to unrecognized tax benefits are included in provision for income taxes in the consolidated statements of earnings. The amount of accrued interest and penalties as of February 2, 2008 reflected in our consolidated balance sheet is \$6.4 million. The provision for income taxes in our consolidated statements of earnings for 2007 includes gross interest and penalties of \$1.1 million.

The U.S. federal income tax returns of Payless have been examined by the Internal Revenue Service through 2004. The U.S. federal income tax returns of Stride Rite have been examined by the Internal Revenue Service through the tax year ended November 2003. With limited exception, the Company is no longer subject to audits of its state and foreign income tax returns for years prior to 2002. The Company has various state and foreign income tax returns in the process of examination or administrative appeal. To the extent that these matters conclude, it is reasonably possible that the amount of our unrecognized tax benefits will increase or decrease. With the exception of a reduction in the unrecognized tax benefit of \$0.9 million related to a recent ruling from a taxing authority, the Company does not expect resolution of these matters to result in significant changes during the next twelve months.

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

(dollars in millions)	2007	2006
Deferred Tax Assets:		
Accrued expenses and reserves	<b>\$93.4</b>	\$49.4
Tax net operating losses and tax credits	<b>17.6</b>	16.6
Other	<b>9.0</b>	1.3
Gross deferred tax assets	<b>120.0</b>	67.3
Less: valuation allowance	<b>(5.8 )</b>	(6.7 )
Deferred tax assets	<b>\$114.2</b>	\$60.6
Deferred Tax Liabilities:		
Short term assets basis differences	<b>\$(8.4 )</b>	\$(9.6 )
Depreciation/amortization and basis differences	<b>(194.8 )</b>	(7.3 )
Other	<b>(6.3 )</b>	(0.2 )
Deferred Tax Liabilities	<b><u>(209.5 )</u></b>	<u>(17.1 )</u>
Net deferred tax (liability) asset	<b><u>\$(95.3 )</u></b>	<u>\$43.5</u>

The deferred tax assets and (liabilities) are included on the consolidated balance sheets as follows:

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(dollars in millions)	2007	2006
Current deferred income taxes	<b>\$23.8</b>	\$15.6
Deferred income tax assets (noncurrent)	<b>1.5</b>	37.7
Accrued expenses	<b>(7.7 )</b>	(9.6 )
Deferred income tax liability (noncurrent)	<b>(112.9 )</b>	(0.2 )
	<b><u>\$ (95.3 )</u></b>	<u>\$43.5</u>

During 2007, the Company recorded an increase to its deferred tax assets, related to items of other comprehensive income, of \$13.7 million, net of translation adjustments of \$1.7 million. An overall net deferred tax liability of \$180.1 million was recorded in connection with the acquisition of the Stride Rite Corporation in 2007.

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 February 2, 2008, deferred tax assets for state and foreign net operating loss carryforwards are \$6.8 million, less a valuation allowance of \$0.5 million. The net operating losses related to recorded assets will expire as follows: \$1.5 million in 2010 through 2011, and \$4.8 million by 2026. Federal foreign tax credit carryforwards are \$1.6 million and state income tax credit carryforwards are \$9.2 million, less a valuation allowance of \$5.1 million. The tax credit carryforwards related to the recorded assets expire as follows: \$1.3 million by 2013, \$1.6 million in 2017 and \$2.8 million may be carried forward indefinitely. The remaining \$0.2 million of our total valuation allowance of \$5.8 million relates to other deferred tax assets in a Latin American country that does not have a history of earnings.

The American Jobs Creation Act of 2004, enacted on October 22, 2004 (the "Jobs Act"), provided 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 \$1.4 million in 2005. As of February 2, 2008, the Company has not provided tax on its cumulative undistributed earnings of foreign subsidiaries of approximately \$32 million, 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 the calculation 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.

**Note 10 – Earnings Per Share**

Basic earnings per share are computed by dividing net earnings by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share include the effect of conversions of stock options, stock-settled stock appreciation rights and nonvested shares. Earnings per share has been computed as follows:

(dollars in millions, except per share amounts; shares in thousands)	2007	2006	2005
Net earnings from continuing operations	<b>\$42.7</b>	<b>\$125.4</b>	<b>\$76.5</b>
Weighted average shares outstanding – basic	<b>64,504</b>	65,894	67,520
Net effect of dilutive stock options	<b>643</b>	952	306
Net effect of dilutive SAR' s	<b>50</b>	6	–
Dilutive shares due to nonvested shares	<b>190</b>	122	28
Weighted average shares outstanding – diluted	<b>65,387</b>	66,974	67,854
Basic earnings per share from continuing operations	<b>\$0.66</b>	<b>\$1.90</b>	<b>\$1.13</b>
Diluted earnings per share from continuing operations	<b>\$0.65</b>	<b>\$1.87</b>	<b>\$1.13</b>

The Company uses the treasury stock method for calculating the dilutive effect of employee stock options, stock-settled SAR' s and nonvested shares. These instruments will have a dilutive effect under the treasury stock method only when the respective period' s average market value of the underlying Company common stock exceeds the actual proceeds. In applying the treasury stock method, assumed proceeds include the amount, if any, the employee must pay upon exercise, the amount of compensation cost for future services that the Company has not yet recognized, and the amount of tax benefits, if any, that would be credited to additional paid-in capital assuming exercise of the options and stock-settled SAR' s and the vesting of nonvested shares. The Company excluded approximately 2.3 million stock options and stock-settled SAR' s from the calculation of diluted earnings per share for the 52 weeks ended February 2, 2008 as their effects were antidilutive. There were no stock options or stock-settled stock appreciation rights excluded from the calculation of diluted earnings per share for the 53 weeks ended February 3, 2007. The Company excluded approximately 1.4 million stock options from the calculation of diluted earnings per share for the 52 weeks ended January 28, 2006 as their effects were antidilutive.

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### Note 11 – Intangible Assets

The following is a summary of the Company's intangible assets:

(dollars in millions)	2007	2006
Intangible assets subject to amortization:		
Favorable lease rights:		
Gross carrying amount	\$69.9	\$67.2
Less: accumulated amortization	(54.7 )	(54.4 )
Carrying amount, end of period	15.2	12.8
Customer relationships:		
Gross carrying amount	73.7	–
Less: accumulated amortization	(5.9 )	–
Carrying amount, end of period	67.8	–
Trademarks and other intangible assets:		
Gross carrying amount	20.7	0.1
Less: accumulated amortization	(3.5 )	–
Carrying amount, end of period	17.2	0.1
Total carrying amount of intangible assets subject to amortization	100.2	12.9
Indefinite-lived trademarks	459.3	26.7
Total intangible assets	<u>\$559.5</u>	<u>\$39.6</u>

The estimated useful life for each class of intangible assets is as follows:

Favorable lease rights	A weighted-average period of 11 years. Favorable lease rights are amortized over the term of the underlying lease, including renewal options in instances where failure to exercise renewals would result in an economic penalty.
Trademarks and other intangible assets	0.75 to 10 years
Customer relationships	8 years

Customer relationships are amortized on an accelerated basis. All other intangible assets subject to amortization are amortized on a straight-line basis. Amortization expense on intangible assets is as follows:

(dollars in millions)	2007	2006	2005
Amortization expense on intangible assets	\$ 12.6	\$ 3.2	\$ 3.4

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

Year	Amount
2008	\$ 21.7
2009	19.2
2010	15.2
2011	12.2
2012	9.9

### Note 12 – Goodwill

Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for under the purchase method. We do not amortize goodwill but test it for impairment annually, or when indications of potential impairment exist, utilizing a fair value approach at the reporting unit level. A reporting unit is the operating segment, or a business unit one level below that operating segment, for which discrete financial information is prepared and regularly reviewed by segment management.

The changes in the carrying amount of goodwill, by reporting segment, for the year ended February 2, 2008, are as follows:



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(dollars in millions)	Payless Domestic	Stride Rite Retail	Stride Rite Wholesale	Consolidated
Balance as of February 3, 2007	\$5.9	\$ –	\$–	\$ 5.9
Goodwill acquired during the year	34.3	42.0	238.8	315.1
Balance as of February 2, 2008	<u>\$40.2</u>	<u>\$ 42.0</u>	<u>\$238.8</u>	<u>\$ 321.0</u>

### Note 13 – Accrued Expenses and Other Liabilities

Major components of accrued expenses included:

(dollars in millions)	2007	2006
Profit sharing, bonus and salaries	\$46.8	\$68.3
Sales, use and other taxes	31.8	34.3
Income taxes	15.3	26.6
Accrued construction in process	17.7	17.7
Other accrued expenses	91.9	43.3
Total	<u>\$203.5</u>	<u>\$190.2</u>

Major components of other liabilities included:

(dollars in millions)	2007	2006
Gross unrecognized tax benefits	\$49.8	\$–
Pension plan	50.3	29.6
Accrued step rent	29.5	24.6
Deferred tenant improvement allowances, net	28.0	26.1
Derivative liability	23.5	–
Worker' s compensation and general liability insurance reserves	19.9	16.3
Other liabilities	53.2	35.8
Total	<u>\$254.2</u>	<u>\$132.4</u>

### Note 14 – Long-term Debt

Long-term debt and capital-lease obligations were:

(dollars in millions)	2007	2006
Term loan facility	\$723.2	\$–
Senior subordinated notes*	197.8	197.6
Capital-lease obligations	1.3	0.5
Other	–	4.0
Total debt	922.3	202.1
Less: current maturities of long-term debt	7.4	0.4
Long-term debt	<u>\$914.9</u>	<u>\$201.7</u>

Future debt maturities as of February 2, 2008 are as follows:

Year	Senior Subordinated Notes	Term Loan Facility	Capital Lease Obligations	Total
2008	\$ –	\$ 7.3	\$0.1	\$7.4
2009	–	7.3	0.1	7.4
2010	–	7.3	0.1	7.4
2011	–	7.3	0.1	7.4
2012	–	7.3	0.1	7.4
Thereafter	200.0 *	686.7	0.8	887.5
Total	<u>\$ 200.0</u>	<u>\$ 723.2</u>	<u>\$ 1.3</u>	<u>\$924.5</u>



\* At February 2, 2008, the \$200 million of 8.25% Senior Subordinated Notes are recorded at \$197.8 million (net of \$2.2 million discount).  
At February 3, 2007, the notes were recorded at \$197.6 million (net of \$2.4 million discount).

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On August 17, 2007, the Company entered into a \$725 million term loan (the “Term Loan Facility”) and a \$350 million Amended and Restated Loan and Guaranty Agreement (the “Revolving Loan Facility” and collectively with the Term Loan Facility, the “Loan Facilities”). The Loan Facilities rank *pari passu* in right of payment and have the lien priorities specified in an intercreditor agreement executed by the administrative agent to the Term Loan Facility and the administrative agent to the Revolving Loan Facility. The Loan Facilities are senior secured loans guaranteed by substantially all of the assets of the borrower and the guarantors, with the Revolving Facility having first priority in accounts receivable, inventory and certain related assets and the Term Loan Facility having first priority in substantially all of the borrower’s and the guarantors’ remaining assets, including intellectual property, the capital stock of each domestic subsidiary, any intercompany notes owned by the Borrower and the guarantors, and 66% of the stock of non-U.S. subsidiaries directly owned by borrower or a guarantor.

The Revolving Loan Facility matures on August 17, 2012. The Revolving Loan Facility bears interest at the London Inter-Bank Offer Rate (“LIBOR”), plus a variable margin of 0.875% to 1.5%, or the base rate as defined in the agreement governing the Revolving Loan Facility, based upon certain borrowing levels and commitment fee payable on the unborrowed balance of 0.25%. The Revolving Loan Facility contains a total leverage ratio covenant and other 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 February 2, 2008, the Company was in compliance with all covenants. The facility will be available as needed for general corporate purposes. The variable interest rate including the applicable variable margin at February 2, 2008, was 3.97%. No amounts were drawn on the Revolving Loan Facility as of February 2, 2008. Based on the Company’s current borrowing base, the Company may borrow up to \$296.2 million under its Revolving Loan Facility, less \$25.8 million in outstanding letters of credit as of February 2, 2008.

The Term Loan Facility matures on August 17, 2014. The Term Loan Facility amortizes quarterly in annual amounts of 1.0% of the original amount, with the final installment payable on the maturity date. The Term Loan Agreement provides for mandatory prepayments, subject to certain exceptions and limitations and in certain instances, reinvestment rights, from (a) the net cash proceeds of certain asset sales, insurance recovery events and debt issuances, each as defined in the Term Loan Agreement, and (b) 25% of excess cash flow, as defined in the Term Loan Agreement, subject to reduction so long as the total leverage ratio, as defined in the Term Loan Agreement, is less than 2.0:1.0. Loans under the Term Loan Facility will bear interest at the Borrower’s option, at either (a) the Base Rate as defined in the Term Loan Facility agreement plus 1.75% per annum or (b) the Eurodollar (LIBOR-indexed) Rate plus 2.75% per annum, with such margin to be agreed for any incremental term loans. The Term Loan Facility contains a total leverage ratio covenant and other 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 February 2, 2008, the Company was in compliance with all covenants.

On August 17, 2007, as part of the Stride Rite acquisition, the Company acquired and immediately repaid \$46.0 million in Stride Rite debt.

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. 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 February 2, 2008, the Company was in compliance with all covenants. As of February 2, 2008, the fair value of the Notes was \$188.3 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 15 – Lease Obligations

Rental expense for the Company's operating leases consisted of:

(dollars in millions)	2007	2006	2005
Minimum rentals	\$290.6	\$270.6	\$264.2
Contingent rentals based on sales	7.2	7.1	7.0
Real property rentals	297.8	277.7	271.2
Equipment rentals	2.5	0.3	0.3
Total	<u>\$300.3</u>	<u>\$278.0</u>	<u>\$271.5</u>

Most store 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 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 February 2, 2008, were as follows:

(dollars in millions)	Capital Leases	Operating Leases	Total
2008	\$0.1	\$295.9	\$296.0
2009	0.1	262.2	262.3
2010	0.1	221.4	221.5
2011	0.1	183.6	183.7
2012	0.1	145.8	145.9
2013 and thereafter	0.8	358.7	359.5
Minimum lease payments	<u>\$1.3</u>	<u>\$1,467.6</u>	<u>\$1,468.9</u>
Less: imputed interest component	–		
Present value of net minimum lease payments included in current liabilities	<u>\$1.3</u>		

At February 2, 2008, the total amount of minimum rentals to be received in the future under non-cancelable subleases was \$14.9 million.

## Note 16 – Common Stock Repurchases

The Company has repurchased the following:

	2007		2006		2005	
(dollars in millions, shares in thousands)	Dollars	Shares	Dollars	Shares	Dollars	Shares
Stock repurchase program	\$47.1	2,387	\$128.4	4,960	\$70.4	3,234
Employee stock purchase, deferred compensation and stock incentive plans	1.3	51	0.9	34	0.8	45
	<u>\$48.4</u>	<u>2,438</u>	<u>\$129.3</u>	<u>4,994</u>	<u>\$71.2</u>	<u>3,279</u>

As of February 2, 2008, we had approximately \$204.8 million of remaining common stock repurchase authorization from our Board of Directors. Under the indenture governing our 8.25% Senior Subordinated Notes, we are restricted on the amount of common stock we may repurchase. This limit may increase or decrease on a quarterly basis based upon our net earnings.

## Note 17 – Derivatives

The Company has entered into an interest rate swap arrangement for \$540 million to hedge a portion of its variable rate Term Loan Facility. The interest rate swap provides for a fixed interest rate of approximately 7.75%, portions of which mature on a series of dates through 2012. This derivative instrument is designated as a cash flow hedge for accounting purposes and the

change in the fair value of this instrument is recorded as a component of accumulated other comprehensive income. There was no ineffectiveness in 2007 related to this derivative instrument.

As of February 2, 2008, the Company has recorded \$23.5 million in other long term liabilities, with the offsetting amounts of \$14.3 million and \$9.2 million recorded to accumulated other comprehensive income and deferred tax assets, respectively, related to the fair value of the interest rate swap. Realized gains or losses on the hedging instrument occur when a portion of the hedge settles or if it is probable that the forecasted transaction will not occur. Realized gains and losses are classified in Interest Expense. For the 52 weeks ended February 2, 2008, the Company has realized gains of \$0.5 million. Approximately \$7.9 million of the fair value of the interest rate swap in other long term liabilities is expected to be recognized in earnings during the next 12 months.

#### **Note 18 – Commitments and Contingencies**

As of February 2, 2008, the Company has \$101.8 million of royalty obligations consisting of minimum royalty payments for the purchase of branded merchandise, \$79.1 million of all future estimated pension obligations related to the Company's pension plans, \$7.0 million of intangible asset obligations related to trademark purchases, \$10.3 million of service agreement obligations relating to minimum payments for services that the Company cannot avoid without penalty, \$12.5 million of employment agreement obligations related to minimum payments to certain of the Company's executives and \$16.3 million of employee severance obligations related to payments to certain of the Company's employees.

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 has filed an answer. The case is currently assigned to Judge George P. Schiavelli who, on January 14, 2008, set the case for trial on July 8, 2008, with a pretrial conference set for June 2, 2008. On October 12, 2006, the Company filed a suit against St. Paul Fire and Marine Insurance Company ("St. Paul"), in Kansas state court seeking damages and a declaratory judgment that St. Paul is obligated to provide coverage in connection with the underlying lawsuit brought by K-Swiss. On October 18, 2006, St. Paul filed a separate declaratory judgment action in the U.S. District Court for the Central District of California seeking a declaration that there is no coverage for the underlying lawsuit. The Company moved to dismiss the California action filed by St. Paul, which was granted on February 12, 2007. On November 2, 2006, St. Paul removed the action from state court to the U.S. District Court for the District of Kansas. Also, on November 2, 2006, St. Paul moved to transfer the Kansas action to the U.S. District Court for the Central District of California, which was denied on January 10, 2007. On January 23, 2007, St. Paul filed a motion to stay the Kansas Action until the underlying lawsuit is resolved, which was granted on March 2, 2007. The Company believes it has meritorious defenses to the claims asserted in the lawsuit. An estimate of the possible loss, if any, or the range of the loss cannot be made and therefore the Company has not accrued a loss contingency related to this matter. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position, results of operations and cash flows.

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 has filed an answer and a motion for summary judgment which the court granted in part. On June 18, 2004, the plaintiff appealed the District Court's ruling on the motion for summary judgment. On January 5, 2006, the 9th Circuit Court of Appeals entered an order reversing the District Court's partial summary judgment order. The Company requested a rehearing en banc, which was denied by the 9th Circuit Court of Appeals. On June 29, 2006, the Company filed a petition for writ of certiorari to the United States Supreme Court, which was denied on October 2, 2006. By Order dated July 9, 2007, the case was assigned to a new judge for trial who subsequently set the pretrial conference for April 1, 2008 and a 14-day trial beginning April 8, 2008. On December 21, 2007, the District Court entered an Order granting, in part, adidas' summary judgment motion and dismissing several of the Company's affirmative defenses including laches, waiver and estoppel. In that same order, the District Court denied several of the Company's summary judgment motions, although the judge did dismiss adidas' state law trademark dilution claims. On February 4, 2008, the Company filed (with the Court's permission) a motion to reconsider the District Court's summary judgment rulings dismissing the Company's laches, waiver and estoppel defenses. The District Court requested additional briefing on Company's motion and will decide the motion without a hearing. The Company believes it has meritorious defenses to claims asserted in the lawsuit. An estimate of the possible loss, if any, or the range of loss cannot be made and therefore the Company has not

accrued a loss contingency related to this matter. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position, results of operations and cash flows.

On or about April 3, 2006, Crocs Inc. filed two companion actions against several manufacturers of foam clog footwear asserting claims for patent infringement, trade dress infringement, and unfair competition. One complaint was filed before the United States International Trade Commission ("ITC") in Washington D.C. The other complaint was filed in federal district court in Colorado. The Company's wholly-owned subsidiary, Collective Licensing International LLC ("Collective Licensing"), was named as a Respondent in the ITC Investigation, and as a Defendant in the Colorado federal court action. The ITC published notice in the Federal Register on May 8, 2006, announcing that it is commencing an investigation into the allegations contained in Crocs' complaint. In accordance with federal law, the Colorado federal court action will be stayed pending the outcome of the ITC investigation. A motion to stay the Colorado federal court action was filed on May 12, 2006. In the ITC investigation, Crocs seeks an order and injunction prohibiting any of the respondents from importing or selling any imported shoes that infringe Crocs' patent and trade dress rights. In the federal court action, which, as noted above, will be stayed, Crocs seeks damages and injunctive relief prohibiting the defendants from infringing on Crocs' intellectual property rights. On November 7, 2006, the Administrative Law Judge in the ITC action entered an order granting summary judgment of non-infringement of design patent No. D517,589 in favor of Collective Licensing and the other remaining respondents. Further, because Crocs' expert and fact witnesses admitted that the recent versions of the shoes of all respondents did not infringe the separate utility patent at issue, Crocs proposed that the trial, which was to commence on November 13, 2006, be continued pending review. All respondents agreed not to oppose Crocs' request to continue the trial and on November 8, 2006, the Administrative Law Judge entered an order on Crocs' motion postponing the trial indefinitely pending review of the summary judgment motion by the ITC. On December 21, 2006, the ITC decided to review, in part, the initial determination granting summary determination of non-infringement of design patent No. D517,589. On February 15, 2007, the ITC vacated the initial determination and remanded for further proceedings. On February 22, 2007, the Administrative Law Judge entered an order extending the date for completion of the investigation to August 11, 2008; affirming his previous narrow claim construction of design patent No. D517,789; and rejecting the claim construction proposed by Crocs. A hearing was held before the Administrative Law Judge from September 7-14, 2007, and all post-hearing briefings have been completed. The deadline for an initial determination by the Administrative Law Judge is April 11, 2008, while the target date for completion of the investigation is August 11, 2008. The Company believes it has meritorious defenses to the claims asserted in the lawsuits and have filed an answer. An estimate of the possible loss, if any, or the range of loss cannot be made and therefore the Company has not accrued a loss contingency related to this matter. However, the ultimate resolution of this matter could have a material adverse effect on the Company's financial position, results of operations and cash flows.

## **Note 19 – Segment Reporting**

Prior to the acquisition of Stride Rite, the Company managed its business in two reporting segments: Payless Domestic and Payless International. In the third quarter of 2007, as a result of the acquisition of Stride Rite, the Company added two additional reporting segments. The Company now has four reporting segments: (i) Payless Domestic, (ii) Payless International, (iii) Stride Rite Retail and (iv) Stride Rite Wholesale. The Company has defined its reporting segments as follows:

The Payless Domestic reporting segment is comprised primarily of domestic retail stores under the Payless ShoeSource name, the Company's sourcing unit and Collective Licensing.

The Payless International reporting segment is comprised of international retail stores under the Payless ShoeSource name in Canada, the South American Region, the Central American Region, Puerto Rico, and the U.S. Virgin Islands.

The Stride Rite Retail reporting segment consists of Stride Rite's retail stores and outlet stores.

The Stride Rite Wholesale reporting segment consists of Stride Rite's global wholesale operations.

Payless International's operations in the Central American and South American Regions are operated as joint ventures in which the Company maintains a 60% ownership interest. Minority interest represents the Company's joint venture partners' share of net earnings or losses on applicable international operations. 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. The total costs and fees amounted to \$31.1 million, \$24.1 million and \$18.1 million during 2007, 2006 and 2005, respectively.

The reporting period for operations in the Central and South American Regions 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. Information on the segments is as follows:

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(dollars in millions)	Payless Domestic	Payless International	Stride Rite Retail	Stride Rite Wholesale	Consolidated
<b>Fiscal year ended February 2, 2008</b>					
Revenues from external customers	\$ 2,298.4	\$ 427.0	\$94.9	\$215.1	\$ 3,035.4
Operating profit (loss) from continuing operations	82.2	52.0	(15.4 )	(27.5 )	91.3
Interest expense	45.9	0.8	–	–	46.7
Interest income	(10.5 )	(3.6 )	–	(0.3 )	(14.4 )
Earnings (loss) from continuing operations before taxes and minority interest	\$ 46.8	\$ 54.8	\$(15.4 )	\$(27.2 )	\$ 59.0
Depreciation and amortization	\$ 88.4	\$ 15.1	\$2.9	\$10.9	\$ 117.3
Total assets	\$ 1,118.9	\$ 173.8	\$98.0	\$1,024.5	\$ 2,415.2
Operating segment long-lived assets	\$ 450.8	\$ 64.0	\$27.6	\$52.6	\$ 595.0
Additions to long-lived assets	\$ 167.4	\$ 17.0	\$3.3	\$1.7	\$ 189.4
<b>Fiscal year ended February 3, 2007</b>					
Revenues from external customers	\$ 2,395.2	\$ 401.5	\$–	\$–	\$ 2,796.7
Operating profit from continuing operations	115.9	50.5	–	–	166.4
Interest expense	18.2	1.0	–	–	19.2
Interest income	(20.7 )	(2.0 )	–	–	(22.7 )
Earnings from continuing operations before taxes and minority interest	\$ 118.4	\$ 51.5	\$–	\$–	\$ 169.9
Depreciation and amortization	\$ 75.4	\$ 14.2	\$–	\$–	\$ 89.6
Total assets	\$ 1,232.4	\$ 195.0	\$–	\$–	\$ 1,427.4
Operating segment long-lived assets	\$ 424.5	\$ 58.6	\$–	\$–	\$ 483.1
Additions to long-lived assets	\$ 146.4	\$ 12.7	\$–	\$–	\$ 159.1
<b>Fiscal year ended January 28, 2006</b>					
Revenues from external customers	\$ 2,306.0	\$ 359.7	\$–	\$–	\$ 2,665.7
Operating profit from continuing operations	83.4	34.3	–	–	117.7
Interest expense	18.6	1.1	–	–	19.7
Interest income	(10.9 )	(1.4 )	–	–	(12.3 )
Earnings from continuing operations before taxes and minority interest	\$ 75.7	\$ 34.6	\$–	\$–	\$ 110.3
Depreciation and amortization	\$ 77.6	\$ 14.0	\$–	\$–	\$ 91.6
Total assets	\$ 1,157.5	\$ 157.0	\$–	\$–	\$ 1,314.5
Operating segment long-lived assets	\$ 368.0	\$ 64.5	\$–	\$–	\$ 432.5
Additions to long-lived assets	\$ 54.3	\$ 5.3	\$–	\$–	\$ 59.6

The following is a summary of revenue from external customers by geographical area:

(dollars in millions)	2007	2006	2005
Domestic	\$ 2,555.8	\$ 2,395.2	\$ 2,306.0
International	479.6	401.5	359.7

The following is a summary of long-lived assets by geographical area:

(dollars in millions)	2007	2006	2005
Domestic	\$ 528.3	\$ 424.5	\$ 368.0
International	66.7	58.6	64.5

### 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 2007.

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 1/100<sup>th</sup> of a share of the Company's Series A Preferred Stock at an exercise price of \$83.33.

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 – Environmental Liability**

In connection with the Stride Rite acquisition, the Company acquired a distribution facility with a related environmental liability. The liability as of February 2, 2008 was \$6.5 million, \$1.0 million of which was included as an accrued expense and \$5.5 million of which was included in other long-term liabilities in the accompanying consolidated balance sheet. The assessment of the liability and the associated costs were an estimate based upon available information after consultation with environmental engineers, consultants and attorneys assisting the Company in addressing these environmental issues. As of February 2, 2008, the estimated costs to address these environmental conditions ranged from \$4.4 million to \$8.8 million, including \$0.9 million of costs that have already been paid. Actual costs to address the environmental conditions may change based upon further investigations, the conclusions of regulatory authorities about information gathered in those investigations and due to the inherent uncertainties involved in estimating conditions in the environment and the costs of addressing such conditions. Any changes to the estimated liability will be finalized as necessary, up to one year after the acquisition of Stride Rite's closing date, when information that is known to be available or obtainable is obtained. Any changes to the liability within one year of this acquisition's closing date will impact goodwill for this transaction.

#### **Note 22 – Asset Retirement Obligations**

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.

#### **Note 23 – Impact of Recently Issued Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies whenever other standards require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position No. FAS 157-1 ("FSP 157-1"), "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13". FSP 157-1 amends SFAS No. 157 to exclude from its scope SFAS No. 13 and other pronouncements that address fair value measurements for purposes of lease classification or measurement. The scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value (including assets and liabilities not related to leases). In February 2008, FASB issued Staff Position 157-2, "Effective Date of FASB Statement No. 157", (FSP 157-2) which delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company is evaluating the impact the adoption of SFAS No. 157 will have on its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities." This statement permits entities to choose to measure many financial instruments and certain other items at fair value. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date. SFAS



No. 159 is effective for fiscal years beginning after November 15, 2007. The Company does not believe the impact of this adoption will have a material effect on its Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations". SFAS No. 141(R) requires the acquiring entity in a business combination to record all assets acquired and liabilities assumed at their respective acquisition-date fair values, changes the recognition of assets acquired and liabilities assumed arising from contingencies, changes the recognition and measurement of contingent consideration, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141(R) also requires additional disclosure of information surrounding a business combination, such that users of the entity's financial statements can fully understand the nature and financial impact of the business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The provisions of SFAS No. 141(R) will only impact the Company if it is party to a business combination after the pronouncement has been adopted.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" (an Amendment of Accounting Research Bulletin ("ARB 51")). SFAS No. 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. In addition this statement establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. SFAS No. 160 becomes effective for fiscal periods beginning after December 15, 2008. The Company is currently evaluating the impact the adoption of SFAS No. 160 will have on its 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 2007 and 2006 were \$9.0 million and \$7.9 million, respectively. Total borrowings from the Company's Latin American partners were \$4.0 million as of the end of 2006. There were no borrowings as of the end of 2007. In addition, the Company recorded interest expense of \$0.1 million, \$0.2 million and \$0.3 million during 2007, 2006 and 2005, respectively, related to these borrowings.

Mr. Matthew E. Rubel is the Company's Chief Executive Officer and President. The Company began a relationship with Celadon Group, Inc. ("Celadon") in 2002. Mr. Rubel's father-in-law, Stephen Russell, is Chairman of the Board and Chief Executive Officer of Celadon. Pursuant to a competitive bid process, during 2006 Celadon won the right to be the primary carrier on two of the Company's transportation lanes. These lanes account for less than two percent of the Company's outbound line haul budget. The Company regularly competitively bids its line haul routes and as a result, Celadon could gain or lose routes based upon its bids.

In June 2006, the Company entered into a Marketing and License Agreement with Ballet Theatre Foundation Inc., a nonprofit organization, to use the American Ballet Theatre and ABT marks in connection with development, manufacture, marketing promotion, distribution, and sale of certain dance footwear. Mr. Rubel became a Trustee of Ballet Theatre Foundation, Inc., in January 2007.

#### **Note 25 – Subsidiary Guarantors of Senior Notes – Consolidating Financial Information**

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.

The following supplemental financial information sets forth, on a consolidating basis, the condensed statements of earnings 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 Collective Brands, Inc. and subsidiaries for the 52 week period ended February 2, 2008, the 53 week period ended February 3, 2007, and the 52 week period ended January 28, 2006, condensed balanced sheets as of February 2, 2008, and February 3, 2007, and the condensed statements of cash flows for the 52 week period ended February 2, 2008, the 53 week period ended February 3, 2007, and the 52 week period ended January 28, 2006. With the exception of operations in the Central and South American Regions 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 equity investment for each subsidiary is recorded by its parent in Other Assets.

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The Non-guarantor Subsidiaries are made up of the Company' s operations in the Central and South American Regions, Canada, Mexico, Germany, the Netherlands, the United Kingdom, Ireland, Australia, Bermuda, Saipan and Puerto Rico and the Company' s sourcing organization in Hong Kong, Taiwan, China, Indonesia and Brazil. The operations in the Central and South American Regions use a December 31 year-end. Operations in the Central and South American Regions are included in the Company' s results on a one-month lag relative to results from other regions. The effect of this one-month lag on the Company' s financial position and results of operations is not significant.

Under the indenture governing the Notes, the Company' s subsidiaries in Singapore are designated as unrestricted subsidiaries. The effect of these subsidiaries on the Company' s financial position and results of operations and cash flows is not significant. The Company' s subsidiaries in Singapore are included in the Non-guarantor Subsidiaries.

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS  
(dollars in millions)

	52 Weeks Ended February 2, 2008				
	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$—	\$ 2,708.9	\$ 1,017.6	\$ (691.1 )	\$ 3,035.4
Cost of sales	—	1,938.6	752.3	(646.4 )	2,044.5
Gross margin	—	770.3	265.3	(44.7 )	990.9
Selling, general and administrative expenses	1.4	767.0	175.7	(44.7 )	899.4
Restructuring charges	—	0.2	—	—	0.2
Operating (loss) profit from continuing operations	(1.4 )	3.1	89.6	—	91.3
Interest expense	37.3	29.1	1.1	(20.8 )	46.7
Interest income	—	(29.2 )	(6.0 )	20.8	(14.4 )
Equity in earnings of subsidiaries	(67.7 )	(73.4 )	—	141.1	—
Earnings from continuing operations before income taxes and minority interest	29.0	76.6	94.5	(141.1 )	59.0
(Benefit) / provision for income taxes	(13.7 )	8.9	13.4	—	8.6
Earnings from continuing operations before minority interest	42.7	67.7	81.1	(141.1 )	50.4
Minority interest, net of income taxes	—	—	(7.7 )	—	(7.7 )
Net earnings	<u>\$42.7</u>	<u>\$67.7</u>	<u>\$ 73.4</u>	<u>\$ (141.1 )</u>	<u>\$ 42.7</u>

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS  
(dollars in millions)

	53 Weeks Ended February 3, 2007				
	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$—	\$ 2,522.6	\$ 872.8	\$ (598.7 )	\$ 2,796.7
Cost of sales	—	1,732.4	674.5	(585.9 )	1,821.0
Gross margin	—	790.2	198.3	(12.8 )	975.7
Selling, general and administrative expenses	4.5	706.3	110.5	(12.8 )	808.5
Restructuring charges	—	0.8	—	—	0.8
Operating (loss) profit from continuing operations	(4.5 )	83.1	87.8	—	166.4
Interest expense	39.0	1.2	1.0	(22.0 )	19.2
Interest income	—	(41.6 )	(3.1 )	22.0	(22.7 )
Equity in earnings of subsidiaries	(151.3)	(67.4 )	—	218.7	—
Earnings from continuing operations before income taxes and minority interest	107.8	190.9	89.9	(218.7 )	169.9
(Benefit) / provision for income taxes	(14.2 )	39.1	15.0	—	39.9
Earnings from continuing operations before minority interest	122.0	151.8	74.9	(218.7 )	130.0
Minority interest, net of income taxes	—	—	(4.6 )	—	(4.6 )
Net earnings from continuing operations	122.0	151.8	70.3	(218.7 )	125.4
Loss from discontinued operations, net of income taxes and minority interest	—	(0.5 )	(2.9 )	—	(3.4 )
Net earnings	<u>\$122.0</u>	<u>\$ 151.3</u>	<u>\$ 67.4</u>	<u>\$ (218.7 )</u>	<u>\$ 122.0</u>

CONDENSED CONSOLIDATING STATEMENTS OF EARNINGS  
(dollars in millions)

	52 Weeks Ended January 28, 2006				
	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$—	\$ 2,424.0	\$ 722.5	\$ (480.8 )	\$ 2,665.7
Cost of sales	—	1,687.4	560.4	(470.7 )	1,777.1
Gross margin	—	736.6	162.1	(10.1 )	888.6
Selling, general and administrative expenses	4.6	673.5	99.1	(10.1 )	767.1
Restructuring charges	—	4.1	(0.3 )	—	3.8
Operating (loss) profit from continuing operations	(4.6 )	59.0	63.3	—	117.7
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	64.7	(135.5 )	110.3
(Benefit) / provision for income taxes	(11.9 )	28.0	14.7	—	30.8
Earnings from continuing operations before minority interest	66.4	98.6	50.0	(135.5 )	79.5
Minority interest, net of income taxes	—	—	(3.0 )	—	(3.0 )
Net earnings from continuing operations	66.4	98.6	47.0	(135.5 )	76.5
Loss from discontinued operations, net of income taxes and minority interest	—	(3.7 )	(2.3 )	—	(6.0 )
Net earnings before cumulative effect of change in accounting principle	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	<u>\$66.4</u>	<u>\$91.1</u>	<u>\$ 44.4</u>	<u>\$ (135.5 )</u>	<u>\$ 66.4</u>

CONDENSED CONSOLIDATING BALANCE SHEET  
As of February 2, 2008  
(dollars in millions)

	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
Current Assets:					
Cash and cash equivalents	\$–	\$ 69.5	\$ 163.0	\$–	\$ 232.5
Accounts receivable, net	–	81.5	7.9	(3.3 )	86.1
Inventories	–	397.5	76.1	(3.5 )	470.1
Current deferred income taxes	–	21.0	2.8	–	23.8
Prepaid expenses	–	85.7	7.7	–	93.4
Other current assets	55.8	290.5	151.9	(466.7 )	31.5
Current assets of discontinued operations	–	0.8	–	–	0.8
Total current assets	<u>55.8</u>	<u>946.5</u>	<u>409.4</u>	<u>(473.5 )</u>	<u>938.2</u>
Property and Equipment:					
Land	–	9.3	–	–	9.3
Property, buildings and equipment	–	1,263.4	176.7	–	1,440.1
Accumulated depreciation and amortization	–	(788.3 )	(110.1 )	–	(898.4 )
Property and equipment, net	–	484.4	66.6	–	551.0
Intangible assets, net	–	532.4	27.1	–	559.5
Goodwill	–	182.9	138.1	–	321.0
Deferred income taxes	–	–	1.5	–	1.5
Other assets	<u>1,366.3</u>	<u>698.7</u>	<u>1.6</u>	<u>(2,022.6)</u>	<u>44.0</u>
Total Assets	<u>\$1,422.1</u>	<u>\$2,844.9</u>	<u>\$ 644.3</u>	<u>\$ (2,496.1)</u>	<u>\$ 2,415.2</u>
<b>LIABILITIES AND SHAREOWNERS' EQUITY</b>					
Current Liabilities:					
Current maturities of long-term debt	\$–	\$ 7.4	\$ –	\$–	\$ 7.4
Accounts payable	–	132.5	183.2	(114.8 )	200.9
Accrued expenses	235.8	290.1	36.3	(358.7 )	203.5
Current liabilities of discontinued operations	–	1.3	–	–	1.3
Total current liabilities	<u>235.8</u>	<u>431.3</u>	<u>219.5</u>	<u>(473.5 )</u>	<u>413.1</u>
Long-term debt	481.0	715.9	11.1	(293.1 )	914.9
Deferred income taxes	–	111.4	1.5	–	112.9
Other liabilities	2.4	233.5	18.8	(0.5 )	254.2
Minority interest	–	–	17.2	–	17.2
Commitments and contingencies					
Total shareowners' equity	<u>702.9</u>	<u>1,352.8</u>	<u>376.2</u>	<u>(1,729.0)</u>	<u>702.9</u>
Total Liabilities and Shareowners' Equity	<u>\$1,422.1</u>	<u>\$2,844.9</u>	<u>\$ 644.3</u>	<u>\$ (2,496.1)</u>	<u>\$ 2,415.2</u>

CONDENSED CONSOLIDATING BALANCE SHEET  
As of February 3, 2007  
(dollars in millions)

	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
Current Assets:					
Cash and cash equivalents	\$–	\$ 239.4	\$ 132.0	\$ –	\$ 371.4
Short-term investments	–	90.0	–	–	90.0
Restricted cash	–	–	2.0	–	2.0
Accounts receivable, net	–	3.5	0.3	–	3.8
Inventories	–	282.8	83.5	(4.4 )	361.9
Current deferred income taxes	–	13.2	2.4	–	15.6
Prepaid expenses	0.6	40.2	5.7	–	46.5
Other current assets	42.3	11.8	57.6	(97.4 )	14.3
Current assets of discontinued operations	–	1.0	0.1	–	1.1
Total current assets	<u>42.9</u>	<u>681.9</u>	<u>283.6</u>	<u>(101.8 )</u>	<u>906.6</u>
Property and Equipment:					
Land	–	6.6	–	–	6.6
Property, buildings and equipment	–	1,096.7	148.4	–	1,245.1
Accumulated depreciation and amortization	–	(741.4 )	(89.1 )	–	(830.5 )
Property and equipment, net	–	361.9	59.3	–	421.2
Intangible assets, net	–	39.6	–	–	39.6
Goodwill	–	5.9	–	–	5.9
Deferred income taxes	–	31.3	6.4	–	37.7
Other assets	<u>1,315.4</u>	<u>460.2</u>	<u>1.3</u>	<u>(1,760.5)</u>	<u>16.4</u>
Total Assets	<u>\$1,358.3</u>	<u>\$ 1,580.8</u>	<u>\$ 350.6</u>	<u>\$ (1,862.3)</u>	<u>\$ 1,427.4</u>
<b>LIABILITIES AND SHAREOWNERS' EQUITY</b>					
Current Liabilities:					
Current maturities of long-term debt	\$–	\$ 0.4	\$ –	\$ –	\$ 0.4
Notes payable	–	–	2.0	–	2.0
Accounts payable	–	146.6	59.5	(20.5 )	185.6
Accrued expenses	175.4	32.3	63.8	(81.3 )	190.2
Current liabilities of discontinued operations	–	2.1	–	–	2.1
Total current liabilities	<u>175.4</u>	<u>181.4</u>	<u>125.3</u>	<u>(101.8 )</u>	<u>380.3</u>
Long-term debt	480.7	0.1	4.0	(283.1 )	201.7
Deferred income taxes	–	–	0.2	–	0.2
Other liabilities	2.1	115.2	15.1	–	132.4
Minority interest	–	–	12.7	–	12.7
Commitments and contingencies					
Total shareowners' equity	<u>700.1</u>	<u>1,284.1</u>	<u>193.3</u>	<u>(1,477.4)</u>	<u>700.1</u>
Total Liabilities and Shareowners' Equity	<u>\$1,358.3</u>	<u>\$ 1,580.8</u>	<u>\$ 350.6</u>	<u>\$ (1,862.3)</u>	<u>\$ 1,427.4</u>

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
For the 52 Weeks Ended February 2, 2008  
(dollars in millions)

	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>Operating Activities:</b>					
Net earnings	\$42.7	\$ 67.7	\$ 73.4	\$ (141.1 )	\$ 42.7
Adjustments for non-cash items included in net earnings:					
Loss on impairment of and disposal of assets	–	6.1	1.1	–	7.2
Depreciation and amortization	1.9	93.0	22.4	–	117.3
Provision for losses on accounts receivable	–	0.9	0.6	–	1.5
Share-based compensation expense	–	14.9	(0.3 )	–	14.6
Deferred income taxes	–	(21.9 )	(3.2 )	–	(25.1 )
Minority interest, net of income taxes	–	–	7.7	–	7.7
Income tax benefit from share-based compensation	–	2.6	–	–	2.6
Excess tax benefit from share-based compensation	–	(2.4 )	–	–	(2.4 )
Interest income on held-to-maturity investments	–	(0.6 )	–	–	(0.6 )
<b>Changes in working capital:</b>					
Accounts receivable, net	–	5.0	4.4	3.3	12.7
Inventories	–	55.9	25.6	(0.9 )	80.6
Prepaid expenses and other current assets	(12.9 )	(27.3 )	(96.7 )	113.4	(23.5 )
Accounts payable	–	(79.1 )	131.4	(94.3 )	(42.0 )
Accrued expenses	60.4	(40.7 )	(28.9 )	(21.5 )	(30.7 )
Other assets and liabilities, net	(52.4 )	22.3	(83.7 )	144.5	30.7
Net cash (used in) provided by discontinued operations	–	(0.6 )	0.1	–	(0.5 )
<b>Cash flow provided by operating activities</b>	<b>39.7</b>	<b>95.8</b>	<b>53.9</b>	<b>3.4</b>	<b>192.8</b>
<b>Investing Activities:</b>					
Capital expenditures	–	(150.3 )	(17.1 )	–	(167.4 )
Restricted cash	–	–	2.0	–	2.0
Proceeds from sale of property and equipment	–	2.9	–	–	2.9
Intangible asset additions	–	–	(0.6 )	–	(0.6 )
Purchases of investments	–	(6.1 )	–	–	(6.1 )
Sales and maturities of investments	–	96.7	–	–	96.7
Acquisition of businesses, net of cash acquired	–	(888.7 )	11.0	–	(877.7 )
<b>Cash flow used in investing activities</b>	<b>–</b>	<b>(945.5 )</b>	<b>(4.7 )</b>	<b>–</b>	<b>(950.2 )</b>
<b>Financing Activities:</b>					
Repayment of notes payable	–	–	(2.0 )	–	(2.0 )
Issuance of debt	–	725.0	24.4	(24.4 )	725.0
Repayment of debt	–	(78.7 )	–	23.4	(55.3 )
Payment of deferred financing costs	–	(12.7 )	–	–	(12.7 )
Issuances of common stock	8.7	–	–	–	8.7
Purchases of common stock	(48.4 )	–	–	–	(48.4 )
Excess tax benefit from share-based compensation	–	2.4	–	–	2.4
Contributions by minority owners	–	–	2.4	(2.4 )	–
Distributions to minority owners	–	–	(2.4 )	–	(2.4 )
Dividends to parent	–	43.8	(43.8 )	–	–
<b>Cash flow (used in) provided by financing activities</b>	<b>(39.7 )</b>	<b>679.8</b>	<b>(21.4 )</b>	<b>(3.4 )</b>	<b>615.3</b>
Effect of exchange rate changes on cash	–	–	3.2	–	3.2
(Decrease)/increase in cash and cash equivalents	–	(169.9 )	31.0	–	(138.9 )
Cash and cash equivalents, beginning of year	–	239.4	132.0	–	371.4



Cash and cash equivalents, end of year	<u>\$-</u>	<u>\$ 69.5</u>	<u>\$ 163.0</u>	<u>\$ -</u>	<u>\$ 232.5</u>
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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
For the 53 Weeks Ended February 3, 2007  
(dollars in millions)

	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>Operating Activities:</b>					
Net earnings	\$122.0	\$ 151.3	\$ 67.4	\$ (218.7 )	\$ 122.0
Loss from discontinued operations, net of income taxes and minority interest	–	0.5	2.9	–	3.4
Adjustments for non-cash items included in net earnings:					
Loss on impairment of and disposal of assets	–	8.7	1.6	–	10.3
Depreciation and amortization	0.9	74.3	14.4	–	89.6
Share-based compensation expense	–	11.0	1.2	–	12.2
Deferred income taxes	–	(1.4 )	10.5	–	9.1
Minority interest, net of income taxes	–	–	4.6	–	4.6
Income tax benefit from share-based compensation	–	8.6	–	–	8.6
Excess tax benefit from share-based compensation	–	(8.0 )	–	–	(8.0 )
Interest income on held-to-maturity investments	–	(3.6 )	–	–	(3.6 )
<b>Changes in working capital:</b>					
Accounts receivable, net	–	0.2	(0.2 )	–	–
Inventories	–	(11.5 )	(20.1 )	1.8	(29.8 )
Prepaid expenses and other current assets	(14.2 )	23.8	(32.7 )	14.1	(9.0 )
Accounts payable	–	(14.5 )	(6.2 )	36.3	15.6
Accrued expenses	123.9	(107.2 )	41.2	(52.2 )	5.7
Other assets and liabilities, net	(150.4)	(67.7 )	2.4	218.7	3.0
Net cash used in discontinued operations	–	(1.2 )	(2.8 )	–	(4.0 )
Cash flow provided by operating activities	<u>82.2</u>	<u>63.3</u>	<u>84.2</u>	<u>–</u>	<u>229.7</u>
<b>Investing Activities:</b>					
Capital expenditures	–	(103.8 )	(14.8 )	–	(118.6 )
Proceeds from sale of property and equipment	–	4.6	–	–	4.6
Intangible asset additions	–	(15.5 )	–	–	(15.5 )
Purchases of investments	–	(214.9 )	(0.7 )	–	(215.6 )
Sales and maturities of investments	–	187.0	1.2	–	188.2
Investment in subsidiaries	–	(1.5 )	–	1.5	–
Cash flow used in investing activities	<u>–</u>	<u>(144.1 )</u>	<u>(14.3 )</u>	<u>1.5</u>	<u>(156.9 )</u>
<b>Financing Activities:</b>					
Repayment of debt	–	(0.4 )	(2.4 )	–	(2.8 )
Payment of deferred financing costs	–	(0.2 )	–	–	(0.2 )
Issuances of common stock	47.1	–	–	–	47.1
Purchases of common stock	(129.3)	–	–	–	(129.3 )
Dividends to parent	–	2.3	(2.3 )	–	–
Excess tax benefits from share-based compensation	–	8.0	–	–	8.0
Contributions by / distributions to parent	–	–	1.5	(1.5 )	–
Distributions to minority owners	–	–	(1.5 )	–	(1.5 )
Net cash provided by discontinued operations	–	–	1.2	–	1.2
Cash flow (used in) provided by financing activities	<u>(82.2 )</u>	<u>9.7</u>	<u>(3.5 )</u>	<u>(1.5 )</u>	<u>(77.5 )</u>
Effect of exchange rate changes on cash	–	–	(2.1 )	–	(2.1 )
(Decrease) increase in cash and cash equivalents	–	(71.1 )	64.3	–	(6.8 )
Cash and cash equivalents, beginning of year	–	310.5	67.7	–	378.2
Cash and cash equivalents, end of year	<u>\$–</u>	<u>\$239.4</u>	<u>\$ 132.0</u>	<u>\$–</u>	<u>\$ 371.4</u>



CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
For the 52 Weeks Ended January 28, 2006  
(dollars in millions)

	Parent Company	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>Operating Activities:</b>					
Net earnings	\$66.4	\$91.1	\$44.4	\$(135.5 )	\$66.4
Loss from discontinued operations, net of income taxes and minority interest	–	3.7	2.3	–	6.0
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 of and disposal of assets	–	7.9	1.9	–	9.8
Depreciation and amortization	0.2	81.7	9.7	–	91.6
Share-based compensation expense	1.3	–	–	–	1.3
Deferred income taxes	–	11.7	2.0	–	13.7
Minority interest, net of income taxes	–	–	3.0	–	3.0
Income tax benefit from share-based compensation	6.5	–	–	–	6.5
Interest income on held-to-maturity investments	–	(1.3 )	–	–	(1.3 )
<b>Changes in working capital:</b>					
Accounts receivable, net	–	(0.9 )	0.5	–	(0.4 )
Inventories	–	5.8	7.9	(0.2 )	13.5
Prepaid expenses and other current assets	(11.9 )	(31.2 )	19.1	22.4	(1.6 )
Accounts payable	–	29.4	(2.7 )	(17.7 )	9.0
Accrued expenses	44.3	(23.3 )	(7.0 )	(4.5 )	9.5
Other assets and liabilities, net	(85.2 )	(42.7 )	(1.2 )	135.5	6.4
Net cash used in discontinued operations	–	(8.3 )	(2.3 )	–	(10.6 )
Cash flow provided by operating activities	21.6	127.4	77.9	–	226.9
<b>Investing Activities:</b>					
Capital expenditures	–	(59.8 )	(4.5 )	–	(64.3 )
Restricted cash	–	–	1.0	–	1.0
Proceeds from sale of property and equipment	–	1.2	–	–	1.2
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 )	–
Net cash used in discontinued operations	–	–	(0.1 )	–	(0.1 )
Cash flow used in investing activities	–	(11.1 )	(4.1 )	(83.4 )	(98.6 )
<b>Financing Activities:</b>					
Repayment of notes payable	–	–	(1.0 )	–	(1.0 )
Issuance of debt	–	–	1.2	–	1.2
Repayment 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 / distributions to parent	–	–	1.7	(1.7 )	–
Dividends to parent	–	–	(85.1 )	85.1	–
Net cash provided by discontinued operations	–	–	0.9	–	0.9
Cash flow (used in) provided by financing activities	(21.6 )	(0.3 )	(83.5 )	83.4	(22.0 )
Effect of exchange rate changes on cash	–	–	0.9	–	0.9
Increase (decrease) in cash and cash equivalents	–	116.0	(8.8 )	–	107.2
Cash and cash equivalents, beginning of year	–	194.5	76.5	–	271.0
Cash and cash equivalents, end of quarter	\$–	\$310.5	\$67.7	\$–	\$378.2



## **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 2007, 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 44 and 45 of Item 8 of this Form 10-K.

### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the fourth quarter of 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, except as follows:

On August 17, 2007, the Company acquired Stride Rite, whose financial statements constitute approximately Corporation's financial statements constitute approximately \$88 million and \$1,123 million of net and total assets, respectively, \$310 million of revenues, and a net loss of \$27 million of the consolidated financial statement amounts as of and for the year ended February 2, 2008. As permitted by the rules of the SEC, the Company has excluded Stride Rite from its annual assessment of the effectiveness on internal control over financial reporting for the year ending February 2, 2008, the year of acquisition. Management continues to evaluate Stride Rite's internal controls over financial reporting.

## **ITEM 9B. OTHER INFORMATION**

None.

## **PART III**

## **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The Board of Directors has established a standing Audit and Finance Committee which currently consists of Mr. John F. McGovern – Chairman, Mr. Daniel Boggan Jr., Mr. Howard R. Fricke, Mr. Robert F. Moran, and Mr. David Scott Olivet. 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.

Our Code of Ethics, formerly known as the Policy On Business Conduct, 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.collectivebrands.com](http://www.collectivebrands.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. The Company intends to satisfy its disclosure requirements under Item 10 of form 8-K, regarding an amendment to or waiver from a provision of its Code of Ethics by posting such information on our website at [www.collectivebrands.com](http://www.collectivebrands.com).

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 22, 2008, under the captions “Election of Directors Directors and Nominees for Director –

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Directors Subject to Election – Continuing Directors and Retiring 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 22, 2008, under the caption “Additional Information – Section 16(a) Beneficial Ownership Reporting Compliance” is incorporated herein by reference.

### ITEM 11. EXECUTIVE COMPENSATION

No member of the Compensation, Nominating and Governance Committee (Ms. Magnum, Ms. Hofer, Messrs. Wheeler and Weiss) has served as one of the Company’s officers or employees. None of the Company’s executive officers named in the Summary Compensation Table (included in the Company’s proxy statement) serve as a member of the board of directors or as a member of a compensation committee of any other company that has an executive officer serving as a member of the Company’s Board or the Compensation, Nominating and Governance Committee.

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 22, 2008, under the captions “Board Compensation,” “Compensation Committee Interlocks and Insider Participation,” “Compensation, Nominating and Governance Committee Report,” “Compensation, Discussion and Analysis,” “Summary Compensation Table,” “Fiscal 2007 Grants of Plan Based Awards,” “Outstanding Equity Awards at the end of Fiscal 2007,” “Fiscal 2007 Options Exercises and Stock Vested,” “Pension Benefits, for Fiscal 2007,” “Nonqualified Deferred Compensation for Fiscal 2007” and, “Potential Payments upon Termination or Change in Control” 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 22, 2008, under the caption “Beneficial Stock Ownership of Directors, Nominees, Executive Officers and More Than Five Percent Owners” is incorporated herein by reference.

The following table summarizes information with respect to the Company’s equity compensation plans at February 2, 2008 (shares in thousands):

Plan category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	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	4,383	\$ 19.42	2,544 (1)
Equity compensation plans not approved by security holders	648	20.65	–
Total	5,031	19.62	2,544

- Includes up to 2,544 thousand shares that may be issued under the Company’s 2006 Stock Incentive Plan. The amount does not include
- (1) up to 5,495 thousand shares that may be purchased under the Payless Stock Ownership Plan and up to 320 thousand shares that can be issued under the Company’s Restricted Stock Plan for Non-Management Directors.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The Company began a relationship with Celadon Group, Inc. (“Celadon”) in 2002. Mr. Rubel’s father-in-law, Stephen Russell, is Chairman of the Board and Chief Executive Officer of Celadon. Pursuant to a competitive bid process, during 2006 Celadon won the right to be the primary carrier on two of the Company’s transportation lanes. These lanes account for less than three percent of the Company’s outbound line haul budget. The Company periodically competitively bids its line haul routes and as a result, Celadon could gain or lose routes based upon its bids.

In June 2006, the Company entered into a Marketing and License Agreement with Ballet Theatre Foundation Inc., a nonprofit organization, to use the American Ballet Theatre and ABT marks in connection with development, manufacture, marketing promotion, distribution, and sale of certain dance footwear. Mr. Rubel became a Trustee of Ballet Theatre Foundation, Inc., in January 2007.



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 22, 2008, under the captions "Election of Directors–Directors and Nominees for Director," "Charters and Corporate Governance Principles–Independence of Directors and Nominees for Director."

## 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 22, 2008.

## 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 <sup>(1)</sup>	Balance at end of period
<b>Year ended January 28, 2006</b>				
Allowance for doubtful accounts	\$ 0.9	\$ 0.8	\$ (0.8 )	\$ 0.9
Deferred tax valuation allowance	6.4	1.9	(0.5 )	7.8
Sales return reserve	1.2	9.5	(9.3 )	1.4
<b>Year ended February 3, 2007</b>				
Allowance for doubtful accounts	\$ 0.9	\$ 1.0	\$ (1.4 )	\$ 0.5
Deferred tax valuation allowance	7.8	(1.1 )	–	6.7
Sales return reserve	1.4	10.1	(10.1)	1.4
<b>Year ended February 2, 2008</b>				
Allowance for doubtful accounts	\$ 0.5	\$ 3.5	\$ (1.5 )	\$ 2.5
Deferred tax valuation allowance	6.7	0.4	(1.3 )	5.8
Sales return reserve	1.4	23.9	(22.0)	3.3

- (1) With regard to allowances for doubtful accounts, deductions relate to uncollectible receivables (both accounts and other 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)
3.3	Certificate of Amendment of the Company’s Certificate of Incorporation. (12)
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. 1996 Stock Incentive Plan, as amended September 18, 2003. (6)

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<b>Number</b>	<b>Description</b>
10.4	Stock Plan for Non-Management Directors of Collective Brands, Inc., as amended August 17, 2007. *
10.5	Form of Employment Agreement between Payless ShoeSource, Inc., and certain of its executives. (7)
10.6	Collective Brands, Inc. Supplementary Retirement Account Plan, as amended and restated January 1, 2008. *
10.7	Payless ShoeSource, Inc., 401(k) Profit Sharing Plan, as amended effective August 1, 2007. *
10.8	Form of Change of Control Agreement between Payless ShoeSource, Inc. and certain of its executives. (8)
10.9	Form of Directors' Indemnification Agreement. (7)
10.10	Form of Officers' Indemnification Agreement. (8)
10.11	Payless ShoeSource, Inc. Deferred Compensation Plan for Non-Management Directors, as amended September 18, 2003. (6)
10.12	The Stock Appreciation and Phantom Stock Unit Plan of Collective Brands, Inc. and its Subsidiaries for Collective Brands International Employees, as amended April 17, 2007. *
10.13	Collective Brands, Inc. Employee Stock Purchase Plan, as amended August 17, 2007. *
10.14	Assumption Agreement, dated as of May 22, 1998, by and between Payless ShoeSource, Inc. (Missouri) and Payless ShoeSource Holdings, Inc. (1)
10.15	Collective Brands, Inc. Deferred Compensation Plan, as amended and restated January 1, 2008. *
10.16	Collective Brands, Inc. Incentive Compensation Plan as amended August 17, 2007. *
10.17	Amended and Restated Loan and Guaranty Agreement, dated August 17, 2007, by and among Collective Brands Finance, Inc. as Borrower, the Guarantors thereto as Credit Parties, the Lenders signatory thereto and Wells Fargo Retail Finance, LLC as the Arranger and Administrative Agent. (12)
10.18	Employment Agreement between Payless ShoeSource, Inc. and Matthew E. Rubel accepted and agreed to June 17, 2005, including form of change of control agreement. (9)
10.19	Form of Restricted Stock Award Agreement. (10)
10.20	Form of Stock Settled Stock Appreciation Rights Award Agreement. (10)
10.21	2006 Collective Brands, Inc. Stock Incentive Plan, amended August 17, 2007. *
10.22	Term Loan Agreement, dated as of August 17, 2007 (the "Term Loan"), among Collective Brands Finance, Inc. as Borrower, and the Lenders party thereto and CitiCorp North America, Inc., as Administrative Agent and Collateral Agent. (12)
10.23	Amendment to Employment Agreement between Payless ShoeSource, Inc. and Matthew E. Rubel accepted and agreed to June 4, 2007. *
10.24	Form of Performance Share Unit Agreement. (11)
10.25	CEO Restricted Stock Award Agreement. (11)
10.26	Amendment to Matthew E. Rubel's Change of Control Agreement made as of the 4 <sup>th</sup> day of June 2007, by and between Payless ShoeSource, Inc. and Matthew E. Rubel. (11)
10.27	Second Amendment to the Term Loan Agreement dated as of March 11, 2008. *
21.1	Subsidiaries of the Company. *

- 23.1 Consent of Independent Registered Public Accounting Firm. \*
- 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. \*

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- \* 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 1-14770) 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 1-14770) 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 January 31, 2004, filed with the SEC on April 9, 2004.
  9. Incorporated by reference from the Company' s Current Report on Form 8-K (File Number 1-14770) filed with the SEC on June 22, 2005.
  10. Incorporated by reference from the Company' s Annual Report on Form 10-K (File Number 1-14770) for the year ended February 2, 2007, filed with the SEC on April 3, 2007.
  11. Incorporated by reference from the Company' s Current Report on Form 8-K (File Number 1-14770) filed with the SEC on June 3, 2007.
  12. Incorporated by reference from the Company' s Current Report on Form 8-K (File Number 1-14770) filed with the SEC on August 17, 2007.

**The Company will furnish to stockholders upon request, and without charge, a copy of the 2007 Annual Report and the 2008 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.

COLLECTIVE BRANDS, INC.

Date: April 1, 2008

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.

/s/ Matthew E. Rubel                      Date: April 1, 2008  
Chief Executive Officer,  
President and Director  
(Principal Executive Officer)

/s/ Ullrich E. Porzig                      Date: April 1, 2008  
Senior Vice President – Chief  
Financial Officer and Treasurer  
(Principal Financial and Accounting  
Officer)

/s/ Howard R. Fricke                      Date: April 1, 2008  
Chairman of the Board and Director

/s/ Daniel Boggan Jr.                      Date: April 1, 2008  
Director

/s/ Judith K. Hofer                      Date: April 1, 2008  
Director Director

/s/ David Scott Olivet                      Date: April 1, 2008

/s/ Robert C. Wheeler                      Date: April 1, 2008  
Director

/s/ John F. McGovern                      Date: April 1, 2008  
Director

/s/ Michael A. Weiss                      Date: April 1, 2008  
Director

/s/ Robert F. Moran                      Date: April 1, 2008  
Director

/s/ Mylle H. Mangum                      Date: April 1, 2008  
Director





**STOCK PLAN FOR NON-MANAGEMENT DIRECTORS**

**Effective May 4, 1996**

Amended as of August 17, 2007

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**STOCK PLAN FOR NON-MANAGEMENT DIRECTORS  
OF  
COLLECTIVE BRANDS, INC.**

**I. GENERAL**

1. Purpose. The purpose of the Plan is to provide certain compensation to eligible directors of the Corporation and to encourage the highest level of performance of non-management directors by providing those directors with a proprietary interest in the Corporation' s success and progress by granting them shares of the Corporation' s common stock or rights to purchase shares of the Corporation' s common stock subject to the terms and conditions set forth below.

2. Definitions. Whenever used herein, the following terms shall have the meanings set forth below:

(a) "Award" means an initial or annual grant of equity, as described in Section 6 of Part I of the Plan.

(b) "Award Agreement" means a document setting forth the terms and conditions applicable to the Award granted to the Participant.

(c) "Board" means the Board of Directors of the Corporation.

(d) "Committee" means the Board or such committee as may be designated by the Board from time to time. Any such Committee must be comprised of at least one employee member of the Board and two or more outside directors who are "non-employee directors" within the meaning of Rule 16b-3 under the Exchange Act.

(e) "Corporation" means Collective Brands, Inc., a Delaware corporation and any successor thereto.

(f) "Disability" means a medically determinable physical or mental impairment which renders a Participant substantially unable to function as a director of the Corporation.

(g) "Dividend Equivalent" means an amount equal to the amount payable with respect to a share of Stock after the date an Award is granted.

(h) "Exchange Act" means the Securities Exchange Act of 1934, as amended. References to a particular section of the Exchange Act include references to successor provisions.

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(i) "Fair Market Value" of Stock means the average of the high and low prices of the Stock on the New York Stock Exchange Composite Transaction Tape on the date in question (or if the Stock is not then so traded, the average of the highest and lowest sale prices of the Stock on the stock exchange or over-the-counter market on which the Stock is principally trading on such date) or, if no sale or sales of the Stock occurred on such exchange on that day, the average of the high and low prices of the Stock on the last preceding day when the Stock was sold on the exchange. If Stock, as later defined, is no longer traded on the New York Stock Exchange and if there is no public market for the Stock, "Fair Market Value" shall be determined in good faith by the Committee using other reasonable means.

(j) "Option Award" means an option granted to a Participant pursuant to Section 6 of Part I of the Plan.

(k) "Participant" means a member of the Board (i) who is not at the time of grant an officer or employee of the Corporation (ii) who has not during the immediately preceding 12 month period been, an officer or employee of the Corporation or any subsidiary of the Corporation and (iii) to whom an Award is made under the Plan.

(l) "Plan" means the Restricted Stock Plan for Non-Management Directors of Collective Brands, Inc., amended, restated and renamed May 25, 2006 or such other date as approved by the stockholders of the Corporation, as the Stock Plan for Non-Management Directors of Collective Brands, Inc.

(m) "Restricted Period" means the period from the vesting of the Stock Award or the receipt of shares of Stock upon exercise of an Option Award until the earlier of (i) the cessation of the Participant's membership on the Board by reason of death or Disability and (ii) the later of (a) the expiration of the six month period immediately following the Award grant or (b) the date the Participant satisfies their stock ownership requirements as set forth in the Stock Ownership Guidelines for Directors, as such guidelines may be amended from time to time.

(n) "Stock" means the common stock of the Corporation, \$.01 par value, or any other equity securities of the Corporation designated by the Committee, including any attached rights.

(o) "Stock Award" means a grant of Stock or of a right to receive Stock or its cash equivalent (or both).

(p) "Stock Ownership Guidelines" means the Stock Ownership Guidelines for Directors adopted by the Company and as amended from time to time.

**3. Administration.** The Plan shall be administered by the Committee. Subject to all the applicable provisions of the Plan, the Committee is authorized: (i) to exercise all of the powers granted to it under the Plan, (ii) to construe and interpret the Plan, to prescribe, amend and rescind rules and regulations relating to the Plan, (iii) to make all determinations and take all actions necessary or advisable for the Plan's administration, (iv) to correct any defect, supply any omission and reconcile any inconsistency in the Plan, (v) to authorize any person to execute on behalf of the Corporation, any instrument required to effect the grant of an Award made by the Committee and (vi) to determine whether, to what extent and under what circumstances Awards may be settled or exercised in cash, shares of Stock, other securities, other Awards or other property, or canceled, forfeited or suspended and the method or methods by which Awards may be settled, canceled, forfeited or suspended. The Committee shall act by vote or written consent of a majority of its members. Whenever the Plan authorizes or requires the Committee to take any action, make any determination or decision or form any opinion, then any such action, determination, decision or opinion by or of the Committee shall be conclusive and binding on all persons. The Committee may obtain such advice or assistance as it deems appropriate from persons not serving on the Committee including but not limited to accountants and counsel. The Committee and others to whom the Committee has allocated or delegated authority or duties shall keep a record of all their proceedings and actions and shall maintain all such books of account, records and other data as shall be necessary for the proper administration of the Plan.

**4. Shares of Stock Available Under the Plan.** Effective May 25, 2006, if this amended and restated Plan is approved by the stockholders of the Company, the Plan provides that there may be granted under the Plan, subsequent to May 25, 2006, an aggregate of not more than 350,000 shares of Stock (the Maximum Limit"), subject to adjustment as provided in Section 3 of Part II of the Plan.

For each Option Award issued, the Maximum Limit shall be decreased based on the term of the grant as follows for each such Option Award granted:

#### EXCHANGE RATIO TABLE

Term of Grant	5 year	6 year	7 year
Option Award	.549	.598	.641

Dividends or Dividend Equivalents, if any, shall be paid in shares of Stock, and shall be deducted from the Plan Maximum Limit if such shares are available. If such shares to pay dividends are not available under the Plan Maximum Limit, but are payable, then

such dividends will be paid in cash. Amounts paid entirely in cash shall not be counted against the Maximum Limit. Shares of Stock covered by the unexercised or terminated or forfeited portion of any Award that did not result in the delivery of Stock shall be available for further Awards. For Stock Awards, if less than the maximum number of shares issuable are actually issued, such difference shall be available for future Awards.

Subject to Section 3 or Part II of the Plan, additional rules for determining the number of shares of Stock granted under an Award may be adopted by the Committee, as it deems necessary and appropriate and consistent with the overall limits set forth in the Plan. Shares of Stock granted under the Plan shall be authorized and issued Stock held in the Corporation's treasury or previously authorized but unissued Stock. If any shares of Stock shall be returned to the Corporation pursuant to the termination provisions described in Sections 7(b) & (g) of Part I of the Plan, or in the instruments evidencing the making of Awards, such shares may again be granted under the Plan.

#### **5. Eligibility.**

The Committee may grant one or more Awards to any Participant designated by it to receive an Award.

#### **6. Awards.**

The Committee may grant any one or more of the following types of Awards, either singly, or in tandem:

- a. **Option Award.** An Option is a right or rights to purchase a specific number of shares of Stock exercisable at such time or times and subject to such terms and conditions, including vesting schedule, as the Committee may determine and specify in the applicable Award Agreement. Options shall be settled in cash or Stock.
- b. **Stock Award.** Stock Awards may be granted either alone, in addition to, or in tandem with other Awards granted under the Plan. Stock Awards are subject to such terms and conditions, including vesting schedules, as the Committee may determine and specify in the applicable Award Agreement. Stock Awards shall be settled in Stock.

#### **7. General Terms and Conditions**

- a. **Term.** The term of an Option Award shall not exceed seven years.

- Restrictions.** Unless otherwise provided under the Plan or by the Committee, during the Restricted Period, no Award shall be sold, exchanged, transferred, assigned, pledged, hypothecated, or otherwise disposed of (other than upon the death of the Participant, by beneficiary designation, by last will and testament or by the laws of descent and distribution) and shall be exercisable and/or subject to receipt during the Restricted Period only by the Participant. Each certificate evidencing shares of Stock granted pursuant to a Stock Award or shares of Stock received upon exercise of an Option shall bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Award. Any attempt to dispose of such shares of Stock in contravention of such terms, conditions and restrictions shall be ineffective. The Corporation itself will hold such shares in custody, until the restrictions thereon shall have lapsed. The Corporation may delay the issuance of shares of Stock covered by any Award and the delivery of a certificate for such shares of Stock until the shares of Stock to be issued in connection with the grant or exercise of an Award, as applicable, are effectively registered under applicable federal securities laws now in force or hereafter amended or until counsel for the Corporation shall have given an opinion, which opinion shall not be unreasonably conditioned or withheld, that such shares of Stock are exempt from registration under applicable federal securities laws now in force or hereafter amended.
- b.
- Exercise Price.** The exercise price of an Option Award shall not be less than 100% of the Fair Market Value of the Stock on the date such Option Award is granted and the exercise opportunity may be capped if the Committee determines appropriate and so specifies in the Award Agreement pertaining thereto.
- c.
- Repricing Prohibited.** There shall be no grant of an Option Award to a Participant in exchange for a Participant's agreement to cancellation of a higher-priced Option Award that was previously granted to such Participant.
- d.
- Payment of Taxes Related to Stock and Option Awards.** The Corporation shall have the right to require the payment (through withholding from any amount payable from the Corporation to Participant) of any withholding taxes required by federal, state or local law, if at all, in respect of an Award.
- e.
- Rights of Holders of Stock.** A Participant shall have, after a certificate or certificates for the number of shares of Stock granted have been issued in his or her name, absolute ownership of such shares including the right to vote the
- f.

same, subject, however, to the terms, conditions and restrictions described in the Plan and in the Award Agreement to such Participant. The Corporation will hold all certificates until all restrictions on them have lapsed.

- Death, Disability & Termination.** Any provision of Section 7(h) of Part I of the Plan to the contrary notwithstanding, if a Participant who has been a member of the Board continuously since the date as of which an Award was made and such Participant shall cease to be such a member of the Board by reason of death or Disability, then an Option Award granted to such Participant may be exercised to the extent exercisable on the date of death or Disability, within the earlier of (x) 360 days after the death or Disability of such person and (y) the date on which the Option expires by its terms, by the estate of such person, or by any person or persons who acquired the right to exercise such Option Award by beneficiary designation, will or by the laws of descent and distribution. Unless the Committee determines otherwise, a Stock Award Agreement shall provide for the forfeiture of the non-vested shares of Stock underlying such Stock Award upon the Participant ceasing to be a Participant for any reason, including death or Disability.
- g.

- Terms of Award Agreement.** After the Committee determines that it will offer an Option Award or Stock Award, it will advise the Participant in writing or electronically, by means of an Award Agreement, of the terms, conditions and restrictions, including vesting, if any, related to the Award grant, including the number of shares of Stock that the Participant shall be entitled to receive or purchase, the price to be paid, if any, and, if applicable, the time within which the Participant must accept the Award grant. The Award grant shall be accepted by execution of an Award Agreement in the manner determined by the Committee. Unless the Committee determines otherwise, the Award Agreement shall provide for the forfeiture of the non-vested shares of Stock underlying such Stock Award and for any such shares of Stock that remain non-vested at the time the Participant ceases to be a Participant, the cessation of Participant status shall cause an immediate sale of such non-vested shares of Stock to the Corporation at the original price per share of Stock, if any, paid by the Participant.
- h.

- No Future Entitlements.** No Participant shall have any claim or right to be granted an Award under this Plan. Having received an Award under this Plan shall not give a Participant any right to receive any other Award under this Plan and the Committee may determine that any or all Participant(s) are not
- i.

eligible to receive an Award under this Plan for an indefinite period or for a specified year or years.

- j. **Other.** The Committee may establish such other terms and conditions for an Award as it deems appropriate.

## II. MISCELLANEOUS

1. **Effective Date.** The Plan became effective on May 4, 1996, was first amended on April 20, 1998 and if so approved by the stockholders of the Corporation, is amended and restated effective on May 25, 2006.

2. **Duration of Plan.** Unless terminated pursuant to Section 5 of Part II, the Plan shall remain in effect.

3. **Changes in Capital Structure.** In the event of any change in the outstanding shares of Stock by reason of a stock dividend greater than 5% of the Stock price, stock split or reverse stock split, recapitalization, merger or consolidation (whether or not the Company is a surviving Company), reorganization, combination, exchange or reclassification of shares, spin-off or other similar corporate changes or an extraordinary dividend payable in cash or property, (i) the number of shares of Stock (or other securities) then remaining subject to this Plan, including those that are then covered by outstanding Awards, and the maximum number of shares of Stock that may be issued, or with respect to which Awards may be granted, to any single Participant or in the aggregate pursuant to this Plan, (ii) the price or exercise price for each share or right then covered by an outstanding Award and (iii) the terms and conditions of each other outstanding Award may be proportionally adjusted as the Committee deems equitable in its absolute discretion to prevent dilution or enlargement of the rights of a Participant. Any adjustment made by the Committee under this Section shall be final, binding and conclusive on all persons..

4. **Expenses of Plan.** The expenses of the Plan shall be borne by the Corporation.

5. **Amendment or Termination.** The Corporation may at any time amend, suspend or terminate the Plan, in whole or in part, and the Committee may, subject to the Plan, at any time alter or amend any or all Award Agreements to the extent permitted by applicable law and the Plan; provided that no such action shall impair the rights of any holder of an Award without the holder's consent. For purposes of the Plan, any action of the Committee that alters or affects the tax treatment of any Award shall not be considered to materially impair any rights of any holder. Notwithstanding the foregoing, neither the Corporation nor the Committee shall (except pursuant to Section 3 of Part II) amend the Plan or any Award Agreement, without the approval of the stockholders of the Company to (i) increase the number of shares of Stock available for Awards as set forth in Section 4 of Part I or (ii) decrease the exercise price of any Award or (iii) make any



other amendments to the Plan or Award Agreement which would require stockholder approval under the General Corporation Law of the State of Delaware, New York Stock Exchange Rules or such other rules as may govern the trading or quotation of the Company' s Stock or Rule 16b-3 of the Securities Exchange Act of 1934, as amended.

6. Nothing in this Plan shall be deemed to create any obligation on the part of the Board to nominate any director for reelection as a director by the shareholders of the Corporation.

**7. Effective Date and Term.** The amended and restated Plan was adopted by the Board of Directors effective as of May 25, 2006, subject to approval by the Company' s stockholders. The Committee may grant Awards prior to stockholder approval, provided, however, that Awards granted prior to such stockholder approval are automatically canceled if stockholder approval is not obtained at or prior to the period ending twelve months after the date the Plan is effective and provided further that no Award may be settled prior to the date stockholder approval is obtained. Unless sooner terminated, the Plan shall remain in effect until May 25, 2016. Termination of the Plan shall not affect any Award previously made



**COLLECTIVE BRANDS, INC.**  
**SUPPLEMENTARY RETIREMENT ACCOUNT PLAN**  
**As Amended and Restated January 1, 2008**

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## Collective Brands, Inc. Supplementary Retirement Account Plan

This document constitutes and sets forth the terms of the Collective Brands, Inc. Supplementary Retirement Account Plan, which is an amendment and restatement of the Payless ShoeSource Supplementary Retirement Plan effective as of January 1, 2008.

### Section 1. Definitions.

1.1 *Account Balance* means, with respect to a Member, a credit on the records of the Employer equal to the sum of (i) the Transition Credit Account balance, (ii) the Basic Credit Account balance, (iii) the Performance Credit Account balance, and (iv) the Discretionary Credit Account balance. The Account Balance, and each component thereof, shall be a bookkeeping entry only and shall be utilized solely as a device for the measurement and determination of the amounts to be paid to a Member, or his or her designated beneficiary, pursuant to this Plan.

1.2 *Actuarial Equivalent* means a benefit of equivalent value when computed on the basis of the actuarial principles and tables adopted or otherwise approved by the Committee.

1.3 *Associate* means any associate of an Employer under the Payless Profit Sharing Plan.

1.4 *Basic Credit* means, for any one Plan Year, the amount determined in accordance with Section 3.2.

1.5 *Basic Credit Account* means (i) the sum of the Member's Basic Credits, plus (ii) amounts credited in accordance with all the applicable crediting provisions of this Plan that relate to the Member's Basic Credit Account, less (iii) all distributions made to the Member or his or her beneficiary pursuant to this Plan that relate to the Member's Basic Credit Account.

1.6 *Cause* means:

(a) the willful and continued failure by the Member to substantially perform his or her duties with the Company or an Employer (other than any such failure resulting from disability or, in the case of a Member with whom the Company or an Employer has entered into a change in control agreement providing for termination of employment for good reason following a Change in Control of the Company, any such actual or anticipated failure after the Member notifies the Company or an Employer of circumstances constituting good reason which occur after a Change in Control of the Company) after a written demand for substantial performance is delivered to the Member by the Company or Employer, which demand specifically identifies the manner in which the Company or Employer believes the Member has not substantially performed his or her duties, or



(b) the willful engaging by the Member in conduct that is demonstrably and materially injurious to the Company or Employer, monetarily or otherwise;

*provided, however*, that a Termination of Employment shall not be deemed for Cause if the Member's employment agreement with the Company provides a definition of "cause" under which "cause" has not occurred. For the purposes of this Section 1.6, "good reason" has the meaning set forth in the change in control agreement between the Member and the Company or an Employer, if any.

1.7 *CEO* means the Company's Chief Executive Officer.

1.8 *Change in Control of the Company* means:

(a) Any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person") acquires beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then-outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or (B) the combined voting power of the then-outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); *provided, however*, that, for purposes of this Section 1.8(a), none of the following shall constitute a Change of Control: (i) any acquisition directly from the Company of 30% or less of Outstanding Company Common Stock or Outstanding Company Voting Securities provided that at least a majority of the members of the board of directors of the Company following such acquisition were members of the Incumbent Board at the time of the Board's approval of such acquisition, (ii) any acquisition by the Company, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any affiliated company, or (iv) any acquisition by the Company which, by reducing the number of shares of Outstanding Company Common Stock or Outstanding Company Voting Securities, increases the proportionate number of shares of Outstanding Company Common Stock or Outstanding Company Voting Securities beneficially owned by any Person to 20% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; *provided, however*, that, if such Person shall thereafter become the beneficial owner of any additional shares of Outstanding Company Common Stock or Outstanding Company Voting Securities and beneficially owns 20% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, then such additional acquisition shall constitute a Change of Control;

(b) Individuals who, as of the date hereof, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; *provided, however*, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding,

for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board;

(c) A reorganization, merger, consolidation or sale or other disposition of all or substantially all of the assets of the Company (a "Business Combination") is consummated, in each case, unless, immediately following such Business Combination, (A), more than 50%, respectively, of the then-outstanding shares of common stock and the combined voting power of the then-outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of (x) the corporation resulting from such Business Combination or (y) a corporation that, as a result of such transaction, owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries, is represented by the Outstanding Company Common Stock and the Outstanding Company Voting Securities (or, if applicable, is represented by shares into which Outstanding Company Common Stock or Outstanding Company Voting Securities were converted pursuant to such Business Combination) in substantially the same proportions as their ownership immediately prior to such Business Combination of the Outstanding Company Common Stock and the Outstanding Company Voting Securities, as the case may be, (B) no Person (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then-outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then-outstanding voting securities of such corporation, except to the extent that such ownership existed prior to the Business Combination, and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement or of the action of the Board providing for such Business Combination; or

(d) The stockholders of the Company approve of a complete liquidation or dissolution of the Company.

1.9 *Code* means the Internal Revenue Code of 1986, as amended from time to time.

1.10 *Committee* means (i) for purposes of establishing and determining the satisfaction of Performance Goals under Sections 1.28 and 3.3, the Compensation, Nominating and Governance Committee of the board of directors of the Company, and (ii) for all other purposes under the Plan, the committee established by Section 4 of this Plan.

1.11 *Company* means Collective Brands, Inc., a Delaware corporation, and any other organization which may be a successor to it.

1.12 *Company Service* means years of service during employment with an Employer, any other subsidiary of the Company or any other affiliated company, determined using the elapsed time method. Members shall receive a year of Company Service on each anniversary date of their commencement of employment with an Employer, subject to any limitations or restrictions as may be imposed in connection with such Employer's adoption of the Plan; *provided, however*, that Company Service shall also include service with The May Department Stores Company for a Member who commenced employment with Payless ShoeSource, Inc.:

(a) on or before May 4, 1996, or

(b) prior to January 1, 1999 and received credit for service with The May Department Stores Company for benefits purposes at the time of the Member's initial employment with Payless ShoeSource, Inc.

In the event of a Member's Termination of Employment and subsequent reemployment by an Employer, any other subsidiary of the Company or any other affiliated company:

(c) within 31 days, Company Service shall include the period between such Termination of Employment and such reemployment and Company Service earned prior to such Termination of Employment;

(d) after 31 days but within one year, Company Service shall not include the period between such Termination of Employment and such reemployment, but shall include Company Service earned prior to such Termination of Employment; or

(e) after one year, Company Service shall not include the period between such Termination of Employment and such reemployment, and Company Service earned prior to such Termination of Employment shall be forfeited.

1.13 *Compensation* means base salary and any annual incentive payment received by an Associate from any Employer during any Plan Year, including amounts not otherwise includable in the Member's taxable income pursuant to Code Section 125 or 402(e)(3), and amounts subject to the Collective Brands, Inc. Deferred Compensation Plan. Compensation shall not include any discretionary or special cash awards, including, but not limited to, retention, spot awards, home sale bonuses, CEO discretionary cash awards and sign on bonuses.

1.14 *Competing Business* includes for purposes of this Plan, but is not limited to, the following:

(a) any retail business with gross sales or revenue in the prior fiscal year of more than \$25 million (or which is a subsidiary, affiliate or joint venture partner of a business with gross sales or revenue in the prior fiscal year of more than \$25 million) that sells footwear

and/or accessories at retail to consumers at price points competitive, or likely to be competitive, with the Company (e.g. including, without limitation, Wal-Mart Stores, Inc., Sears Holdings Corporation, Target Corporation, Shoe Zone Limited, Bata Limited, Aldo Shoes, Inc., Genesco, Inc., Footlocker, Inc., Brown Shoe Company, Inc., Shoe Carnival, Inc., Kohl's Corporation, Liz Claiborne Inc., Big 5 Sporting Goods Corporation, and J.C. Penney Company, Inc.) within 10 miles of any Company store or the store of any wholesale customer of the Company in the United States or anywhere in any foreign country in which the Company has retail stores, franchisees or wholesale customers;

(b) any franchising or wholesaling business with gross sales or revenue in the prior fiscal year of more than \$25 million (or which is a subsidiary, affiliate or joint venture partner of a business with gross sales or revenue in the prior fiscal year of more than \$25 million) which sells footwear at wholesale to franchisees, retailers or other footwear distributors located within 10 miles of any Company store or the store of any wholesale customer of the Company in the United States, or anywhere in any foreign country in which the Company has retail stores, franchisees or wholesale customers;

(c) any footwear and/or accessory manufacturing business with gross sales or revenue in the prior fiscal year of more than \$25 million (or which is a subsidiary, affiliate or joint venture partner of a business with gross sales or revenue in the prior fiscal year of more than \$25 million) that sells footwear and/or accessories to retailers or other footwear distributors located within 10 miles of any Company store or the store of any wholesale customer of the Company in the United States, or anywhere in any foreign country in which the Company has retail stores, franchisees or wholesale customers (e.g. including without limitation, Nine West Shoes, Dexter Shoe Company, Liz Claiborne Inc., Wolverine World Wide, Inc., The Timberland Company, Nike, Inc., Reebok International Ltd., K-Swiss Inc. and Adidas Salomon AG); or

(d) any business that provides buying office services to any store or group of stores or businesses referred to in (a), (b) and (c) above.

1.15 *Discretionary Credit* means, for any one Plan Year, the amount determined in accordance with Section 3.4.

1.16 *Discretionary Credit Account* means (i) the sum of the Member's Discretionary Credits, plus (ii) amounts credited in accordance with all the applicable crediting provisions of this Plan that relate to the Member's Discretionary Credit Account, less (iii) all distributions made to the Member or his or her beneficiary pursuant to this Plan that relate to the Member's Discretionary Credit Account.

1.17 *Effective Date* means January 1, 2008. The Plan was originally effective on May 4, 1996.

1.18 *Employer* means the Company and, if authorized by the Company to participate herein, any subsidiary of the Company or any other affiliated company which elects to participate herein.

1.19 *Executive Management Member* means any Member who is employed by an Employer in a position at the level of Vice President or above.

1.20 *Fiscal Year* means the fiscal year of the Company.

1.21 *Key Employee* shall means any Member who is a "key employee" (as defined in Code Section 416(i) without regard to paragraph (5) thereof) based upon the 12-month period ending on each December 31<sup>st</sup> (such 12-month period is referred to below as the "identification period"). All Members who are determined to be key employees under Code Section 416(i) (without regard to paragraph (5) thereof) during the identification period shall be treated as Key Employees for purposes of the Plan during the 12-month period that begins on the first day of the 4<sup>th</sup> month following the close of such identification period. For purposes of determining whether a Member is a Key Employee, the definition of compensation set forth in Treasury Regulation Section 1.415(c)-2(a) shall be applied [without respect to any safe harbor provided in Section 1.415(c)-2(d), without respect to the special timing rules in Section 1.415(c)-2(e), and without respect to any of the special rules in Section 1.415(c)-2(g)].

1.22 *Member* means any person included in the membership of the Plan as provided in Section 2.

1.23 *Minimum Benefit* means the amount determined in accordance with Section 3.7.

1.24 *Payless Profit Sharing Plan* means the Payless ShoeSource, Inc. 401(k) Profit Sharing Plan, as amended from time to time, and any other successor retirement plan which may be designated by the Committee, including the Payless ShoeSource, Inc. Profit Sharing Plan for Puerto Rico Associates.

1.25 *Payment Date* means January 1 or July 1 of any Plan Year; *provided, however*, that payment on any subsequent day during the same Plan Year shall constitute payment on the applicable Payment Date.

1.26 *Performance Credit* means, for any one Plan Year, the amount determined in accordance with Section 3.3.

1.27 *Performance Credit Account* means (i) the sum of the Member' s Performance Credits, plus (ii) amounts credited in accordance with all the applicable crediting provisions of this Plan that relate to the Member' s Performance Credit Account, less (iii) all distributions made to the Member or his or her beneficiary pursuant to this Plan that relate to the Member' s Performance Credit Account.

1.28 *Performance Goal* means the goal or goals established with respect to the Executive Management Members for a Plan Year by the Committee pursuant to Section 3.3.

1.29 *Performance Measures* means any of the following performance criteria, either alone or in any combination, and may be expressed with respect to the Company or one or more operating units, groups, or any Employer, as the Committee may determine: cash flow; cash flow from operations; total earnings; earnings per share, diluted or basic; earnings per share from continuing operations, diluted or basic; earnings before interest and taxes; earnings before interest, taxes, depreciation, and amortization; earnings from continuing operations; net asset turnover; inventory turnover; net earnings; operating earnings; operating margin; return on equity; return on net assets; return on total assets; return on capital; return on investment; return on sales; revenues; sales; market share; economic value added; expense reduction levels; stock price; total shareholder return and operating income. For any Plan Year, Performance Measures may be determined on an absolute basis or relative to internal goals or relative to levels attained in a year or years prior to such Plan Year or related to other companies or indices or as ratios expressing relationships between two or more Performance Measures. For any Plan Year, the Committee shall provide how any Performance Measure shall be adjusted to the extent necessary to exclude the effects of extraordinary, unusual, or non-recurring items; changes in applicable laws, regulations, or accounting principles; currency fluctuations; discontinued operations; non-cash items, such as amortization, depreciation, or reserves; or any recapitalization, restructuring, reorganization, merger, acquisition, divestiture, consolidation, spin-off, split-up, combination, liquidation, dissolution, sale of assets, or other similar corporate transaction, or stock dividends, or stock splits or combinations.

1.30 *Plan Year* means the period between January 1<sup>st</sup> and December 31<sup>st</sup> of each year.

1.31 *Termination of Employment* means a Member's separation from service with all Employers, other subsidiaries of the Company and other affiliated companies, involuntarily or voluntarily, for any reason other than death, as determined in accordance with Code Section 409A.

1.32 *Transition Credit* means the amount determined in accordance with Section 3.1.

1.33 *Transition Credit Account* means (i) the Member's Transition Credit, plus (ii) amounts credited in accordance with all the applicable crediting provisions of this Plan that relate to the Member's Transition Credit Account, less (iii) all distributions made to the Member or his or her designated beneficiary pursuant to this Plan that relate to the Member's Transition Credit Account.

1.34 *Trust* means one or more trusts, commonly referred to as a "rabbi trust," established between the Company and the trustee named therein, as amended from time to time.

## **Section 2. Membership.**

**2.1 Prior Members.** Each Associate who was a Member on December 31, 2007, under the terms and conditions of the Plan in effect on such date, shall continue to be a Member on the Effective Date.

**2.2 New Members.** On or after the Effective Date, each Associate not described in Section 2.1 shall become a Member hereunder on January 1 of the first Plan Year (or such earlier date determined by the Committee, in its sole discretion) on or after the date that both of the following requirements are satisfied:

(a) such Associate is employed by an Employer in a position at the level of Director or above; and

(b) such Associate's base salary in effect on December 31 of the immediately preceding Plan Year (or such other date determined by the Committee, in its sole discretion) equaled or exceeded 150% of the dollar amount in effect under Code Section 414(q) for such Plan Year or such larger amount that the Committee, in its sole discretion, determines for such Plan Year;

*provided, however*, that any Associate who is employed by an Employer that is organized under the laws of any country other than the United States, or who participates in the retirement or pension scheme of any such country, shall not be eligible to become a Member; *provided, however*, that if an Associate is not employed by an Employer on the date the requirements under this Section 2.2 are satisfied, such Associate shall not become a Member until the date he or she becomes employed by an Employer; *provided, however*, the CEO as of the Effective Date shall not be a Member; *provided, however*, that an Associate shall not become a Member if an employment agreement between such Associate and an Employer provides that such Associate shall not become a Member; *provided, however*, that, on or before the date an Associate would otherwise become a Member under this Section 2.2, the Committee may, in its sole discretion, exclude such Associate from membership in the Plan (and, in its sole discretion, the Committee may designate any such Associate as a Member as of any subsequent date that the Committee determine, provided that such Associate satisfies the requirements under this Section 2.2 on such date).

**2.3 Reemployed Members.** In the event of a Member's Termination of Employment and subsequent reemployment by an Employer:

(a) if such reemployment occurs within one year after the date of such Termination of Employment, such former Member shall resume active membership in the Plan on the date of such reemployment, provided that such former Member is reemployed in a position at the level of Director or above and his or her base salary in effect upon such reemployment equals or exceeds the dollar amount determined under Section 2.2(b) for the immediately preceding Plan Year;

(b) if such reemployment occurs more than one year after the date of such Termination of Employment, or such former Member is reemployed in a position below the level of Director or his or her base salary in effect upon such reemployment is less than the dollar amount determined under Section 2.2(b) for the immediately preceding Plan Year, such former Member must subsequently satisfy the requirements set forth in Section 2.2 to resume active membership in the Plan on January 1 of the first Plan Year on or after the date such requirements are satisfied.

If any such former Member is receiving annual installment payments under the Plan, such payments shall continue following reemployment and, if such former Member resumes active membership in the Plan, a new Account Balance shall be established for such former Member in accordance with the applicable terms and conditions of the Plan.

**2.4 Eligibility for Benefits.** Notwithstanding anything herein to the contrary, with respect to any Member (whether described in Section 2.1, 2.2 or 2.3), on the date:

- (a) such Member is transferred to any subsidiary of the Company or any other affiliated company which is not an Employer, or
- (b) such Member is demoted to a position below the level of Director,

such Member shall cease to be eligible for any Basic Credit, Performance Credit or Discretionary Credit for any Plan Year ending on or after such date, except as otherwise provided in Section 3.2, 3.3 or 3.4, unless such Member subsequently satisfies the requirements set forth in Section 2.2 to resume active membership in the Plan on January 1 of the first Plan Year on or after the date such requirements are satisfied. Notwithstanding anything herein to the contrary, a Member whose base salary is reduced to less than the dollar amount determined under Section 2.2(b) for the immediately preceding Plan Year shall remain eligible for Basic Credits, Performance Credits and Discretionary Credits, in accordance with the applicable provisions of the Plan, unless the Committee determines, in its sole discretion, that such continued eligibility would result in the Plan ceasing to be maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees for purposes of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

### **Section 3. Benefits.**

**3.1 Transition Credit.** As of the Effective Date, the Employer shall credit the greatest of the following amounts to the Transition Credit Account of a Member described in Section 2.1:

- (a) The Actuarial Equivalent of the annual supplementary retirement benefit payable to such Member upon attainment of age 65 (or, if later, on the Effective Date), based



on such Member' s Average Annual Compensation, Plan Service, Annual Estimated Social Security Benefits, Annual Retirement Benefits Offset and Annual Minimum Benefit Amount as determined as of the day immediately preceding the Effective Date in accordance with the provisions of the Plan in effect on such date.

(b) An amount equal to the product of 5% of such Member' s base salary in effect on the Effective Date multiplied by such Member' s Plan Service prior to the Effective Date, as determined in accordance with the provisions of the Plan in effect on such date.

(c) In the case of a Member whose projected Account Balance upon attainment of age 65 would be less than the Actuarial Equivalent of the projected annual supplementary retirement benefit payable to such Member upon attainment of age 65 under the terms of the Plan in effect on the day immediately preceding the Effective Date, as determined in accordance with such assumptions and methodology as are prescribed by the Committee, an amount that would limit such reduction to 25%; *provided, however*, this Section 3.1(c) shall apply only in the case of a Member (i) whose age plus years of Plan Service as of the day immediately preceding the Effective Date, as determined in accordance with the provisions of the Plan in effect on such date, equals or exceeds 55, and (ii) who has completed at least five years of such Plan Service as of the day immediately preceding the Effective Date.

**3.2 Basic Credit.** For each Plan Year ending after the date an Associate becomes a Member, the Employer shall credit to the Basic Credit Account of such Member an amount equal to 5% of such Member' s Compensation for such Plan Year; *provided, however* that no such amount shall be credited for a Plan Year in the case of a Member (i) who is not employed by an Employer, any other subsidiary of the Company or any other affiliated company on December 31 of such Plan Year, unless otherwise determined by the Committee, in its sole discretion, in the case of a Member whose Termination of Employment is not due to Cause, or (ii) who is demoted to a position below the level of Director during such Plan Year, unless otherwise determined by the Committee, in its sole discretion; *provided, however*, the Committee may, in its sole discretion, reduce the amount of the Basic Credit for any Plan Year for any Member for any nondiscriminatory reason. If a Member commences membership during a Plan Year on a date other than January 1, such Member' s Basic Credit for such Plan Year for such Plan Year shall be based on Compensation paid on or after the date such membership commences. The Basic Credit for the Plan Year in which a Member is transferred to any subsidiary of the Company or any other affiliated company which is not an Employer shall be based on Compensation paid on or before the date of such transfer, demotion or reduction. The Basic Credit for any Plan Year shall be credited to a Member' s Basic Credit Account as of a date in the following Plan Year determined by the Committee that is not later than April 15.

**3.3 Performance Credit.** Within 90 days after the commencement of each Fiscal Year, the Committee shall, in writing, determine for such Fiscal Year the Performance Goal or Performance Goals applicable to each Executive Management Member based on one or more Performance Measures. If, upon completion of the Fiscal Year, the Committee determines

that such Performance Goal or Performance Goals applicable to any Executive Management Member have been satisfied, the Employer shall credit to Performance Credit Account of such Executive Management Member:

(a) in the case of an Executive Management Member who is employed in a position at the level of Vice President, an amount equal to 5% of such Executive Management Member's Compensation for such Fiscal Year (or for the portion of the Fiscal Year during which such Executive Management Member is employed at such level); and

(b) in the case of an Executive Management Member who is employed in a position above the level of Vice President, an amount equal to 10% of such Executive Management Member's Compensation for such Fiscal Year (or for the portion of the Fiscal Year during which such Executive Management Member is employed at such level);

*provided, however* that no such amount shall be credited for a Fiscal Year in the case of an Executive Management Member (i) who is not employed by an Employer, any other subsidiary of the Company or any other affiliated company on the last day of such Fiscal Year, unless otherwise determined by the Committee, in its sole discretion, in the case of an Executive Management Member whose Termination of Employment is not due to Cause, or (ii) who is demoted to a position below the level of Vice President, unless otherwise determined by the Committee, in its sole discretion. The Performance Credit for any Fiscal Year shall be credited to an Executive Management Member's Performance Credit Account as of a date in the following Fiscal Year determined by the Committee that is not later than April 15.

**3.4 Discretionary Credit.** For each Plan Year, an Employer, in its sole discretion, may, but is not required to, credit to the Discretionary Credit Account of any Member (including, solely for purposes of this Section 3.4, any former Member who has been transferred to any subsidiary of the Company or any other affiliated company which is not an Employer) any amount it desires. The amount so credited to a Member may be smaller or larger than the amount credited to any other Member, and the amount credited to any Member for a Plan Year may be zero, even though one or more other Members are credited with a Discretionary Credit for that Plan Year. The Discretionary Credit for any Plan Year shall be credited to a Member's Discretionary Credit Account as of the date determined by the Employer.

### **3.5 Vesting.**

(a) A Member shall become vested in his or her Transition Credit Account, if any, upon the later of attainment of age 55 and completion of five years of Company Service.

(b) A Member shall become vested in his or her Basic Credit Account, Performance Credit Account and Discretionary Account, as applicable, in accordance with the following schedule:

Years of Company Service	Vested Percentage
Fewer than 5 years	0 %
5 years	50 %
6 years	60 %
7 years	70 %
8 years	80 %
9 years	90 %
10 years or more	100 %

(c) Notwithstanding anything to the contrary contained in subsection (a) or (b), a Member' s Account Balance shall immediately become 100% vested in the event of a Change in Control of the Company.

(d) The nonvested portion of a Member' s Account Balance shall be forfeited immediately upon such Member' s death or Termination of Employment. If such Member is reemployed by an Employer, any other subsidiary of the Company or any other affiliated company within one year following Termination of Employment, the amount of his or her Account Balance which was forfeited shall be restored on the date of such reemployment without adjustment for any interest that would otherwise have been credited under Section 3.6 following Termination of Employment.

### *3.6 Adjustment of Account Balance.*

(a) A Member' s Transition Credit Account and the nonvested portion of a Member' s Basic Credit Account, Performance Credit Account and Discretionary Credit Account shall be credited with interest for each Plan Year at a rate determined by the Committee, in its sole discretion, for such Plan Year. Such interest shall be credited as of such dates as shall be determined by the Committee, in its sole discretion

(b) The vested portion of a Member' s Basic Credit Account, Performance Credit Account and Discretionary Credit Account ("Vested Accounts") shall be credited with earnings or debited for losses based on the performance of investment funds designated by the Committee, in its sole discretion, from time to time. Such earnings or losses shall be credited or debited as of such dates as shall be determined by the Committee, in its sole discretion.

(i) A Member may elect, in increments of 1%, the percentage of his or her Vested Accounts which shall have earnings credited or losses debited based on the performance of each such investment fund, in accordance with rules and procedures established by the Committee. Any such election may be changed by the Member as of such dates as shall be determined by the Committee, in its sole discretion.

(ii) In the event a Member fails to make the election described in paragraph (i), such Member's Vested Accounts shall have earnings credited or losses debited based on the performance of one or more such investment funds as determined by the Committee, in its sole discretion.

(iii) Notwithstanding the foregoing, neither the Employer nor, if applicable, the trustee of the Trust shall be required to actually invest a Member's Vested Accounts in the investment funds elected by such Member. If any such investment is made, no Member shall have any rights or interest therein, and Members shall at all times remain unsecured creditors of the Employer.

**3.7 Minimum Benefit.** A Minimum Benefit shall be determined for each Member described in Section 2.1 who has attained age 55 and completed at least five years of Plan Service as of the day immediately preceding the Effective Date, as determined in accordance with the provisions of the Plan in effect on such date. The amount of the Minimum Benefit shall be equal to the Actuarial Equivalent of the annual supplementary retirement benefit immediately payable to such Member if such Member's Termination of Employment occurred on the Effective Date, based on such Member's Average Annual Compensation, Plan Service, Annual Estimated Social Security Benefits, Annual Retirement Benefits Offset and Annual Minimum Benefit Amount as determined as of the day immediately preceding the Effective Date in accordance with the provisions of the Plan in effect on such date. A Member's Minimum Benefit (i) shall be fully vested at all times, and (ii) is a frozen amount which shall not be credited with interest or earnings or debited for losses. Notwithstanding anything herein to the contrary, the amount distributed under the Plan with respect to any Member described in this Section 3.7 shall not be less than his or her Minimum Benefit.

**3.8 Distributions to Members.** Following Termination of Employment, a Member's vested Account Balance or, if greater, his or her Minimum Benefit, if any, shall be distributed in accordance with the following:

(a) A Member may elect in writing, on a form prescribed by the Committee (or in an electronic format acceptable to the Committee), to receive his or her Account Balance in the form of (i) a single lump sum payment, or (ii) annual installment payments over a period not to exceed 15 years as approved by the Committee, with each annual installment payment equal to the amount determined by dividing the Member's Account Balance on each applicable Payment Date by the number of annual installments remaining to be paid. Such election must be received by the Committee (i) prior to the Effective Date in the case of a Member described in Section 2.1, or (ii) no later than 30 days after commencement of membership in the Plan in the case of a Member described in Section 2.2 (or, in the case of any such Member who previously participated in a nonqualified deferred compensation plan aggregated with this Plan under Section 409A, prior to the Plan Year in which membership in the Plan commences). If a Member fails to timely make an election under this subsection (a), such Member shall be deemed to have elected to receive his or her Account Balance in the form of a single lump sum payment. Except as otherwise provided in this subsection (a)

or subsection (d), any election under this subsection (a) shall be irrevocable. If permitted by the Committee, a Member may, prior to the beginning of each Plan Year, make a separate election regarding the form of payment for amounts attributable to his or her Basic Credits, Performance Credits and Discretionary Credits for such Plan Year; *provided, however*, that a Member's election under this subsection (a) shall remain in effect with respect to such amounts for subsequent Plan Years unless changed by such Member in accordance with the foregoing for any such Plan Year.

(b) Notwithstanding anything to the contrary in subsection (a), in the case of a Member described in Section 3.7, such Member shall receive an amount equal to his or her Minimum Benefit in 10 equal annual installment payments. Any such Member's election under subsection (a) shall apply to the amount of his or her Account Balance in excess of the Minimum Benefit, if any.

(c) Except as otherwise provided in subsection (d), payments under subsection (a) or (b) shall be made or commence (i) in the case of a Key Employee, on the first Payment Date coinciding with or next following the date which is six months after the date of his or her Termination of Employment, or (ii) in the case of any other Member, on the first Payment Date coinciding with or next following the date of his or her Termination of Employment. In the case of installment payments, such payments shall continue on the same Payment Date in each subsequent Plan Year for the period elected by the Member.

(d) A Member may make a new election under subsection (a) with respect to his or her Transition Credit Account and amounts attributable to his or her Basic Credits, Performance Credits and Discretionary Credits for prior Plan Years. Any such election must be received by the Committee at least 12 months before the Payment Date on which payment would otherwise be made or commence under subsection (c). Payment pursuant to any such new election shall be made or commence on the Payment Date which is five years after the Payment Date on which payment would otherwise have been made or commenced. This subsection (d) shall not apply with respect to an amount equal to a Member's Minimum Benefit, if any.

(e) Notwithstanding anything in Section 3.8 to the contrary, in the event a Member's vested Account Balance, plus his or her vested interest in any other nonqualified deferred compensation plan aggregated with the Plan under Code Section 409A, does not exceed the applicable dollar amount under Code Section 402(g)(1)(B) in effect on the date of his or her Termination Employment (or, in the case of a Key Employee, the date which is six months after the date of his or her Termination of Employment), such Member shall receive his or her vested Account Balance in a single lump sum payment on such date; *provided, however*, that this subsection (e) shall only be applicable if such Member's interest in any other nonqualified deferred compensation plan aggregated with the Plan under Code Section 409A is also paid in a single lump sum on such date.

### 3.9 *Death of Member.*

(a) If a Member dies prior to Termination of Employment, or after Termination of Employment but prior to the Payment Date on which payments would otherwise be made or commence under Section 3.8, such Member' s vested Account Balance or, if applicable, Minimum Benefit shall be paid to his or her designated beneficiary in a single lump sum on the first Payment Date following the date of such Member' s death.

(b) If a Member dies after commencing receipt of annual installment payments of his or her vested Account Balance or, if applicable, Minimum Benefit, the remainder of such vested Account Balance or Minimum Benefit shall be paid to such Member' s designated beneficiary in a single lump sum on the first Payment Date following the date of such Member' s death.

(c) Each Member shall have the right, at any time, to designate one or more persons or entities as beneficiaries (both primary and contingent) to receive payments under the Plan in the event of such Member' s death. Any designation of a beneficiary must be made in writing on a form prescribed by the Committee, and must be received by the Committee prior to the Member' s death. A Member may change his or her designated beneficiary at any time in accordance with the foregoing, and any such new beneficiary designation shall cancel any prior beneficiary designation. If a Member fails to designate a beneficiary in accordance with the foregoing, or if all of a Member' s designated beneficiaries predecease such Member or die prior to the Payment Date determined under subsection (b), such Member' s designated beneficiary shall be deemed to be his or her estate.

3.10 *Noncompetition.* It is recognized that a Member' s duties during the period of employment with the Company or an Employer entail the receipt of confidential information concerning not only the current operations and procedures of the Company or an Employer but also its short-range and long-range plans. If (A) the Member during any portion of the period of two (2) years following his or her Termination of Employment (1) has an aggregate investment (as determined from time to time) in a Competing Business equal to at least the greater of (i) \$100,000, (ii) 1% in value of such Competing Business, or (iii) such greater amount as the Committee may establish on a case by case basis, or (2) personally renders services to a Competing Business in any manner, including without limitation, as owner, partner, director, trustee, officer, employee, consultant or advisor thereof, and (B) the Committee determines, in its sole discretion, that such investment or rendering of personal services is contrary to the best interests of the Company, then all rights to receive any payment of his or her Account Balance or Minimum Benefit under the Plan shall immediately cease, and the Member shall be obligated to repay to the Employer any payments previously received under the Plan, if the Member does not reduce such aggregate investment to an amount permitted hereunder or cease rendering such personal services, within 60 days of receipt of written notice of such determination from the Committee. The term "value" as used herein shall mean the net worth of such Competing Business, as disclosed by the balance sheet of such Competing Business, as of the close of the last preceding fiscal year; provided, however, that with respect to an investment in stock or other

securities of a Competing Business, if such stock or other securities are part of a class of stock or other securities listed on any stock exchange, the term “value” shall mean the market value of such class of stock or other securities of such Competing Business, as of the date of any such determination by the Committee.

3.11 *Indirect Payment of Benefits.* If any Member or his or her designated beneficiary is, in the judgment of the Committee, legally, physically or mentally incapable or incompetent, payment may be made to the guardian or other legal representative of such Member or designated beneficiary or, if there be none, to such other person or institution who or which, in the opinion of the Committee, based on information furnished to the Committee, is then maintaining or has custody of such Member or designated beneficiary. Such payment shall constitute a full discharge with respect thereto.

3.12 *Withholding.* The Employer shall withhold from amounts otherwise payable under this Plan any amounts required to be withheld under federal, state or local law or regulations, such amounts to be remitted on a timely basis to the appropriate governmental authorities. When a Member becomes vested in any portion of his or her Account Balance, the Employer shall withhold from the Member’s Compensation, in a manner determined by the Employer, the Member’s share of FICA and other employment taxes on such vested portion of his or her Account Balance; *provided, however*, if necessary, the Committee may reduce the vested portion of the Member’s Account Balance in order to comply with such withholding obligation.

#### **Section 4. Administration of the Plan.**

4.1 *The Committee.* Except as otherwise provided herein, the Plan shall be administered by the Committee constituted under the Payless Profit Sharing Plan.

4.2 *Delegation of Duties.* In the administration of the Plan, the Committee may, from time to time, appoint agents and delegate to such agents and to the Administrative Subcommittee such duties as it considers appropriate and to the extent that such duties have been so delegated, the Administrative Subcommittee or agent, as the case may be, shall be exclusively responsible for the proper discharge of such duties. The Committee, the Administrative Subcommittee or any agent may from time to time consult with counsel who may be counsel to the Company.

4.3 *Authority.* Any decision or action of the Committee (or, with respect to any duty delegated to it, any decision or action of the Administrative Subcommittee or of a duly appointed agent) in respect of any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations thereunder shall be in its absolute discretion and shall be final, conclusive and binding upon all persons having any interest in the Plan.

## **Section 5. Claims Procedure.**

**5.1 Claim.** A Member, beneficiary or other person who believes that he or she is being denied a benefit to which he or she is entitled (hereinafter referred to as "Claimant"), or his or her duly authorized representative, may file a written request for such benefit with a committee consisting of the Vice President/Human Resources Solutions, the Director of Benefits and the Director of Compensation (the "Review Committee") setting forth his or her claim. The request must be addressed to: Vice President/Human Resources Solutions, c/o Collective Brands, Inc. 3231 East Sixth Street, Topeka, Kansas 66607.

**5.2 Claim Decision.** Upon receipt of a claim, the Review Committee shall advise the Claimant that a reply will be forthcoming within a reasonable period of time, but ordinarily not later than 90 days, and shall, in fact, deliver such reply within such period. However, the Review Committee may extend the reply period for an additional ninety days for reasonable cause. If the reply period will be extended, the Review Committee shall advise the Claimant in writing during the initial 90-day period indicating the special circumstances requiring an extension and the date by which the Review Committee expects to render the benefit determination. If the claim is denied in whole or in part, the Review Committee will render a written opinion, using language calculated to be understood by the Claimant, setting forth:

- (a) the specific reason or reasons for the denial;
- (b) the specific references to pertinent Plan provisions on which the denial is based;
- (c) a description of any additional material or information necessary for the Claimant to perfect the claim and an explanation as to why such material or such information is necessary;
- (d) appropriate information as to the steps to be taken if the Claimant wishes to submit the claim for review, including a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following an adverse benefit determination on review; and
- (e) the time limits for requesting a review of the denial under Section 5.3 hereof and for the actual review of the denial under Section 5.4 hereof.

**5.3 Request for Review.** Within 60 days after the receipt by the Claimant of the written opinion described above, the Claimant may request in writing that the Committee review the Review Committee's prior determination. Such request must be addressed to the Committee, c/o Collective Brands, Inc. 3231 East Sixth Street, Topeka, Kansas 66607. The Claimant or his or her duly authorized representative may submit written comments, documents, records or other information relating to the denied claim, which such information shall be considered in the review under this subsection without regard to whether such information was submitted or considered in the initial benefit determination. The Claimant or his or her duly



authorized representative shall be provided, upon request and free of charge, reasonable access to, and copies of, all non-privileged documents, records and other information which (i) was relied upon by the Review Committee in making its initial claims decision, (ii) was submitted, considered or generated in the course of the Review Committee making its initial claims decision, without regard to whether such information was actually relied upon by the Review Committee in making its decision or (iii) demonstrates compliance by the Review Committee with its administrative processes and safeguards designed to ensure and to verify that benefit claims determinations are made in accordance with governing Plan documents and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants. If the Claimant does not request a review of the Review Committee's determination within such 60-day period, he or she shall be barred and estopped from challenging such determination.

*5.4 Review of Decision.* Within a reasonable period of time, ordinarily not later than 60 days, after the Committee's receipt of a request for review, it will review the Review Committee's prior determination. If special circumstances require that the 60-day time period be extended, the Committee will so notify the Claimant within the initial 60-day period indicating the special circumstances requiring an extension and the date by which the Committee expects to render its decision on review, which shall be as soon as possible but not later than 120 days after receipt of the request for review. In the event that the Committee extends the determination period on review due to a Claimant's failure to submit information necessary to decide a claim, the period for making the benefit determination on review shall not take into account the period beginning on the date on which notification of extension is sent to the Claimant and ending on the date on which the Claimant responds to the request for additional information. The Committee has discretionary authority to determine a Claimant's eligibility for benefits and to interpret the terms of the Plan. Benefits under the Plan will be paid only if the Committee decides in its discretion that the Claimant is entitled to such benefits. The decision of the Committee shall be final and non-reviewable, unless found to be arbitrary and capricious by a court of competent review. Such decision will be binding upon the Employer and the Claimant. If the Committee makes an adverse benefit determination on review, the Committee will render a written opinion, using language calculated to be understood by the Claimant, setting forth:

- (a) the specific reason or reasons for the denial;
- (b) the specific references to pertinent Plan provisions on which the denial is based;
- (c) a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all non-privileged documents, records and other information which (i) was relied upon by the Committee in making its decision, (ii) was submitted, considered or generated in the course of the Committee making its decision, without regard to whether such information was actually relied upon by the Committee in making its decision or (iii) demonstrates compliance by the Committee with its

administrative processes and safeguards designed to ensure and to verify that benefit claims determinations are made in accordance with governing Plan documents, and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants; and

(d) a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following the adverse benefit determination on such review.

## **Section 6. Certain Rights and Obligations.**

**6.1 *Rights of Members and Beneficiaries.*** The rights of the Members, their designated beneficiaries and other persons are hereby expressly limited as set forth herein and shall be determined solely in accordance with the provisions of the Plan. The full payment of the applicable benefit under the Plan shall completely discharge all obligations of the Company and any Employer to a Member and his or her designated beneficiary.

**6.2 *Employer-Associate Relationship.*** The establishment of the Plan shall not be construed as conferring any legal or other rights upon any Associate or any other person for a continuation of employment or as interfering with or affecting in any manner the right of the Company or any Employer to discharge any Associate or otherwise act with relation to such Associate. The Company or an Employer may take action (including discharge) with respect to any Associate or other person and may treat him or her without regard to the effect which such action or treatment might have upon him or her under the Plan.

**6.3 *Unfunded Nature of Plan.*** The Plan shall be unfunded. Neither an Employer nor the Committee shall be required to segregate any assets in connection with benefits provided by the Plan. Neither the Company, an Employer nor the Committee shall be deemed to be a trustee of any amounts to be paid under the Plan. Any liability of the Company or an Employer to any person with respect to benefits payable under the Plan shall be based solely upon such contractual obligations, if any, as shall be created by the Plan and shall be only a claim against the general assets of the Company or the Employer, and no such liability shall be deemed to be secured by any pledge or any other encumbrance on any specific property of the Company or any Employer.

### **6.4 *Trust.***

(a) Each Employer may, but is not obligated to, transfer over to the Trust such assets as the Employer determines, in its sole discretion, are necessary to provide, on a present value basis, for its respective future liabilities created with respect to the Account Balances and Minimum Benefits for such Employer's Members as of the date of such transfer.

(b) The provisions of the Plan shall govern the rights of a Member to receive distributions pursuant to the Plan. The provisions of the Trust shall govern the rights of the

Employers, Members and the creditors of the Employers to the assets transferred to the Trust. Each Employer shall at all times remain liable to carry out its obligations under the Plan.

(c) Each Employer's obligations under the Plan may be satisfied with Trust assets distributed pursuant to the terms of the Trust, and any such distribution shall reduce the Employer's obligations under this Plan.

#### **Section 7. Non-Alienation of Benefits.**

*7.1 Provisions with Respect to Assignment and Levy.* No benefit payable under the 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, pledge, 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.

*7.2 Alternate Application.* If any Member or designated beneficiary under the Plan becomes bankrupt or attempts to anticipate, alienate, sell, transfer, assign, pledge, encumber or charge any benefit under the Plan, except as specifically provided herein, or any benefit shall be levied upon, garnished or attached, then such 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 designated beneficiary, spouse, children or other dependents, or any of them, or in such other manner and in such proportion as the Committee may deem proper.

#### **Section 8. Amendment and Termination.**

*8.1 Right to Amend.* The Company reserves the right at any time and from time to time in its sole discretion to modify or amend in whole or in part any or all of the provisions of the Plan, provided that no amendment shall reduce any Member's vested Account Balance or Minimum Benefit, as applicable, as of the date of such amendment. Notwithstanding anything provided to the contrary in this Section 8.1 or Section 8.2, following a Change in Control of the Company the Plan may not be amended or terminated in a manner that would adversely affect the rights of any Member to his or her Account Balance. Notwithstanding any provision of the Plan to the contrary, in the event that the Company determines that any provision of the Plan may cause amounts credited under the Plan to become immediately taxable to any Member under Code Section 409A, the Company may (i) adopt such amendments to the Plan and appropriate policies and procedures, including amendments and policies with retroactive effect, that the Company determines necessary or appropriate to preserve the intended tax treatment of the Plan benefits provided by the Plan, and/or (ii) take such other actions as the Company determines necessary or appropriate to comply with the requirements of Code Section 409A; *provided, however*, that the Company shall have no liability to any Member, designated beneficiary or other person with respect to any such amendment or actions, or the failure to adopt any such amendment or take any such actions.

**8.2 Rights to Terminate.** Except as provided in Section 8.1, the Company reserves the right at any time and from time to time in its sole discretion to terminate the Plan in accordance with Code Section 409A. In the event the Plan is terminated, the Employer shall be under no further obligation to provide benefits under the Plan, except to the extent of a Member's vested Account Balance or Minimum Benefit, as applicable, as of the date of such termination.

## **Section 9. Construction.**

**9.1 Governing Law.** The provisions of the Plan shall be construed, regulated, administered and enforced according to the laws of the State of Kansas and in a manner consistent with Code Section 409A and the regulations thereunder.

**9.2 Terms and Headings.** Wherever applicable, any words used herein in the masculine gender shall be construed as though they included the feminine gender, and any words used herein in the singular form shall be construed as though they included in the plural form. Section headings are inserted for convenience of reference and are not to be considered in the construction of the Plan.



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

As Amended and Restated Effective August 1, 2007, or as otherwise specified

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**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 as specified to provide for a guaranteed minimum Company Matching Contribution. 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 Plan was further amended effective January 1, 2007 to provide for Part-Time Associates to be eligible to participate in the Plan upon turning age 21 and completing a full year of employment and to remove the re-employment provision specified under Section 2.02.

Effective August 1, 2007, the terms and provisions of this restated 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 1.35 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 3.04 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(1) 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 3.04 to violate the permitted disparity limitations of Treas. Reg. Section 1.401(l)-2, Allocation Pay Amount shall be adjusted to permit Section 3.04 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" (as defined in Code Section 414(n), without regard to Section 414(n)(2)(B)).

**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 3.01.

**1.16 Effective Date** originally meant April 1, 1996. However, the effective date of this amendment and restatement of the Plan shall be August 1, 2007, 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.

**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 Highly Compensated Employee** means any Member who (a) was a "five percent owner" as defined in Section 21.06(f)(2) at any time during either the determination year or the look-back year; or (b) received compensation within the meaning of Code Section 415(c)(3) (including the deferrals described in Code Section 415(c)(3)(D)) from the Employer in excess of \$100,000 (as adjusted pursuant to Code Section 415(d)) during the look-back year. For purposes of this Section 1.22, compensation within the meaning of Code Section 415(c)(3) shall mean the remuneration as defined in Treasury Regulation Section 1.415(c)-2(d)(2) and shall include the deferrals described in Code Section 415(c)(3)(D).

For purposes of this Section, the determination year shall be the Plan Year, and the look-back year shall be the 12-month period immediately preceding the determination year. The determination of who is a Highly Compensated Employee, including the determination of the compensation that is considered, will be made in accordance with Code Section 414(q) and the regulations thereunder.

**1.23 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.

**1.24 Investment Fund** means any fund for investment of contributions as described in Section 5.01.

**1.25 May Plan** means The May Department Stores Company Profit Sharing Plan.

**1.26 Member** means any person included in the membership of this Plan as provided in Section 2.

**1.27 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.

**1.28 Member After-Tax Accounts** means the Member Accounts with respect to a Member's After-Tax Contributions.

**1.29 Member Before-Tax Accounts** means the Member Accounts with respect to a Member's Before-Tax Contributions.

**1.30 Member Contributions** means the Member's Before-Tax Contributions and After-Tax Contributions.

**1.31 Member Rollover Contribution Accounts** means the Member Accounts with respect to an Associate's or Member's Rollover Contributions.

**1.32 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).

**1.33 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.

**1.34 Non-Highly Compensated Employee** means any Employee who is not a Highly Compensated Employee but who is eligible to participate in the Plan.

**1.35 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 \$225,000 shall be disregarded, although such amount shall be adjusted for cost-of-living increases in accordance with Code Section 401(a)(17)(B).

**1.36 Pooled Investment Account** means an account established pursuant to an administrative services agreement between the Company and the Trustee.

**1.37 Plan** means this Payless ShoeSource, Inc. 401(k) Profit Sharing Plan.

**1.38 Plan Year** means a calendar year ending each December 31.

**1.39 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.

**1.40 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.

**1.41 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.

**1.42 Rollover Contributions** means contributions which the Associate or Member, as applicable, elects to make in accordance with Section 11.02.

**1.43 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.

**1.44 Total and Permanent Disability or Disability** means the qualification for disability under Title 11 of the Federal Social Security Act.

**1.45 Transferred Accounts** means Member and Company Accounts transferred from the May Plan.

**1.46 Trust Agreement** means the agreement or agreements provided for in Section 15 as amended from time to time.



**1.47 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.

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

**1.49 Unit** means one of the units representing an interest in an Investment Fund as provided in Section 6.03.

**1.50 Unit Value** means the value of each Unit in an Investment Fund as of the Valuation Date as determined pursuant to Section 6.04.

**1.51 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.

**1.52 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.
- (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.

**1.53 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 1.52 shall be determined by the Company or by the Committee on a case-by-case basis.

## SECTION 2

### Membership

#### 2.01 Conditions of Eligibility.

(a) Each Associate who on July 31, 2007 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) On and after August 1, 2007, each other Associate shall be eligible to become a Member of the Plan when the Associate attains age 21 and meets such other eligibility criteria for Part-Time and Full-Time Associates as set forth below. Once determined eligible, membership commences as of the first day of the month coincident with or following the date the Associate has met the applicable 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.

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. Effective January 1, 2007, a Part-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 one full year of employment. Prior to the effective date of January 1, 2007, Part-Time Associates must have completed one full Year of Service to be eligible to make Member Contributions.

(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 4.01(b) to make an After-Tax or a Before-Tax Contribution of an amount other than three percent (3%).

(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.

(e) Notwithstanding any other provisions of the Plan, any individual who is providing services to the Employer in the capacity of, or who is designated by the Employer as an independent contractor, and who is subsequently reclassified as an Associate by court or similar action (whether retroactively or prospectively), shall not be eligible to participate in the Plan, and shall be treated as a member of an excluded class. No such excluded individual shall have any claim for benefits under the Plan for any period during which he is excluded from participation.

**2.02 Re-Employment ..** A former or inactive Member who is reemployed by the Employer more than 31 days after his prior termination of employment must satisfy the eligibility requirements in Section 2.01 in order to become a Member of the Plan again.

## 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 2½% of its Net Profits, until determined otherwise by the Board of Directors, in the form of a Company Matching Contribution. Effective beginning with the 2006 Plan Year, the Board has determined that a minimum guaranteed Company Matching Contribution of \$.25 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 4.01(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.

## 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,

(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.

(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 \$15,500 (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 \$15,500 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 such reduction is necessary to prevent the Plan from failing both tests in Code Section 401(k)(3). Such adjustments shall be made in accordance with rules prescribed by the Committee. The Committee may implement rules limiting contributions under Section 4.01(b) which may be made on behalf of some or all Highly Compensated Employees so that the limits of Section 401(k)(3) or 401(m)(2) of the Code are satisfied. 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 percentage 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 equal to the sum of all such reductions. 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.

**(a) Coordination With Distributions Of Elective Deferrals.** If the Plan is required to distribute both elective deferrals and excess contributions for a Plan Year, the Plan shall:

- (i) calculate and distribute the elective deferrals before determining the excess contributions to be distributed to Highly Compensated Employees;
- (ii) calculate the actual deferral percentage including the amount of excess elective deferrals distributed pursuant to (i) above; and
- (iii) 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.

**(b) Election To Make Additional Contributions.** Notwithstanding the above, in accordance with Treasury Regulation Section 1.401(k)-2(a)(6), the Company may elect, in lieu of all or a portion of the corrective distribution described above in this Section, to make additional qualified nonelective contributions or qualified matching contributions which are treated as elective deferrals under the Plan and that, in combination with the elective deferrals, satisfy the actual deferral percentage test. Any such additional qualified nonelective contributions will be credited to a Member Before-Tax Account and shall be allocated to each Member who is not a Highly Compensated Employee in an amount as determined by the Company and will be contributed as a percentage of such Member's Pay for the Plan Year. Any such additional qualified matching contributions will be credited to a Member Before-Tax Account and shall be allocated to each Member who is not a Highly Compensated Employee and will be contributed as a percentage of the amount contributed by such Member under Section 4.01(b).

**(c) Testing Year.** The actual deferral percentage of Non-Highly Compensated Employees shall be determined 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).

#### **4.03 Distributions of Excess Deferrals.**

If a Member's elective deferrals for any calendar year exceed \$15,500 (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 Employer Matching Contributions under Section 3.02 and Member After-Tax Contributions 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 both tests in Code Section 401(m)(2). Such reduction shall be made in accordance with rules prescribed by the Committee. Notwithstanding anything herein to the contrary, the tests in Code Section 401(m)(2) shall be treated as satisfied with respect to such Matching Contributions and After-Tax Contributions to the Plan, or a portion of the Plan, if the Plan or such portion is a collectively bargained plan that automatically satisfies Code Section 410(b), in accordance with Treasury Regulation Sections 1.401(m)-1(b)(2) and 1.410(b)-2(b)(7). 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 equal to the sum of all such reductions. 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.

(a) **Election To Make Additional Contributions.** Notwithstanding the above, in accordance with Treasury Regulation Section 1.401(m)-2(a)(6), the Company may elect, in lieu of all or a portion of the distribution described above, to either (i) make an additional qualified nonelective contribution that, in combination with Matching Contributions and After-Tax Contributions for the Plan Year, satisfies the actual contribution percentage test or (ii) recharacterize elective contributions as Matching Contributions. Any such additional qualified nonelective contributions will be credited to a Member Before-Tax Account and shall be allocated to each Member who is not a Highly Compensated Employee in an amount as determined by the Company and will be contributed as a percentage of such Member's Pay for the Plan Year.

(b) The actual contribution percentage of Non-Highly Compensated Employees shall be determined 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).

#### **4.05 Definitions and Special Rules.**

(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.

(c) **Special Rule For Early Participation.** If the Company applies Code Section 410(b)(4)(B) in determining whether the Plan satisfies Code Section 410(b) by excluding from consideration eligible Associates who have not met minimum age and service requirements, the Company may exclude from consideration all Non-Highly Compensated Employees who have not met the minimum age and service requirements of Code Section 410(a)(1)(A) for purposes of satisfying the tests in Code Sections 401(k)(3) and 401(m)(2).

(d) **Highly Compensated Employee In Two Or More Qualified Plans.** 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 (i) cash or deferred arrangements or (ii) Matching Contributions or After-Tax Contributions features 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 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.

(e) **Plan Restructuring.** The Plan may be aggregated with another plan or other plans or disaggregated under Section 1.401(k)-1(b)(4) and Section 1.401(m)-1(b)(4) of the Treasury Regulations for any Plan Year in order to pass the actual contribution percentage and actual deferral percentage tests set forth in this Section.

**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.

## 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 Contributions 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 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 (d) 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 (e) 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 1.52(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) and (d), 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.

## 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) Expenses for (or necessary to obtain) medical care that would be deductible under Code Sections 213(a) and (d) (determined without regard to whether the expenses exceed any applicable threshold amount of adjusted gross income);
- (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);
- (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 59½, 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 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.

Any person who is a Leased Employee (as defined in Code Section 414(n), without regard to Section 414(n)(2)(B)) of any member of the Group shall be treated for all purposes of the Plan as if he were employed by a member of the Group which has not adopted the Plan. Notwithstanding anything to the contrary in the Plan, a transfer from the status of an employee of the Employer to that of a Leased Employee shall not be considered a termination of employment under the Plan. An individual who has such a transfer shall not have a termination of employment until he ceases to be an employee of the Employer and all members of its Group and is no longer a Leased Employee.

**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 Member has no designated beneficiary, 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 Members who are Highly Compensated Employees. 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 70½, 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.

(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 70½ 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 21.06(f)(2), Required Beginning Date means the first day of April following the calendar year in which the Member attains age 70½.

**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 17.01 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.

## 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 (i) an individual retirement account or annuity described in Sections 408(a) or (b) of the Code, or (ii) effective January 1, 2007, a qualified plan described in Section 401(a) of the Code or an annuity contract described in Code Section 403(b) 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 60<sup>th</sup> 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.

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. 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. Moreover, for purposes of Section 11.01, a designated non-spouse Beneficiary may be a Distributee only with respect to an Eligible Retirement Plan that is an individual retirement account described in Code Section 408(a) or an individual retirement annuity described in Code Section 408(b).

(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 to Members who are employed with the Employer on the date the loan is made (and subject to the terms of this Section 12, to an interested party as defined in Section 3(14) of ERISA, even if such interested party is no longer an Associate) pursuant to a uniform and non-discriminatory 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 Member. For the purpose of the above limitation, all loans from all plans of the Employer and other members of the Group 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 Member, 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 Member'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 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) All loans shall be made pursuant to a written Member loan program incorporated herein by reference.

(g) 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

(h) 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.

## 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 Member during the Limitation Year under the Plan and allocated to the Member 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) \$45,000; or
- (2) 100% of the Member'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(c)-2(d)(2) and shall include the deferrals described in Code Section 415(c)(3)(D).

(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(c), 403(a)(4), 403(b)(8), 408(d)(3) and 457(e)(16), 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 Section 408(k)(6) of the Code) and reallocated 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 limited facts and circumstances, the Annual Additions under this Plan would cause the 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.

## 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 1.44 (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), 19.02 (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), Section 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 Sections 15.03(b), 15.03(c) and 15.03(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, 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.

**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.

## 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 or other person who believes that he is being denied a benefit to which he is entitled (hereinafter referred to as "Claimant") may file a written request for such benefit with the Committee, setting forth his or her claim. The request must be addressed to: The Committee, Payless ShoeSource, Inc. 401(k) Profit Sharing Plan, 3231 SE Sixth Avenue, Topeka, KS 66607. Notwithstanding anything in the Plan to the contrary, a claim must be filed within one year from the date such claim first accrues or the Claimant will be forever barred from pursuing such claim. A claim by a Claimant shall be deemed to have accrued on the earlier of (i) the date the Claimant's benefits commence or (ii) the date the Claimant became aware, or should have become aware, that his or her position regarding his or her entitlement to benefits is different from the Plan's or the Company's position regarding the Claimant's entitlement to benefits.

(a) **Claim Decision.** Upon receipt of a claim, the Committee shall advise the Claimant that a reply will be forthcoming within 90 days and shall in fact deliver such

reply in writing within such period. The Committee may, however, extend the reply period for an additional 90 days for reasonable cause. If the reply period will be extended, the Committee shall advise the Claimant in writing during the initial 90-day period indicating the special circumstances requiring an extension and the date by which the benefit determination is expected. If the claim is denied in whole or in part, the Committee will render a written opinion using language calculated to be understood by the Claimant setting forth:

- (i) the specific reason or reasons for the denial;
- (ii) specific references to pertinent Plan provisions on which the denial is based;
- (iii) a description of any additional material or information necessary for the Claimant to perfect the claim and an explanation why such material or such information is necessary;
- (iv) appropriate information as to the steps to be taken if the Claimant wishes to submit the claim for review, including a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following an adverse benefit determination on review; and
- (v) the time limits for requesting a review of the denial and for the actual review of the denial.

(b) **Request For Review.** Within 60 days after the receipt by the Claimant of the written opinion described above, the Claimant may request in writing that the committee, which shall be comprised of up to three individuals (which may include members of the Committee) appointed by the Company or by the Committee, review the determination of the Committee. Such request must be addressed to: The Committee, Payless ShoeSource, Inc. 401(k) Profit Sharing Plan, 3231 SE Sixth Avenue, Topeka, KS 66607. The Claimant or his or her duly authorized representative may submit written comments, documents, records or other information relating to the denied claim, which shall be considered in the review under this subsection without regard to whether such information was submitted or considered in the initial benefit determination.

The Claimant or his or her duly authorized representative shall be provided, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information which (i) was relied upon by the Committee in making its initial claims decision, (ii) was submitted, considered or generated in the course of making the initial claims decision, without regard to whether such instrument was actually relied upon in making the decision or (iii) demonstrates compliance by the Committee with its administrative processes and safeguards designed to ensure and to verify that benefit claims determinations are made in accordance with governing Plan documents and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants. If the Claimant does not request a review of the

Committee's determination by the committee within such 60-day period, he shall be barred and estopped from challenging the Committee's determination.

**(c) Review Of Decision.** Within a reasonable period of time, ordinarily not later than 60 days, after the committee's receipt of a request for review, it will review the prior determination. If special circumstances require that the sixty (60) day time period be extended, the committee will so notify the Claimant within the initial sixty (60)-day period indicating the special circumstances requiring an extension and the date by which the committee expects to render its decision on review, which shall be as soon as possible but not later than one hundred twenty (120) days after receipt of the request for review. In the event that the committee extends the determination period on review due to a Claimant's failure to submit information necessary to decide a claim, the period for making the benefit determination on review shall not take into account the period beginning on the date on which notification of extension is sent to the Claimant and ending on the date on which the Claimant responds to the request for additional information.

The committee has discretionary authority to determine a Claimant's eligibility for benefits and to interpret the terms of the Plan. Benefits under the Plan will be paid only if the committee decides in its discretion that the Claimant is entitled to such benefits. The decision of the committee shall be final and non-reviewable, unless found to be arbitrary and capricious by a court of competent review. Such decision will be binding upon the Company and the Claimant.

If the committee makes an adverse benefit determination on review, the committee will render a written opinion, using language calculated to be understood by the Claimant, setting forth:

- (i) the specific reason or reasons for the denial;
- (ii) the specific references to pertinent Plan provisions on which the denial is based;
- (iii) a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information which (A) was relied upon by the committee in making its decision, (B) was submitted, considered or generated in the course of the committee making its decision, without regard to whether such instrument was actually relied upon by the committee in making its decision or (C) demonstrates compliance by the committee with its administrative processes and safeguards designed to ensure and to verify that benefit claims determinations are made in accordance with governing Plan documents, and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants; and
- (iv) a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following the adverse benefit determination on such review.

**16.06 Venue for Litigation.** In light of the Plan Administrator's substantial contacts with the State of Kansas, the fact that the Plan Administrator resides in Kansas and the Company is headquartered in Topeka, Kansas, and the Company's establishment of, and the Plan Administrator's maintenance of, this Plan in Kansas, any cause of action brought by a Claimant, Associate, Member, former Associate, former Member or any beneficiary of such an individual involving benefits under the Plan shall be filed and conducted exclusively in the federal courts in the District of Kansas.

No action at law or in equity shall be brought to recover under the Plan prior to the expiration of 60 days after receipt by the Claimant of the written decision regarding the Claimant's request for review under the claims procedure, nor shall such action be brought at all unless within three years from receipt by the Claimant of such written decision by the final claims reviewer under the claims procedure.

**16.07 Acquisition Of Assets.** If the Employer acquires the assets (through purchase, merger or otherwise) of any other entity and hires persons who had been employed by such entity, the division or other subgroup in which such persons are employed shall be excluded from the groups included in the definition of "Associate" unless the Company communicates to such division or subgroup that such division or subgroup is accruing benefits under the Plan.

## 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 Member 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.

## 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.

## 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).

## 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.



## SECTION 21

### Top-Heavy Requirements

**21.01 Generally.** For any Plan Year in which the Plan is a Top-Heavy Plan, the provisions of Section 21.02 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 Top-Heavy Compensation: (i) three percent (3%) 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 Top-Heavy Compensation not in excess of \$225,000, 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).

(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 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 21.03.

(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.

**21.04 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.

**21.05 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 21.05.
- (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 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.

#### **21.06 Other Definitions.**

(a) Solely for purposes of this Section 21, the definitions in paragraphs (b) through (g) of this Section 21.06 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 Section 21.02 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 the Group,

(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 than \$145,000 (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).

(g) Top-Heavy Compensation means the remuneration as defined in Treasury Regulation Section 1.415(c)-2(d)(2) and shall include the deferrals described in Code Section 415(c)(3)(D). Such compensation shall be considered only if earned while a Member.

**IN WITNESS WHEREOF**, the Company has caused this amended Plan to be executed by a duly authorized officer effective this 1st day of August, 2007.

**PAYLESS SHOESOURCE, INC.**

By: \_\_\_\_\_



**THE STOCK APPRECIATION AND PHANTOM STOCK UNIT PLAN OF  
COLLECTIVE BRANDS, INC. AND ITS SUBSIDIARIES  
FOR  
COLLECTIVE BRANDS INTERNATIONAL EMPLOYEES**

**AS**

**AMENDED AUGUST 17, 2007**

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**THE STOCK APPRECIATION AND PHANTOM STOCK UNIT PLAN  
OF  
COLLECTIVE BRANDS, INC. AND ITS SUBSIDIARIES  
FOR  
COLLECTIVE BRANDS INTERNATIONAL EMPLOYEES**

Amended August 17, 2007

**PART I. GENERAL**

1. **Purpose.** The purpose of the Plan is to aid Collective Brands, Inc. and its subsidiaries in attracting, retaining, motivating and rewarding certain management employees.

2. **Definitions.** Whenever used herein, the following terms shall have the meanings set forth below:

- a. “Agreement” means the agreement between the Company or any International Subsidiary and a Participant evidencing the award of Stock Appreciation Units or Phantom Stock Units and containing the terms and conditions, not inconsistent with the Plan, that are applicable to such Units.
- b. “Award” means an award of Units under the Plan.
- c. “Exercise Price” means, with respect to a Stock Appreciation Unit, the Fair Market Value of a share of Stock on the date the Stock Appreciation Unit is granted.
- d. “Board” means the Board of Directors of Collective Brands, Inc., a Delaware corporation.
- e. “Committee” means a committee designated by the Board which shall consist of not less than 2 members of the Board who shall be appointed by and serve at the pleasure of the Board and who shall be “outside” directors within the meaning of Section 162(m) of the Code.
- f. “Company” means Collective Brands, Inc., a Delaware corporation.
- g. “Disability” means a total and permanent disability which enables the Participant to be eligible for and to receive disability benefits under (i) the Social Security Act of the United States of America or (ii) under any comparable governmental arrangements in the country in which the Participant resides.

h. **“Fair Market Value”** means:

- For Awards granted on or after May 25, 2007, the closing price of the Stock on the New York Stock Exchange Composite Transaction Tape on the date in question, (or if the Stock is not then traded on the New York Stock Exchange, the closing price of the Stock on the stock exchange or over-the-counter market on which the Stock is principally trading on such date)
- (i) or, if no sale of the Stock occurred on such exchange on that day, the closing price of the Stock on the last preceding day when the Stock was sold on such exchange. In the event that no sale of the Stock occurred on such exchange or over the counter market on that day because the exchange was closed, then Fair Market Value shall be the closing price of the Stock on the next day the exchange is open for trading; or

- For Awards granted prior to May 25, 2007, the average of the high and low prices of the Stock on the New York Stock Exchange Composite Transaction Tape on the date in question, (or if the Stock is not then traded on the New York Stock Exchange, the average of the high and low prices of the Stock on the stock exchange or over-the-counter market on which the Stock is principally trading on such date) or, if no sale of the Stock occurred on such exchange on that day, the average of the
- (ii) high and low prices of the Stock on the last preceding day when the Stock was sold on such exchange. In the event that no sale of the Stock occurred on such exchange or over the counter market on that day because the exchange was closed, then Fair Market Value shall be the average of the high and low prices of the Stock on the next day the exchange is open for trading; or if the Stock is no longer traded on the New York Stock Exchange and if there is no public market for the Stock, “Fair Market Value” shall be determined in good faith by the Committee using other reasonable means.

i. “International Subsidiary” means any Subsidiary primarily engaged in business outside of the United States of America.

j. “Participant” means an individual to whom an Award for Stock Appreciation Units or a Phantom Stock Units is made under the Plan.

k. “Phantom Stock Unit” means a non-transferrable, non-assignable right described in Part II of the Plan awarded by the Company or any Subsidiary and approved by the Committee under or pursuant to the Plan which provides for the payment of an amount in cash in accordance with such terms and conditions, not inconsistent with the Plan, that are applicable to such Unit.



l. "Plan" means The Stock Appreciation and Phantom Stock Unit Plan of Collective Brands, Inc. and Its Subsidiaries For Collective Brands International Employees.

m. "Retirement" means "retirement" as that word is defined in any retirement plan sponsored by an International Subsidiary which is applicable to the Participant or, if there is no such plan, as defined in the Company's Profit Sharing Plan.

n. "Subsidiary" means any company owned, directly or indirectly by the Company or any subsidiary thereof.

o. "Stock" means common stock of the Company.

p. "Stock Appreciation Unit" means a non-transferrable, non-assignable right described in Part II of the Plan awarded by the Company or any Subsidiary and approved by the Committee under or pursuant to the Plan which provides for the payment of an amount in cash in accordance with such terms and conditions, not inconsistent with the Plan, that are applicable to such Unit and whose Exercise Price is the Fair Market Value of a share of Stock on the date of the Award.

q. "Unit" means a Stock Appreciation Unit or a Phantom Stock Unit. Each Phantom Stock Unit shall represent the right to receive 100% of the value of a share of Stock on the day the Unit vests. Each Stock Appreciation Unit shall represent the right to receive the difference, if positive, between the Fair Market Value of a share of stock on the date the Unit is exercised and the Exercise Price of the Unit. Units are not shares of stock and do not entitle Participants to receive Stock or exercise any rights incident to ownership of Stock, except that the Committee may provide in an agreement that holders of Phantom Stock Units will receive dividend equivalents if any cash dividends are paid on its Stock by the Company.

**3. Administration.** The Plan shall be administered by the Committee. Subject to all the applicable provisions of the Plan, including, without limitation, Section 4 of Part I of the Plan, the Committee is authorized to approve Awards of Units in accordance with the Plan, to construe and interpret the Plan, to prescribe, amend, and rescind rules and regulations relating to the Plan, and to make all determinations and take all actions necessary or advisable for the Plan's administration. The Committee shall act by vote or written consent of a majority of its members. Whenever the Plan authorizes or requires the Committee to take any action, make any determination or decision, or form any opinion, then any such action, determination, decision or opinion by or of the Committee shall be in the absolute discretion of the Committee.

**4. Participants.** The individuals who are eligible to receive Awards for Units hereunder shall be limited to management employees of any Subsidiary who, on the date of the award of Units under the Plan, are not citizens of the United States of America and who are employed and reside out of the boundaries of the United States of America.

From time to time the Committee shall in its sole discretion, but subject to all of the provisions of the Plan, determine which eligible employees will receive Awards of Units

under the Plan and the size, terms and conditions of the Unit or Units to be awarded to each Participant. In any year, the Committee may approve the award to any eligible employee of Units subject to differing terms and conditions. Neither the Committee's decision to approve the award of a Unit to that employee in any other year or to any other employee in any other year, nor the Committee's decision with respect to the size, terms and conditions of the Award(s) to be made to an employee in any year, require the Committee to approve the award of the Unit(s) of the same size or with the same terms and conditions to such employee in any other year or to any other employee in any year. The Committee shall not be precluded from approving the award of a Unit to any eligible employee solely because such employee may previously have received an Award under the Plan.

5. **Employment.** In the absence of any specific agreement to the contrary, no Award of Units to a Participant under the Plan shall affect any right of the Participant's employer to terminate the Participant's employment at any time.

## **PART II. UNITS**

1. **Units.** The Committee may from time to time in its discretion approve the award of Units to employees who are eligible to receive an Award in accordance with Section 4 of Part I of the Plan. An Award shall be evidenced by an Agreement which shall contain such terms and conditions (which may include vesting provisions and other restrictions not inconsistent with the Plan as the Committee shall determine); provided, however, that an Award shall satisfy the requirements set forth in Part II of the Plan.

2. **Grant.** An Award may be granted by the Committee and shall be effective upon the date approved by the Committee.

3. **Exercise and Vesting.** Stock Appreciation Unit Awards may be exercised by the Participant only at such time or times, and only upon such terms and conditions, as shall be set forth in the Agreement relating to such Stock Appreciation Unit Award. A Phantom Stock Unit Award will vest on the date or dates as are set forth in the Agreement respecting such Phantom Stock Unit Award.

4. **Amount of Payment.** Upon the exercise of a Stock Appreciation Unit Award, a Participant shall be entitled to receive the excess of the Fair Market Value of a share of Stock over the Exercise Price of a Unit with respect to each Unit exercised. Upon vesting of a Phantom Stock Unit, a participant shall be entitled to receive an amount for such Unit equal to the Fair Market Value of a share of Stock on the date the Unit vests.

5. **Form of Payment.** Any amount which becomes payable upon exercise or vesting of an Award under the Plan shall be paid entirely in cash. The Committee may determine that amounts shall be payable in United States dollars or in local currency, converted on such basis and at such conversion rate as the Committee shall deem reasonable.

## 6. Termination.

(a) **General.** A Stock Appreciation Unit Award shall terminate as of the earlier of (i) the date of exercise of Award, to the extent that it is exercised, or (ii) the expiration date specified in the Agreement with respect to such Award. If an unexercised Stock Appreciation Unit Award is otherwise exercisable on the date that it expires, and if the Fair Market Value of Stock with respect to which it was granted, determined as of the date of such expiration, exceeds the Exercise Price of the Units (under such Award as set forth in the Stock Appreciation Unit Agreement), then the Award shall automatically be deemed to have been exercised as of the date of such expiration.

(b) **Termination of Employment.** If a Participant ceases to be an employee of the Company or of a Subsidiary, for any reason other than such Participant's Disability, Retirement or Death, then any Award not theretofore exercised or vested, as applicable, shall immediately be terminated and may not thereafter be exercised, and no payment shall be made hereunder pursuant to such Award. Each Agreement shall provide that the Committee may terminate any Award prior to the date on which the Unit is exercised or vested, as applicable, if the Participant engages during the life of the Award in employment or activities contrary, in the opinion of the Committee, to the best interests of the Company or of any Subsidiary.

(c) **Disability.** If a Participant ceases to be an employee of the Company or of a Subsidiary by reason of such Participant's Disability, then the Participant's rights under the Award after the date of such Disability shall be determined by the provisions of the Agreement applicable to such Award.

(d) **Death.** If a Participant ceases to be an employee of the Company or of a Subsidiary by reason of the Participant's death, the participant's rights under the Award shall be determined by the provisions of the Agreement applicable to such Award.

(e) **Retirement.** If a Participant ceases to be an employee of the Company or of a Subsidiary by reason of the Participant's Retirement, any unvested Phantom Stock Units shall expire. The right to exercise all or any portion of any Award of Stock Appreciation Units shall be determined by the provisions of the Agreement applicable to such Award.

7. **Non-Assignability.** An Award shall not be transferable (other than by will or the laws of descent and distribution) and, during the Participant's lifetime, shall be exercisable by, and payable to, only the Participant.

8. **Restrictions.** Awards shall be subject to the condition that if at any time the Company shall determine in its discretion that the registration of the Plan with any regulatory authority, the satisfaction of withholding tax or other withholding liabilities under the law of any applicable jurisdiction or the consent or approval of any regulatory body is necessary or desirable as a condition of, or in connection with, the exercise or vesting of such Award, then, in any such event, such exercise or vesting shall not be effective unless such registrations withholding, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Company.

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**9. Repricing Prohibited.** There shall be no grant of a Stock Appreciation Unit in exchange for a Participant's agreement to cancellation of a Stock Appreciation Unit with a higher Exercise Price that was previously granted to such Participant.

### **PART III. CANCELLATION AND RESCISSION**

#### **1. Competition; Confidential Information.**

- a. Unless a Stock Appreciation Right Agreement (any such agreement being referred to herein as an "Agreement") specifies otherwise, the Committee may
  - (i) cancel at any time any unexercised Stock Appreciation Unit; or
  - (ii) rescind any exercise of a Stock Appreciation Unit

if the Participant is not in compliance with all other applicable provisions of the Agreement or the Plan or if, prior to any such exercise or within six months after such exercise, the Participant

- (A) engages in a Competing Business, as such term is defined in the Agreement; or
  - (B) solicits for employment, hires or offers employment to, or discloses information to or otherwise aids or assists any other person or entity other than the Company in soliciting for employment, hiring or offering employment to, any employee of the Company; or
  - (C) takes any action which is intended to harm the Company or its reputation, which the Company reasonably concludes could harm the Company or its reputation or which the Company reasonably concludes could lead to unwanted or unfavorable publicity to the Company; or
  - (D) discloses to anyone outside the Company, or uses in other than the Company's business, any "confidential information," as such term is defined in the Agreement.
- b. Upon exercise of Stock Appreciation Unit, the Participant shall certify on a form acceptable to the Committee that the Participant is in compliance with the terms and conditions of the Agreement and the Plan.
  - c. The Company shall immediately notify the Participant in writing of any cancellation of any unexercised Stock Appreciation Unit.
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Following receipt of such notice, the Participant shall have no further rights with respect to such Stock Appreciation Unit.

- d. The Company shall notify the Participant in writing of any rescission of an exercise of a Stock Appreciation Unit within one year after the activity referred to in Part III, Section 1(a). Within ten days after receiving such a notice from the Company, the Participant shall pay to the Company the excess of the Fair Market Value of the Stock on the date of exercise of a Stock Appreciation Unit over the Exercise Price for the Unit.

**2. Agreement by Participant Regarding Deduction.** The Participant shall agree and consent to a deduction from any amounts the Company or a Subsidiary owes to the Participant from time to time (including amounts owed as wages or other compensation, fringe benefits, or vacation pay, as well as any other amounts owed to the Participant by the Company or a subsidiary), to the extent of the amounts the Participant owes the Company under this Article III. Whether or not the Company elects to make any set-off in whole or in part, if the Company does not recover by means of set-off the full amount owed by the Participant, calculated as set forth in this Article III, then the Participant agrees to pay immediately the unpaid balance to the Company.

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#### PART IV. MISCELLANEOUS

1. **Effective Date.** The Plan shall become effective on May 14, 1997.
  2. **Duration of Plan.** The Plan shall remain in effect until it is terminated by the Company.
  3. **Withholding.** The Company or any Subsidiary shall have the right to deduct from the amount of any payment arising from the exercise or vesting of an Award any taxes required by applicable law to be withheld from such amount.

**Unfunded Plan.** The Plan shall be unfunded. Neither the Company nor any Subsidiary nor the Committee shall be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company nor the Committee shall
  4. be deemed to be a trustee of any amounts to be paid under the Plan. Any liability of the Company to any Participant with respect to an Award shall be based solely upon any contractual obligations created by the Plan or an Agreement, and no such obligation shall be deemed to be secured by any pledge or any encumbrance on any property of the Company or of any Subsidiary.

**Changes in Capital Structure.** In the event that there is any change in the capital structure of the Company, through merger, consolidation, reorganization, recapitalization, spinoff or otherwise, or if there shall be any dividend on the Stock, payable in such Stock, or if there shall be a stock split or combination of shares, the number and/or the Exercise Price of the Units shall be
  5. proportionately adjusted by the Board as it deems equitable, in its absolute discretion, to prevent dilution or enlargement of the Participant's Award. The issuance of Stock for consideration and the issuance of Stock rights shall not be considered a change in the Company's capital structure. No adjustment provided for in this section will result in fractional Units.

**Amendment or Termination.** The Board may, by resolution, amend or terminate the Plan at any time; provided, however, that the
  6. Board may not, without the consent of the holder of the Unit, alter or impair any Award previously granted under the Plan except as authorized herein.
- Notwithstanding the foregoing, the Board may, by resolution, amend the Plan in any way that it deems necessary or appropriate in order to make income with respect to the Plan deductible for United States Federal income tax purposes under Section 162(m) of the Code without regard to the foregoing proviso and any such amendment shall be effective as of such date as is necessary to make such income under the Plan so deductible.
7. **Change of Control.** If while unexercised awards remain outstanding under the Plan:
    - (a) Any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person")
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acquires beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (i) the then-outstanding shares of common stock of the Company (the “Outstanding Company Common Stock”) or (ii) the combined voting power of the then-outstanding voting securities of the Company entitled to vote generally in the election of directors (the “Outstanding Company Voting Securities”); *provided, however*, that, for purposes of this Section 7, none of the following shall constitute a Change of Control: (A) any acquisition directly from the Company of 30% or less of Outstanding Company Common Stock or Outstanding Company Voting Securities provided that at least a majority of the members of the board of directors of the Company following such acquisition were members of the Incumbent Board at the time of the Board’s approval of such acquisition, (B) any acquisition by the Company, (C) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any affiliated company, or (D) any acquisition by the Company which, by reducing the number of shares of Outstanding Company Common Stock or Outstanding Company Voting Securities, increases the proportionate number of shares of Outstanding Company Common Stock or Outstanding Company Voting Securities beneficially owned by any Person to 20% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; *provided, however*, that, if such Person shall thereafter become the beneficial owner of any additional shares of Outstanding Company Common Stock or Outstanding Company Voting Securities and beneficially owns 20% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, then such additional acquisition shall constitute a Change of Control; or

(b) Individuals who, as of the date hereof, constitute the Board (the “Incumbent Board”) cease for any reason to constitute at least a majority of the Board; *provided, however*, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company’s stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board;

(c) A reorganization, merger, consolidation or sale or other disposition of all or substantially all of the assets of the Company (a “Business Combination”) is consummated, in each case, unless, immediately following such Business Combination, (i), more than 50%, respectively, of the then-outstanding shares of common stock and the combined voting power of the then-outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of (x) the corporation resulting from such Business Combination or (y) a corporation that, as a result of such transaction, owns the Company or all or substantially all of the Company’s assets either directly or through one or more subsidiaries, is represented by the Outstanding Company Common Stock and the

Outstanding Company Voting Securities (or, if applicable, is represented by shares into which Outstanding Company Common Stock or Outstanding Company Voting Securities were converted pursuant to such Business Combination) in substantially the same proportions as their ownership immediately prior to such Business Combination of the Outstanding Company Common Stock and the Outstanding Company Voting Securities, as the case may be, (ii) no Person (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then-outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then-outstanding voting securities of such corporation, except to the extent that such ownership existed prior to the Business Combination, and (iii) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement or of the action of the Board providing for such Business Combination; or

(d) The stockholders of the Company approve of a complete liquidation or dissolution of the Company.

then from and after the date of the first of the foregoing events to occur, all outstanding Stock Appreciation Unit Awards held by active employees on such date shall be exercised in full, whether or not otherwise exercisable, and all outstanding Phantom Stock Unit Awards held by active employees on such date shall vest in full, and shall be deemed fully payable.





COLLECTIVE BRANDS, INC.  
EMPLOYEE STOCK PURCHASE PLAN  
(as amended August 17, 2007)

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 Collective Brands, 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 6,000,000 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:** Collective Brands, 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.

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**INVESTMENT DATE:** The date on which the shares of Common Stock are purchased for the Plan.

**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 "Collective Brands, Inc. Employee Stock Purchase Plan" (formerly 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-one 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.



**Collective Brands, Inc.**  
Deferred Compensation Plan  
**As Amended and Restated January 1, 2008**

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COLLECTIVE BRANDS, INC.  
DEFERRED COMPENSATION PLAN

As Amended and Restated

January 1, 2008

**Purpose**

The purpose of this Plan is to provide specified benefits to a select group of management and highly compensated Employees who contribute materially to the continued growth, development and future business success of Collective Brands, Inc., a Delaware corporation, and its subsidiaries, if any, that sponsor this Plan. This Plan shall be unfunded for tax purposes and for purposes of Title I of ERISA. This is an amendment and restatement of the Collective Brands, Inc. Deferred Compensation Plan, formerly known as the Payless ShoeSource, Inc. Deferred Compensation 401(k) Mirror Plan, and is intended to comply with Code Section 409A. The Plan document in effect prior to the effective date of this amendment and restatement of January 1, 2008 will remain in effect for amounts which were both earned and vested on December 31, 2004. Such amounts are "grandfathered" under the pre-Code Section 409A rules. The Plan was originally effective on October 1, 2000.

**ARTICLE 1**

**Definitions**

For purposes of this Plan, unless otherwise clearly apparent from the context, the following phrases or terms shall have the following indicated meanings:

- 1.1 "Account Balance" shall mean, with respect to a Participant, a credit on the records of the Employer equal to the sum of (i) the Deferral Account balance, (ii) the Company Contribution Account balance and (iii) the Company Matching Account balance. The Account Balance, and each other specified account balance, shall be a bookkeeping entry only and shall be utilized solely as a device for the measurement and determination of the amounts to be paid to a Participant, or his or her designated Beneficiary, pursuant to this Plan.
- 1.2 "Annual Deferral Amount" shall mean that portion of a Participant's Annual Salary and Bonus that a Participant elects to have, and is, deferred, in accordance with Article 3, for any one Plan Year. In the event of a Participant's Retirement, Disability, death or a Termination of Employment prior to the end of a Plan Year, such year's Annual Deferral Amount shall be the actual amount withheld prior to such event.
- 1.3 "Annual Installment Method" shall mean annual installments over the number of years selected by the Participant or Committee in accordance with this Plan, calculated in accordance with this Section 1.3. The first annual installment shall be paid during the later of (a) the month of January of the calendar year immediately following the calendar year in which the Participant Retires, experiences a Termination of Employment or dies, as

applicable, or (b) the 30-day period beginning on the Benefit Distribution Date. Each subsequent annual installment shall be paid during the month of January of each succeeding calendar year. The Account Balance of the Participant shall be calculated on the date determined by the Committee for payment in accordance with the Plan. The annual installment shall be calculated by multiplying this balance by a fraction, the numerator of which is one, and the denominator of which is the remaining number of annual installments due the Participant. By way of example, if the Participant elects a 10-year Annual Installment Method, the first annual installment shall be 1/10 of the Account Balance, calculated as described in this definition. The following year, the annual installment shall be 1/9 of the Account Balance, calculated as described in this definition.

- 1.4 “Annual Salary” shall mean the annual cash compensation relating to services performed during any Plan Year, whether or not paid in such Plan Year, excluding bonuses, commissions, royalties, overtime, fringe benefits, relocation expenses, incentive payments, non-monetary awards, directors fees and other fees and automobile and other allowances paid to a Participant for employment services rendered (whether or not such allowances are included in the Employee’s gross income). Annual Salary shall be calculated before reduction for compensation voluntarily deferred or contributed by the Participant pursuant to all qualified or non-qualified plans of any Employer and shall be calculated to include amounts not otherwise included in the Participant’s gross income under Code Sections 125, 402(e)(3), 402(h), or 403(b) pursuant to plans established by any Employer; provided, however, that all such amounts will be included in compensation only to the extent that, had there been no such plan, the amount would have been payable in cash to the Employee.
- 1.5 “Beneficiary” shall mean one or more persons, trusts, estates or other entities, designated in accordance with Article 9, that are entitled to receive benefits under this Plan upon the death of a Participant.
- 1.6 “Beneficiary Designation Form” shall mean the form established from time to time by the Committee that a Participant completes, signs and returns to the Committee to designate one or more Beneficiaries.
- 1.7 “Benefit Distribution Date” shall mean the date that triggers distribution of a Participant’s vested Account Balance. A Participant’s Benefit Distribution Date shall be determined upon the occurrence of any one of the following: (a) If the Participant Retires, his or her Benefit Distribution Date shall be (i) the last day of the six-month period immediately following the date on which the Participant Retires if the Participant is a Key Employee, and (ii) for all other Participants, the date on which the Participant Retires; provided, however, in the event the Participant changes his or her Retirement Benefit election in accordance with Section 5.2, his or her Benefit Distribution Date shall be postponed in accordance with Section 5.2; (b) If the Participant experiences a Termination of Employment, his or her Benefit Distribution Date shall be (i) the last day of the six-month period immediately following the date on which the Participant experiences a Termination of Employment if the Participant is a Key Employee, and (ii) for all other Participants, the date on which the Participant experiences a Termination of Employment; provided, however, in the event the Participant changes his or her Termination Benefit election in accordance with Section 7.2, his or her Benefit Distribution Date shall be postponed in accordance with Section 7.2; or (c) the date of the Participant’s death, if the Participant

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dies prior to the complete distribution of his or her vested Account Balance; or (d) the date on which the Participant becomes Disabled.

1.8 "Board" shall mean the board of directors of the Company.

1.9 "Bonus" shall mean any compensation, in addition to Annual Salary, relating to services performed during any Plan Year or fiscal year of the Company, as applicable, whether or not paid in such Plan Year or fiscal year, payable to a Participant as an Employee under any Employer' s bonus, commissions, royalties and cash incentive plans, excluding stock based incentive programs and including special retention and sign-on bonuses, if any.

1.10 "Change in Control" shall mean the first to occur of any of the following events:

- (a) One person, or more than one person acting as a group, acquires ownership of stock of the Company that, together with stock held by such person or group, constitutes more than 50% of the total fair market value or total voting power of the stock of the Company; or
- (b) One person, or more than one person acting as a group, acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or group) ownership of stock of the Company possessing 30% or more of the total voting power of the stock of the Company;
- (c) A majority of the members of the Board is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of such appointment or election; or
- (d) One person, or more than one person acting as a group, acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or group) assets from the Company that have a total gross fair market value equal to or more than 40% of the total gross fair market value of all assets of the Company immediately prior to such acquisition or acquisitions..

1.11 "Claimant" shall have the meaning set forth in Section 14.1.

1.12 "Code" shall mean the Internal Revenue Code of 1986, as it may be amended from time to time.

1.13 "Committee" shall mean the administrative committee appointed pursuant to the Plan as described in Article 12. The Committee shall consist of the members of the Payless ShoeSource, Inc. 401(k) Profit Sharing Plan Committee as such term is defined in the Payless ShoeSource, Inc. 401(k) Profit Sharing Plan.

1.14 "Company" shall mean Collective Brands, Inc., a Delaware corporation, and any successor to all or substantially all of the Company' s assets or business.

1.15 "Company Contribution Account" shall mean (i) the sum of the Participant' s Company Contribution Amounts, plus or minus (ii) amounts credited or debited in accordance with

all the applicable crediting and debiting provisions of this Plan that relate to the Participant's Company Contribution Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to the Participant's Company Contribution Account.

1.16 "Company Contribution Amount" shall mean, for any one Plan Year, the amount determined in accordance with Section 3.5.

1.17 "Company Matching Account" shall mean (i) the sum of all of a Participant's Company Matching Amounts, plus or minus (ii) amounts credited or debited in accordance with all the applicable crediting and debiting provisions of this Plan that relate to the Participant's Company Matching Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to the Participant's Company Matching Account.

1.18 "Company Matching Amount" for any one Plan Year shall be the amount determined in accordance with Section 3.6.

1.19 "Deduction Limitation" shall mean the following described limitation on a benefit that may otherwise be distributable pursuant to the provisions of this Plan. Except as otherwise provided, this limitation shall be applied to all distributions that are "subject to the Deduction Limitation" under this Plan. If an Employer reasonably anticipates prior to a Change in Control that any compensation paid to a Participant for a taxable year of the Employer would not be deductible by the Employer solely by reason of the limitation under Code Section 162(m), then to the extent deemed necessary by the Employer to ensure that the entire amount of any distribution to the Participant pursuant to this Plan prior to the Change in Control is deductible, the Employer may defer all or any portion of a distribution under this Plan. Any amounts deferred pursuant to this limitation shall continue to be credited/debited with additional amounts in accordance with Section 3.10 below. The amounts so deferred and amounts credited/debited thereon shall be distributed to the Participant or his or her Beneficiary (in the event of the Participant's death) at the earliest possible date on which the Employer reasonably anticipates, or should reasonably anticipate, that the deductibility of compensation paid or payable to the Participant for the taxable year of the Employer during which the distribution is made will not be limited by Section 162(m) (or, in the event of the Participant's Retirement, Termination of Employment or death, within sixty (60) days after the applicable Benefit Distribution Date). Notwithstanding anything to the contrary in this Plan, the Deduction Limitation shall not apply to any distributions made after a Change in Control.

1.20 "Deferral Account" shall mean (i) the sum of all of a Participant's Annual Deferral Amounts, plus or minus (ii) amounts credited or debited in accordance with all the applicable crediting and debiting provisions of this Plan that relate to the Participant's Deferral Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to his or her Deferral Account.

1.21 "Disability" or "Disabled" shall mean that a Participant is (i) unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or (ii) by reason of any medically

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determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident or health plan covering employees of the Participant's Employer. For purposes of this Plan, a Participant shall be deemed Disabled if determined to be totally disabled by the Social Security Administration, or if determined to be disabled in accordance with any disability insurance program of such Participant's Employer, provided that the definition of "disability" applied under such disability insurance program complies with the requirements in the preceding sentence.

1.22 "Disability Benefit" shall mean the benefit set forth in Article 8.

1.23 "Election Form" shall mean the form established from time to time by the Committee that a Participant completes, signs and returns to the Committee to make an election under the Plan.

1.24 "Employee" shall mean a person who is an employee of any Employer.

"Employer(s)" shall mean the Company and if authorized by the Company to participate herein, any subsidiary of the Company or any affiliated corporation or partnership which elects to participate herein. An Employer may terminate its participation in the Plan as of the first day of any Plan Year, which shall mean a determination by the Employer's Board of Directors no later than December 31 preceding such Plan Year that (i) all of its Participants in the Plan shall no longer be eligible to participate in the Plan, (ii) no new deferral elections for such Participants shall be permitted, and (iii) such Participants shall no longer be eligible to receive Company Contribution Amounts or Company Matching Amounts under this Plan. The Account Balances of the Participants of any Employer which terminates its participation in the Plan shall continue to be credited or debited with earnings or losses and distributed in accordance with the remaining provisions of the Plan.

1.26 "ERISA" shall mean the Employee Retirement Income Security Act of 1974, as it may be amended from time to time.

1.27 "401(k) Plan" shall be the Payless ShoeSource, Inc. 401(k) Profit Sharing Plan or any successor plan adopted by the Company, and as amended from time to time.

"Key Employee" shall mean any Participant who is a "key employee" (as defined in Code Section 416(i) without regard to paragraph (5) thereof) of an Employer based upon the 12-month period ending on each December 31st (such 12-month period is referred to below as the "identification period"). All Participants who are determined to be key employees under Code Section 416(i) (without regard to paragraph (5) thereof) during the identification period shall be treated as Key Employees for purposes of the Plan during the 12-month period that begins on the first day of the 4th month following the close of such identification period. For purposes of determining whether a Participant is a Key Employee, the definition of Compensation set forth in Treasury Regulation Section 1.415(c)-2(a) shall be applied [without respect to any safe harbor provided in



Section 1.415(c)-2(d), without respect to the special timing rules in Section 1.415(c)-2(e), and without respect to any of the special rules in Section 1.415(c)-2(g)].

1.29 “Participant” shall mean any Employee of an Employer (i) who is selected to participate in the Plan, (ii) who elects to participate in the Plan, (iii) who signs and properly completes an Election Form, (iv) whose signed and properly completed Election Form is timely submitted to the Committee, (v) who commences participation in the Plan, and (vi) whose participation has not terminated. A spouse or former spouse of a Participant shall not be treated as a Participant in the Plan or have an account balance under the Plan, even if he or she has an interest in the Participant’s benefits under the Plan as a result of applicable law or property settlements resulting from legal separation or divorce.

1.30 “Performance Based Compensation” shall have such definition as set forth in Code Section 409A and related Treasury guidance and Regulations. As specified under Code Section 409A, until such time as amended under Code Section 409A, performance based compensation refers to compensation where (i) the payment of the compensation or the amount of the compensation is contingent on the satisfaction of organizational or individual performance criteria established in writing no later than ninety (90) days after the commencement of the performance period to which the criteria relate, and (ii) the performance criteria are not substantially certain to be met at the time the criteria are established. Performance Based Compensation may include payments based upon subjective performance criteria, but (i) any subjective performance criteria must relate to the performance of the Participant, a group of Participants that includes the Participant, or a business unit for which the Participant provides services (which may include the entire organization); and (ii) the determination that any subjective performance criteria have been met must not be made by the Participant, a family member of the Participant (as defined in Code Section 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family) or a person under the effective control of the Participant or any such family member. Performance Based Compensation may also include payments based on performance criteria that are not approved by a compensation committee of the Board of Directors or by the stockholders or members of the Company or an Employer. Notwithstanding the foregoing, Performance Based Compensation does not include any amount or portion of any amount that will be paid either regardless of performance, or based upon a level of performance that is substantially certain to be met at the time the criteria are established, or that is based solely on the value of, or appreciation in value of, the Company or the stock of the Company.

1.31 “Plan” shall mean the Collective Brands, Inc. Deferred Compensation Plan, formerly the Payless ShoeSource, Inc. Deferred Compensation 401(k) Mirror Plan, which shall be evidenced by this instrument, as it may be amended from time to time.

1.32 “Plan Year” shall mean (a) prior to February 1, 2009, the fiscal year of the Company, (b) effective February 1, 2009, the period beginning on February 1, 2009 and ending on December 31, 2009, and (c), effective January 1, 2010, the period beginning on January 1st and ending on December 31st of each year.

1.33 “Pre-Retirement Survivor Benefit” shall mean the benefit set forth in Article 6.

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- 1.34 “Retirement”, “Retire(s)” or “Retired” shall mean, with respect to an Employee, separation from service with all Employers, and all other corporations, trades or businesses aggregated with any Employer under Code Section 414(b) or (c), for any reason other than death or Disability, as determined in accordance with Code Section 409A and related Treasury guidance and Regulations, on or after the earlier of the attainment of (a) age sixty-five (65) or (b) age fifty-five (55) with five (5) Years of Service.
- 1.35 “Retirement Benefit” shall mean the benefit set forth in Article 5.
- 1.36 “Scheduled Distribution” shall mean the distribution set forth in Section 4.1.
- 1.37 “Stock” shall mean Collective Brands, Inc. common stock, \$ .001 par value, or any other equity securities of the Company designated by the Committee.
- 1.38 “Terminate the Plan” or “Termination of the Plan” shall mean a determination by the Board to terminate and liquidate the Plan in accordance with Section 11.1.
- 1.39 “Termination Benefit” shall mean the benefit set forth in Article 7.
- 1.40 “Termination of Employment” shall mean the separation from service with all Employers, and all other corporations, trades or businesses aggregated with any Employer under Code Section 414(b) or (c), involuntarily or voluntarily, for any reason other than Retirement, Disability or death, as determined in accordance with Code Section 409A and related Treasury guidance and Regulations.
- 1.41 “Trust” shall mean one or more trusts, commonly referred to as a “rabbi trust,” established between the Company and the Trustee named therein, as amended from time to time.
- 1.42 “Unforeseeable Emergency” shall mean a severe financial hardship of the Participant or his or her Beneficiary resulting from (i) an illness or accident of the Participant or Beneficiary, the Participant’ s or Beneficiary’ s spouse, or the Participant’ s or Beneficiary’ s dependent (as defined in Code Section 152, without regard to Code Section 152(b)(1), (b)(2) and (d)(1)(B)), (ii) a loss of the Participant’ s or Beneficiary’ s property due to casualty, or (iii) such other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant or the Participant’ s Beneficiary, all as determined in the sole discretion of the Committee.
- 1.43 “Variable Account” shall mean, with respect to a Participant, a credit on the records of the Employer equal to the sum of (i) the Deferral Account balance, (ii) the Company Contribution Account balance, and (iii) the Company Matching Account balance. The Variable Account, and each other specified account balance, shall be a bookkeeping entry only and shall be utilized solely as a device for the measurement and determination of the amounts to be paid to a Participant, or his or her designated Beneficiary, pursuant to this Plan.
- 1.44 “Year of Service” shall have the same meaning as the term Vesting Service under the 401(k) Plan.

## ARTICLE 2

### **Selection, Enrollment, Eligibility**

2.1 **Selection by Committee.** Participation in the Plan shall be limited to a select group of management and highly compensated Employees of the Employers, as determined by the Committee in its sole discretion. From that group, the Committee shall select, in its sole discretion, Employees to participate in the Plan.

2.2 **Enrollment Requirements.**

(a) As a condition to participation, each selected Employee who is eligible to participate in the Plan effective as of the first day of a Plan Year shall properly complete, execute and return to the Committee an Election Form on or before the December 31<sup>st</sup> preceding such Plan Year, or such earlier deadline as may be established by the Committee in its sole discretion, in order to participate for that Plan Year. In addition, the Committee shall establish from time to time such other enrollment requirements as it determines in its sole discretion are necessary. An eligible Employee who satisfies the enrollment requirements of this subsection (a) shall commence or continue participation in the Plan as of the first day of the applicable Plan Year.

(b) An Employee who first becomes eligible to participate in this Plan after the first day of a Plan Year must properly complete, execute and return to the Committee an Election Form within thirty (30) days after he or she first becomes eligible to participate in the Plan, or within such other earlier deadline as may be established by the Committee, in its sole discretion, in order to participate for that Plan Year; provided, however, that this Section 2.2(b) shall not apply with respect to any Employee who previously participated in a nonqualified deferred compensation plan aggregated with this Plan, as determined in accordance with Code Section 409A and related Treasury guidance or Regulations, and any such Employee may participate in the Plan only in accordance with Section 2.2(a). In addition, the Committee shall establish from time to time such other enrollment requirements as it determines in its sole discretion are necessary. An eligible Employee who satisfies the enrollment requirements of this subsection (b) shall commence participation in the Plan as of the date his or her Election Form is returned to the Committee.

(c) If an Employee fails to meet the requirements contained in Section 2.2 within the period required, that Employee shall not be eligible to participate in the Plan during the Plan Year.

2.3 **Termination of Participation and/or Deferrals.** If the Committee determines in good faith that a Participant no longer qualifies as a member of a select group of management or highly compensated employees, as membership in such group is determined in accordance with Sections 201(2), 301(a)(3) and 401(a)(1) of ERISA, the Committee shall have the right, in its sole discretion, to prevent the Participant from making future deferral elections.

**ARTICLE 3**  
**Deferral Commitments/Company Matching/Crediting/Taxes**

**3.1 Minimum Deferrals.**

**Annual Salary and Bonus.** For each Plan Year, a Participant may elect to defer, as his or her Annual Deferral Amount, Annual

- (a) Salary payable for such Plan Year and/or Bonus payable for the Plan Year or the fiscal year of the Company beginning in such Plan Year, in the following combined minimum amount.

Deferral	Minimum Amount
Annual Salary	\$ 0
Bonus	\$ 0
Annual Salary plus Bonus	\$ 500

If an election is made for less than the stated minimum amount, or if no election is made, the amount deferred shall be zero.

**Short Plan Year.** Notwithstanding the foregoing, if a Participant first becomes a Participant after the first day of a Plan Year the minimum Annual Deferral Amount with respect to Annual Salary plus Bonus shall be an amount equal to the minimum set forth above, multiplied by a fraction, the numerator of which is the number of complete months remaining in the Plan Year and the denominator of which is 12.

(b)

**3.2 Maximum Deferral.**

**Annual Salary and Bonus.** For each Plan Year, a Participant may elect to defer, as his or her Annual Deferral Amount, Annual

- (a) Salary payable for such Plan Year and/or Bonus payable for the Plan Year or the fiscal year of the Company beginning in such Plan Year, as applicable, up to the following maximum percentages for each deferral elected:

	Deferral	Maximum Amount
Annual Salary		75 %
Bonus		100%

Notwithstanding the foregoing, if a Participant first becomes a Participant after the first day of a Plan Year the maximum Annual Deferral Amount with respect to Annual Salary and Bonus shall be limited to the amount of compensation not yet earned by the Participant as of the date the Participant submits an Election Form to the Committee in accordance with Section 2.2(b), except that

(b) in the case of compensation that is earned based upon a specified performance period, the Participant's deferral election will apply to the portion of such compensation that is equal to (i) the total amount of such compensation for the performance period, multiplied by (ii) a fraction, the numerator of which is the number of days remaining in the performance period after the Participant's deferral election is made, and the denominator of which is the total number of days in the performance period.

### 3.3 **Election to Defer; Effect of Election Form.**

- First Plan Year.** In connection with a Participant's commencement of participation in the Plan, the Participant shall make an irrevocable deferral election for the Plan Year in which the Participant commences participation in the Plan, along with such other elections as the Committee deems necessary or desirable under the Plan. For these elections to be valid, the Election Form must be completed and signed by the Participant and timely delivered to the Committee (in accordance with Section 2.2 above). Any such
- (a) election shall be applicable with respect to (i) Annual Salary payable for the portion of such Plan Year after the date of such election, and (ii) in accordance with rules and procedures prescribed by the Administrator, one or more categories of Bonus payable for the portion of the Plan Year or the fiscal year of the Company beginning in such Plan Year, as applicable, determined in accordance with Section 3.2(b).

- General Timing Rule for Subsequent Plan Years.** For each succeeding Plan Year, a Participant may irrevocably elect to defer Annual Salary and Bonus and make such other elections as the Committee deems necessary or desirable under the plan by timely delivering a new Election Form to the Committee, in accordance with its rules and procedures, on or before the December 31<sup>st</sup> preceding the Plan Year in which such compensation is earned, or before such other deadline established by the Committee in
- (b) accordance with the requirements of Code Section 409A and related Treasury guidance or Regulations. Any such election shall be applicable with respect to (i) Annual Salary payable for such Plan Year, and (ii) in accordance with rules and procedures prescribed by the Administrator, one or more categories of Bonus payable for the Plan Year or the fiscal year of the Company beginning in such Plan Year, as applicable.

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- (c) **Performance-Based Compensation.** Notwithstanding the foregoing, the Committee may, in its sole discretion, determine that an irrevocable deferral election pertaining to Performance-Based Compensation based on services performed over a period of at least twelve (12) months, may be made by timely delivering a properly completed and signed Election Form to the Committee in accordance with its rules and procedures no later than six (6) months before the end of the performance period. In order to be eligible to make a deferral election for Performance-Based Compensation, a Participant must perform services continuously from the later of the beginning of the performance period or the date upon which the performance criteria for such compensation are established through the date upon which the Participant makes a deferral election for such compensation. In no event shall an election to defer Performance-Based Compensation be permitted after such compensation has become readily ascertainable.

- (d) **Compensation Subject to Risk of Forfeiture.** With respect to compensation (i) to which a Participant has a legally binding right to payment in a subsequent year, and (ii) that is subject to a forfeiture condition requiring the Participant's continued services for a period of at least twelve (12) months from the date the Participant obtains the legally binding right, the Committee may, in its sole discretion, determine that an irrevocable deferral election for such compensation may be made by timely delivering a properly completed and signed Election Form to the Committee in accordance with its rules and procedures no later than the 30th day after the Participant obtains the legally binding right to the compensation, provided that the election is made at least twelve (12) months in advance of the earliest date at which the forfeiture condition could lapse.

- 3.4 **Withholding of Annual Deferral Amounts.** For each Plan Year, the Annual Salary portion of the Annual Deferral Amount shall be withheld from each regularly scheduled Annual Salary payroll in equal amounts, as adjusted from time to time for increases and decreases in Annual Salary. The Bonus portion of the Annual Deferral Amount shall be withheld at the time the Bonus is or otherwise would be paid to the Participant, whether or not this occurs during the Plan Year itself. Annual Deferral Amounts shall be credited to a Participant's Deferral Account at the time such amounts would otherwise have been paid to the Participant.

- 3.5 **Company Contribution Amount.** For each Plan Year, an Employer, in its sole discretion, may, but is not required to, credit any amount it desires to any Participant's Company Contribution Account under this Plan, which amount shall be for that Participant. The amount so credited to a Participant may be smaller or larger than the amount credited to any other Participant, and the amount credited to any Participant for a Plan Year may be zero, even though one or more other Participants receive a Company Contribution Amount for that Plan Year. If a Participant is not employed by an Employer as of the last day of a Plan Year other than by reason of his or her Retirement, Disability or death (while employed), the Company Contribution Amount for that Plan Year shall be zero.

- 3.6 **Company Matching Amount.** For each Plan Year, an Employer, in its sole discretion, may, but is not required to, credit any amount it desires to any Participant's Matching Contribution Account under this Plan, which amount shall be for that Participant.

- 3.7 **Crediting of Amounts after Benefit Distribution.** Notwithstanding any provision of this Plan to the contrary, should the complete distribution of a Participant's vested Account Balance occur prior to the date on which any portion of (i) the Annual Deferral Amount that a Participant has elected to defer in accordance with Section 3.3, (ii) the Company Contribution Amount, or (iii) the Company Matching Amount, would otherwise be credited to the Participant's Account Balance, such amounts shall not be credited to the Participant's Account Balance, but shall be paid to the Participant by the last day of the Plan Year in which such amount would otherwise have been credited to the Participant's Account Balance.

- 3.8 **Investment of Trust Assets.** The Trustee of the Trust shall be authorized, upon written instructions received from the Committee or investment manager appointed by the Committee, to invest and reinvest the assets of the Trust in accordance with the applicable Trust Agreement.

3.9 **Vesting.**

A Participant shall at all times be 100% vested in his or her Deferral Account.

- (a) A Participant shall be vested in his or her Company Contribution Account and Company Matching Account as follows: (i) with respect to all benefits under this Plan other than the Termination Benefit, a Participant's Company Contribution Account and Company Matching Account shall equal 100% of such Participant's Company Contribution Account and Company Matching Account; and (ii) with respect to the Termination Benefit, a Participant's Company Contribution Account and Company Matching Account shall vest on the basis of the Participant's Years of Service at the time the Participant experiences a Termination of Employment, in accordance with the following schedule:

Years of Service at Date of Termination of Employment	Vested Percentage of Company Contribution Account and Company Matching Account
Fewer than 2 years	0 %
2 years	25 %
3 years	50 %
4 years	75 %
5 years or more	100%

- (b) Notwithstanding anything to the contrary contained in this Section 3.9, a Participant's Company Contribution Account and Company Matching Account shall immediately become 100% vested (if it is not already vested in accordance with the above vesting schedules) in the event of the following with respect to a

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Participant while employed by an Employer: Retirement; Disability; death; or a Change in Control.

- (c) Notwithstanding subsection (a), the vesting schedule for a Participant's Company Contribution Account and Company Matching Account shall not be accelerated to the extent that the Committee determines that such acceleration would cause the deduction limitations of Section 280G of the Code to become effective (except as may be provided in agreements that exist from time to time between any Employer and a Participant which provides for acceleration of vesting upon a Change in Control). In the event that all of a Participant's Company Contribution Account and/or Company Matching Account is not vested pursuant to such a determination, the Participant may request independent verification of the Committee's calculations with respect to the application of Section 280G. In such case, the Committee must provide to the Participant within 15 business days of such a request an opinion from a nationally recognized accounting firm selected by the Participant (the "Accounting Firm"). The opinion shall state the Accounting Firm's opinion that any limitation in the vested percentage hereunder is necessary to avoid the limits of Section 280G and contain supporting calculations. The cost of such opinion shall be paid for by the Company.

**Crediting/Debiting of Account Balances.** In accordance with, and subject to, the rules and procedures that are established from time to time by the Committee, in its sole discretion, amounts shall be credited or debited to a Participant's Account Balance in accordance with the following rules:

- Election of Measurement Funds for Variable Account.** A Participant, in connection with his or her initial deferral election in accordance with Section 3.3(a) above, shall elect, on the Election Form, one or more Measurement Fund(s) (as described in Section 3.10(c) below) to be used to determine the additional amounts to be credited or debited to his or her Variable Account when the Participant commences participation in the Plan and continuing thereafter for each subsequent business day in which the Participant participates in the Plan, unless changed in accordance with the next sentence. Commencing with the business day that follows the Participant's commencement of participation in the Plan and continuing thereafter for each subsequent business day in which the Participant participates in the Plan, the Participant may (but is not required to) elect, by submitting an Election Form to the Committee that is accepted by the Committee, to reallocate among the available Measurement Fund(s) to be used to determine the additional amounts to be credited or debited to his or her Variable Account, or to change the portion of his or her Variable Account allocated to each previously or newly elected Measurement Fund. If an election is made in accordance with the previous sentence, it shall apply as soon as administratively possible and shall continue thereafter for each subsequent business day in which the Participant participates in the Plan, unless changed in accordance with the previous sentence. A Participant shall be permitted to request that the Committee reallocate the amount available in the Measurement Fund(s) once during a calendar month.
- (a)



- (b) **Proportionate Allocation.** In making any election described in Section 3.0(a) above, the Participant shall specify on the Election Form, in increments of one percentage point (1%), the percentage of his or her Variable Account to be allocated to a Measurement Fund (as if the Participant was making an investment in that Measurement Fund with that portion of his or her Variable Account).

- (c) **Measurement Funds.** The Participant may elect one or more measurement funds (the "Measurement Funds") for the purpose of crediting or debiting additional amounts to his or her Variable Account. The Committee shall, in its sole discretion, select, discontinue, substitute or add a Measurement Fund at any time. Subject to the shareholders of the Company approving the use of Stock under the Plan, the Committee may offer a Collective Brands, Inc. Stock Fund (the "Stock Fund") as a Measurement Fund.

- (d) **Crediting or Debiting Method.** The performance of each elected Measurement Fund (either positive or negative) will be determined by the Committee, in its reasonable discretion, based on the performance of the Measurement Funds themselves. A Participant's Account balance shall be credited or debited on a daily basis based on the performance of each Measurement Fund selected by the Participant for the Variable Account, as determined by the Committee, as though (i) a Participant's Account Balance were invested in the selected or required Measurement Fund(s), or both, in the percentages applicable to such business day, as of the close of business on the business day, at the closing price on such date; (ii) the portion of the Annual Deferral Amount that was actually deferred as of the business day were invested in the Measurement Fund(s) selected by the Participant, in the percentages applicable to such business day, as soon as administratively possible after the day on which such amounts are actually deferred from the Participant's Annual Salary through reductions in his or her payroll; and (iii) any distribution made to a Participant that decreases such Participant's Account Balance ceased being invested in the Measurement Fund(s), in the percentages applicable to such business day, as soon as administratively possible. The Participant's Company Matching Amount, if any, shall be credited to his or her Company Matching Account for purposes of this Section 3.10(d) on the date selected by the Committee in its sole and absolute discretion. The Participant's Company Contribution Amount, if any, shall be credited to his or her Company Contribution Account for purposes of this Section 3.10(d) on the date selected by the Committee, in its sole and absolute discretion.

- (e) **Special Rule for Variable Account Invested in Stock.** Notwithstanding any provision of this Plan that may be construed to the contrary, (i) the portion of the Participant's Variable Account allocated to the Stock Fund must at all times prior to distribution be allocated to the Stock Fund, and (ii) the portion of the Participant's Variable Account allocated to the Stock Fund must be distributed in the form of Stock.

- (f) **No Actual Investment.** Notwithstanding any other provision of this Plan that may be interpreted to the contrary, the Measurement Funds are to be used for measurement purposes only, and a Participant's election of any such Measurement

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Fund, the allocation to his or her Account Balance thereto, the calculation of additional amounts and the crediting or debiting of such amounts to a Participant's Account Balance shall not be considered or construed in any manner as an actual investment of his or her Account Balance in any such Measurement Fund. In the event that the Company or the Trustee (as that term is defined in the Trust), in its own discretion, decides to invest funds in any or all of the Measurement Funds, no Participant shall have any rights in or to such investments themselves. Without limiting the foregoing, a Participant's Account Balance shall at all times be a bookkeeping entry only and shall not represent any investment made on his or her behalf by the Company or the Trust; the Participant shall at all times remain an unsecured creditor of the Company.

### **3.11 FICA and Other Taxes.**

**Annual Deferral Amounts.** For each Plan Year in which an Annual Deferral Amount is being withheld from a Participant, the Participant's Employer(s) shall withhold from that portion of the Participant's Annual Salary and Bonus that is not being deferred, in a manner determined by the Employer(s), the Participant's share of FICA and other employment taxes on such Annual Deferral Amount. **(a)** If necessary, the Committee may reduce the Deferral Account in order to comply with this Section 3.11 and to satisfy any withholding obligation of the Employer(s) for income or earnings taxes under federal, state or local law resulting from such reduction.

**Company Matching Account and Company Contribution Account.** When a Participant becomes vested in a portion of his or her Company Matching Account or Company Contribution Account, or both, the Participant's Employer(s) shall withhold from the Participant's Annual Salary and/or Bonus that is not deferred, in a manner determined by the Employer(s), the Participant's share of **(b)** FICA and other employment taxes on such vested portions of his or her Company Matching Account and/or Company Contribution Account. If necessary, the Committee may reduce the vested portion of the Participant's Company Matching Account or Company Contribution Account, or both, as the case may be, in order to comply with this Section 3.11 and to satisfy any withholding obligation of the Employer(s) for income or other taxes under federal, state or local law resulting from such reduction.

**Distributions.** The Participant's Employer(s), or the Trustee of the Trust, shall withhold from any distributions made to a Participant under this Plan all federal, state and local income, employment and other taxes required to be withheld by the Employer(s), or the **3.12** Trustee of the Trust, in connection with such distributions, in amounts and in a manner to be determined in the sole discretion of the Employer(s) and the Trustee of the Trust.

**ARTICLE 4**  
**Scheduled Distribution; Unforeseeable Emergencies;**  
**Withdrawal Election**

4.1 **Scheduled Distribution.** In connection with each election to defer an Annual Deferral Amount, a Participant may irrevocably elect to receive a Scheduled Distribution, in the form of a lump sum payment, from the Plan with respect to all or a portion of the Annual Deferral Amount. Subject to the Deduction Limitation, the Scheduled Distribution shall be a lump sum payment in an amount that is equal to the Annual Deferral Amount plus amounts credited or debited in the manner provided in Section 3.10 above on that amount, determined at the time that the Scheduled Distribution becomes payable. Subject to the Deduction Limitation and the other terms and conditions of this Plan, each Scheduled Distribution elected shall be paid out during a sixty (60) day period commencing immediately after the last day of any calendar year designated by the Participant that is at least three Plan Years after the Plan Year in which the Annual Deferral Amount is actually deferred (“Scheduled Distribution Date”). With respect to any Scheduled Distribution election, a Participant may make a one time election to re-defer that distribution to a specified date that is not less than the first day of the Plan Year that is five (5) Plan Years after the Plan Year in which the Scheduled Distribution would otherwise be paid. The Participant may make this re-deferral election by submitting an Election Form to the Committee, provided that any such Election Form is submitted at least one (1) year prior to the first day of the Plan Year in which the Scheduled Distribution would otherwise be paid.

4.2 **Other Benefits Take Precedence Over Scheduled Distribution.** Should an event occur that triggers a benefit under Article 5, 6, 7 or 8, any Annual Deferral Amount, plus amounts credited or debited thereon, that is subject to a Scheduled Distribution election under Section 4.1 shall not be paid in accordance with Section 4.1 but shall be paid in accordance with the other applicable Article. Notwithstanding the foregoing, the Committee shall interpret this Section 4.2 in a manner that is consistent with Code Section 409A and related Treasury guidance and Regulations.

4.3 **Unforeseeable Emergencies.**

- (a) If the Participant experiences an Unforeseeable Emergency, the Participant may petition the Committee to receive a partial or full payout from the Plan, subject to the provisions set forth below.

The payout, if any, from the Plan shall not exceed the lesser of (i) the Participant’ s vested Account Balance, calculated as of the close of the business on or as soon as administratively feasible after the date on which the amount becomes payable, as determined by the Committee, or (ii) the amount necessary to satisfy the Unforeseeable Emergency, plus amounts necessary to pay Federal,

- (b) state, or local income taxes or penalties reasonably anticipated as a result of the distribution. Notwithstanding the foregoing, a Participant may not receive a payout from the Plan to the extent that the Unforeseeable Emergency is or may be relieved (A) through reimbursement or compensation by insurance or otherwise, (B) by liquidation of the Participant’ s assets, to the extent the liquidation of such assets would not itself cause severe financial hardship or (C) by cessation of deferrals

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under this Plan. The availability of payments due to the unforeseeable emergency under any other nonqualified deferred compensation plan as defined for purposes of Code Section 409A, including plans that would be nonqualified deferred compensation plans for purposes of Code Section 409A except due to the effective date thereof, or under any qualified plan (including any assets available by obtaining a loan under a qualified plan), need not be considered in determining whether an emergency is or may be relieved through other means. If an event would constitute an Unforeseeable Emergency under the Plan if it occurred with respect to the Participant's spouse or dependent, such event will be deemed to constitute an Unforeseeable Emergency if it occurs with respect to a person who is a Participant's Beneficiary under the Plan.

- (c) If the Committee, in its sole discretion, approves a Participant's petition for payout from the Plan, the Participant shall receive a payout from the Plan within sixty (60) days of the date of such approval, and the Participant's deferrals under the Plan shall be terminated as of the date of such approval.

- (d) In addition, a Participant's deferral elections under this Plan shall be terminated to the extent the Committee determines, in its sole discretion, that termination of such Participant's deferral elections is required pursuant to Treas. Reg. §1.401(k)-1(d)(3) for the Participant to obtain a hardship distribution from an Employer's 401(k) Plan. If the Committee determines that a termination of the Participant's deferrals is required in accordance with the preceding sentence, the Participant's deferrals shall be terminated as soon as administratively practicable following the date on which such determination is made.

- (e) Notwithstanding the foregoing, the Committee shall interpret all provisions relating to a payout and/or termination of deferrals under Section 4.3 in a manner that is consistent with Code Section 409A and related Treasury guidance and Regulations.

**ARTICLE 5**  
**Retirement Benefit**

- 5.1 **Retirement Benefit.** A Participant who Retires shall receive, as a Retirement Benefit, his or her Account Balance, calculated as of the close of the business on or as soon as administratively feasible after the Participant's Benefit Distribution Date and each date provided under Section 1.3, if applicable, as determined by the Committee.
- 5.2 **Payment of Retirement Benefit.** A Participant, in connection with his or her commencement of participation in the Plan, shall elect on an Election Form to receive the Retirement Benefit pursuant to a lump sum or an Annual Installment Method paid over a period not to exceed 15 years. The Participant may annually change his or her election to an allowable alternative payout form or period by submitting a new Election Form to the Committee, provided that any such Election Form is submitted at least one year prior to the Participant's Benefit Distribution Date, and that such payout shall not be made or commence until a specified date that is not less than five years after such Benefit Distribution Date. The Election Form most recently submitted by the Participant in accordance with the foregoing provisions of this Section 5.2 shall govern the payout of the Retirement Benefit. If a Participant does not make any election with respect to the payment of the Retirement Benefit, then such benefit shall be payable in a lump sum. The lump sum payment shall be made on or within sixty (60) days after his or her Benefit Distribution Date. Payments made pursuant to the Annual Installment Method shall be made in accordance with Section 1.3.
- 5.3 **Death Prior to Completion of Retirement Benefit.** If a Participant dies after Retirement but before the Retirement Benefit is paid in full, the Participant's unpaid Account Balance shall be paid to the Participant's Beneficiary in a lump sum (or, if a Beneficiary dies before such lump sum is paid, to the beneficiary designated in writing by the Beneficiary on a form to be submitted by the Beneficiary to the Committee (or to the Beneficiary's estate if the Beneficiary fails to so designate a beneficiary)). The lump sum payment shall be made no later than sixty (60) days after the date of the Participant's death (or, if later, in January 2009).
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**ARTICLE 6**  
**Pre-Retirement Survivor Benefit**

- 6.1 **Pre-Retirement Survivor Benefit.** The Participant's Beneficiary shall receive a Pre-Retirement Survivor Benefit equal to the Participant's Account Balance, calculated as of the close of the business on or as soon as administratively feasible after the Participant's Benefit Distribution Date and each date provided under Section 1.3, if applicable, as determined by the Committee, if the Participant dies before he or she Retires, experiences a Termination of Employment or suffers a Disability.
- 6.2 **Payment of Pre-Retirement Survivor Benefit.** A Participant, in connection with his or her commencement of participation in the Plan, shall elect on an Election Form the form of payment to be made to his or her Beneficiary. The Pre-Retirement Survivor Benefit shall be paid in a lump sum or an Annual Installment Method paid over a period not to exceed 15 years. The Participant may annually change his or her election to an allowable alternative payout form or period by submitting a new Election Form to the Committee, provided that any such Election Form is submitted at least one year prior to the Participant's death. The Election Form most recently submitted by the Participant in accordance with the foregoing provisions of this Section 5.2 shall govern the payout of the Pre-Retirement Survivor Benefit. If a Participant does not make any election with respect to the payment of the Pre-Retirement Survivor Benefit, then such benefit shall be payable in a lump sum. The lump sum payment shall be made no later than sixty (60) days after the date of the Participant's death. Payments made pursuant to the Annual Installment Method shall be made in accordance with Section 1.3.
- 6.3 **Death of Beneficiary Prior to Completion of Pre-Retirement Survivor Benefit.** If a Beneficiary dies before the Pre-Retirement Survivor Benefit is paid in full, the unpaid Pre-Retirement Survivor Benefit shall continue and shall be paid to the beneficiary designated in writing by the Beneficiary on a form to be submitted by the Beneficiary to the Committee (or to the Beneficiary's estate if the Beneficiary fails to so designate a beneficiary) over the remaining period of time and in the same amounts as that benefit would have been paid to the Beneficiary had the Beneficiary survived.

**ARTICLE 7**  
**Termination Benefit**

- 7.1 **Termination Benefit.** The Participant shall receive a Termination Benefit, which shall be equal to the Participant' s vested Account Balance if a Participant experiences a Termination of Employment prior to his or her Retirement, death or Disability. The Termination Benefit will be calculated as of the close of business on or as soon as administratively feasible after the Participant' s Benefit Distribution Date and each date provided under Section 1.3, if applicable, as determined by the Committee in.
- 7.2 **Payment of Termination Benefit.** A Participant, in connection with his or her commencement of participation in the Plan, shall elect on an Election Form to receive the Termination Benefit pursuant to a lump sum or an Annual Installment Method paid over a period not to exceed 15 years. Notwithstanding the above, if the Participant' s vested Account Balance at the time of his or her Termination of Employment (or, in the case of a Key Employee, the date which is six months after the date of his or her Termination of Employment), plus his or her vested interest in any other nonqualified deferred compensation plan aggregated with the Plan under Code Section 409A, does not exceed the limitation described in Section 402(g) of the Code, payment of his or her Termination Benefit shall be paid in a lump sum on such date; provided, however, that this sentence shall only be applicable if such Participant' s interest in any other nonqualified deferred compensation plan aggregated with the Plan under Code Section 409A is also paid in a lump sum on such date. The Participant may annually change his or her election to an allowable alternative payout form or period by submitting a new Election Form to the Committee, provided that any such Election Form is submitted at least one year prior to the Participant' s Benefit Distribution Date, and that such payout shall not be made or commence until a specified date that is not less than five years after such Benefit Distribution Date. The Election Form most recently submitted by the Participant in accordance with the foregoing provisions of this Section 7.2 shall govern the payout of the Termination Benefit. If a Participant does not make any election with respect to the payment of the Termination Benefit, then such benefit shall be payable in a lump sum. The lump sum payment shall be made on or within sixty (60) days after his or her Benefit Distribution Date. Payments made pursuant to the Annual Installment Method shall be made in accordance with Section 1.3.
- 7.3 **Death Prior to Completion of Termination Benefit.** If a Participant dies after Termination of Employment but before the Termination Benefit is paid in full, the Participant' s unpaid Account Balance shall be paid to the Participant' s Beneficiary in a lump sum (or, if a Beneficiary dies before such lump sum is paid, to the beneficiary designated in writing by the Beneficiary on a form to be submitted by the Beneficiary to the Committee (or to the Beneficiary' s estate if the Beneficiary fails to so designate a beneficiary)). The lump sum payment shall be made no later than sixty (60) days after the date of the Participant' s death (or, if later, in January 2009).
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**ARTICLE 8**  
**Disability Benefit**

- 8.1 **Disability Benefit**. Upon a Participant's Disability, the Participant shall receive a Disability Benefit, which shall be equal to the Participant's Account Balance, calculated as of the close of business on or as soon as administratively feasible after the Participant's Benefit Distribution Date, as determined by the Committee.
- 8.2 **Payment of Disability Benefit**. The Disability Benefit shall be paid to the Participant (or, if a Participant dies after becoming Disabled but before the Disability Benefit is paid, his or her Beneficiary) in a lump sum payment on or within sixty (60) days after the Participant's Benefit Distribution Date.



**ARTICLE 9**  
**Beneficiary Designation**

- 9.1 **Beneficiary**. Each Participant shall have the right, at any time, to designate his or her Beneficiary(ies) (both primary as well as contingent) to receive any benefits payable under the Plan to a beneficiary upon the death of a Participant. The Beneficiary designated under this Plan may be the same as or different from the Beneficiary designation under any other plan of an Employer in which the Participant participates.
- 9.2 **Beneficiary Designation and Change of Beneficiary**. A Participant shall designate his or her Beneficiary by completing and signing the Beneficiary Designation Form, and returning it to the Committee or its designated agent. A Participant shall have the right to change a Beneficiary by completing, signing and otherwise complying with the terms of the Beneficiary Designation Form and the Committee's rules and procedures, as in effect from time to time. Upon the acceptance by the Committee of a new Beneficiary Designation Form, all Beneficiary designations previously filed shall be canceled. The Committee shall be entitled to rely on the last Beneficiary Designation Form filed by the Participant and accepted by the Committee prior to his or her death.
- 9.3 **Acknowledgment**. No designation or change in designation of a Beneficiary shall be effective until received and acknowledged in writing by the Committee or its designated agent.
- 9.4 **No Beneficiary Designation**. If a Participant fails to designate a Beneficiary as provided in Sections 9.1, 9.2 and 9.3 above or, if all designated Beneficiaries predecease the Participant, then the Participant's designated Beneficiary shall be deemed to be his or her estate.
- 9.5 **Doubt as to Beneficiary**. If the Committee has any doubt as to the proper Beneficiary to receive payments pursuant to this Plan, the Committee shall have the right, exercisable in its discretion, to cause the Participant's Employer to withhold such payments until this matter is resolved to the Committee's satisfaction.
- 9.6 **Discharge of Obligations**. The payment of benefits under the Plan to a Beneficiary shall fully and completely discharge all Employers and the Committee from all further obligations under this Plan with respect to the Participant, and that Participant's participation in the Plan shall terminate upon such full payment of benefits.
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**ARTICLE 10**  
**Leave of Absence**

- 10.1 **Paid Leave of Absence.** If a Participant is authorized by the Participant's Employer to take a paid leave of absence from the employment of the Employer, and such leave of absence does not constitute a separation from services as determined by the Committee in accordance with Code Section 409A and related Treasury guidance and Regulations, (i) the Participant shall continue to be considered eligible for the benefits provided in Articles 4, 5, 6, 7 and 8 in accordance with the provisions of those Articles, and (ii) the Annual Deferral Amount shall continue to be withheld during such paid leave of absence in accordance with Section 3.3.
- 10.2 **Unpaid Leave of Absence.** If a Participant is authorized by the Participant's Employer for any reason to take an unpaid leave of absence from the employment of the Employer, and such leave of absence does not constitute a separation from service, as determined by the Committee in accordance with Code Section 409A and related Treasury guidance and Regulations, such Participant shall continue to be eligible for the benefits provided in Articles 4, 5, 6, 7 and 8 in accordance with the provisions of those Articles. However, if the Participant returns to employment during the same Plan Year as the unpaid leave of absence begins, the Participant's deferral election shall apply to Annual Salary earned during the remainder of the Plan Year. Even if the Participant does not return to employment during the same Plan Year, the Participant's deferral election shall apply to any Bonus earned for the year in which such unpaid leave of absence commences.

**ARTICLE 11**  
**Termination, Amendment or Modification**

11.1 **Termination.** Although the Company anticipates that it will continue the Plan for an indefinite period of time, there is no guarantee that the Company will continue the Plan or will not Terminate the Plan at any time in the future. The Company may Terminate the Plan in accordance with Code Section 409A as follows:

(A) by irrevocable action taken during the 30 days before or 12 months after a Change in Control and provided that all agreements, methods, programs and other arrangements sponsored by the Company, and all other corporations, trades or businesses aggregated with the Company under Code Section 414(b) or (c), immediately after the time of the Change in Control event with respect to which deferrals of compensation are treated as having been deferred under a single plan under Code Section 409A, are terminated and liquidated with respect to each Participant that experienced the Change in Control event, so that all such Participants are required to receive all amounts of compensation deferred under such terminated agreements, methods, programs and other arrangements within 12 months of the date all necessary action to terminate and liquidate such agreements, methods, programs and other arrangements is irrevocably taken; or

(B) within 12 months of a corporate dissolution taxed under Code Section 331, or with the approval of a bankruptcy court pursuant to 11 U.S.C. Section 503(b)(1)(A), provided that amounts deferred under the Plan are included in the Participants' gross incomes in the latest of the following years (or, if earlier, the taxable year in which the amount is actually or constructively received): (i) the calendar year in which the Plan termination and liquidation occurs, (ii) the first calendar year in which the amount is no longer subject to a substantial risk forfeiture, or (iii) the first calendar year in which the payment is administratively practicable; or

(C) if (i) all "similar plans" within the meaning specified under Code Section 409A and related Treasury guidance or Regulations are terminated, (ii) distributions are made no sooner than 12 months and no later than 24 months after termination, (iii) neither the Company nor any other corporation, trade or business aggregated with any Employer under Code Section 414(b) or (c) adopts any new plan of the same type for three years and (iv) the termination and liquidation does not occur proximate to a downturn in the financial health of the Company and such corporations, trades or businesses; or

(D) as a result of such other events and conditions as the U.S. Treasury Commissioner may prescribe in generally applicable guidance published in the Internal Revenue Bulletin.

In the event of a permissible Termination of the Plan as specified above, the Participants' vested Account Balances, determined as if they had experienced a Termination of Employment on the date of Termination of the Plan or, if Plan termination occurs after the date upon which a Participant was eligible to Retire, then with respect to that Participant as if he or she had Retired on the date of Termination of the Plan, shall be paid to the Participants as follows: Prior to a Change in Control, an Employer shall, notwithstanding any elections made by the Participant, pay such vested Account Balances in a lump sum within the timeframes specified in subsection (B) or (C) above, as applicable. After a

Change in Control, the Account Balances of all Participants shall be fully vested and the Employer shall be required to pay such benefits in a lump sum within five (5) business days after Termination of the Plan pursuant to subsection (A) above.

**11.2 Amendment.**

- (a) Any Employer may, at any time, amend or modify the Plan in whole or in part with respect to that Employer by the action of its board of directors; provided, however, that: (i) no amendment or modification shall be effective to decrease or restrict the value of a Participant's vested Account Balance in existence at the time the amendment or modification is made, calculated as if the Participant had experienced a Termination of Employment as of the effective date of the amendment or modification or, if the amendment or modification occurs after the date upon which the Participant was eligible to Retire, the Participant had Retired as of the effective date of the amendment or modification, and (ii) no amendment or modification of this Section 11.2 or Section 12.2 of the Plan shall be effective. The amendment or modification of the Plan shall not affect any Participant or Beneficiary who has become entitled to the payment of benefits under the Plan as of the date of the amendment or modification.
- (b) Notwithstanding any provision of the Plan to the contrary, in the event that the Company determines that any provision of the Plan may cause amounts deferred under the Plan to become immediately taxable to any Participant under Code Section 409A, and related Treasury guidance or Regulations, the Company may (i) adopt such amendments to the Plan and appropriate policies and procedures, including amendments and policies with retroactive effect, that the Company determines necessary or appropriate to preserve the intended tax treatment of the Plan benefits provided by the Plan and/or (ii) take such other actions as the Company determines necessary or appropriate to comply with the requirements of Code Section 409A, and related Treasury guidance or Regulations.

- 11.3 Effect of Payment.** The full payment of the applicable benefit under Articles 4, 5, 6, 7 or 8 of the Plan shall completely discharge all obligations to a Participant and his or her designated Beneficiaries under this Plan and the Participant's participation in the Plan shall terminate.

**ARTICLE 12**  
**Administration**

- 12.1 **Committee Duties.** Except as otherwise provided in this Article 12, this Plan shall be administered by a Committee which shall consist of the members of the Payless ShoeSource, Inc. 401(k) Profit Sharing Plan Committee, or such other committee as the Board shall appoint. Members of the Committee may be Participants in this Plan. The Committee shall also have the discretion and authority to (i) make, amend, interpret, and enforce all appropriate rules and regulations for the administration of this Plan and (ii) decide or resolve any and all questions including interpretations of this Plan, as may arise in connection with the Plan. Any individual serving on the Committee who is a Participant shall not vote or act on any matter relating solely to himself or herself. When making a determination or calculation, the Committee shall be entitled to rely on information furnished by a Participant or the Company.
- 12.2 **Administration Upon Change In Control.** For purposes of this Plan, the Committee shall be the “Administrator” at all times prior to the occurrence of a Change in Control. Upon and after the occurrence of a Change in Control, the “Administrator” shall be the Trustee appointed under the Trust. The Administrator shall have the discretionary power to determine all questions arising in connection with the administration of the Plan and the interpretation of the Plan and Trust including, but not limited to benefit entitlement determinations and responses to legal inquiries and challenges. Upon and after the occurrence of a Change in Control, the Company must: (i) pay out the Account Balances of all Participants, in a lump sum within five (5) business days after Plan termination pursuant to Section 11.1(A); (ii) pay all reasonable administrative expenses and fees of the Administrator; (iii) indemnify the Administrator against any costs, expenses and liabilities including, without limitation, attorney’s fees and expenses arising in connection with the performance of the Administrator hereunder, except with respect to matters resulting from the gross negligence or willful misconduct of the Administrator or its employees or agents; and (iv) supply full and timely information to the Administrator on all matters relating to the Plan, the Trust, the Participants and their Beneficiaries, the Account Balances of the Participants, the date of circumstances of the Retirement, Disability, death or Termination of Employment of the Participants, and such other pertinent information as the Administrator may reasonably require. Upon and after a Change in Control, the Administrator may be terminated (and a replacement appointed) by the Company only with the written consent of a majority of the Participants.
- 12.3 **Agents.** In the administration of this Plan, the Committee may, from time to time, employ agents and delegate to them such administrative duties as it sees fit (including acting through a duly appointed representative) and may from time to time consult with counsel who may be counsel to any Employer.
- 12.4 **Binding Effect of Decisions.** The decision or action of the Administrator with respect to any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
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- 12.5 **Indemnity of Committee.** All Employers shall indemnify and hold harmless the members of the Committee, and any Employee to whom the duties of the Committee may be delegated, and the Administrator against any and all claims, losses, damages, expenses or liabilities arising from any action or failure to act with respect to this Plan, except in the case of willful misconduct by the Committee, any of its members, any such Employee or the Administrator.
- 12.6 **Employer Information.** To enable the Committee and/or Administrator to perform its functions, the Company and each Employer shall supply full and timely information to the Committee and/or Administrator, as the case may be, on all matters relating to the compensation of its Participants, the date and circumstances of the Retirement, Disability, death or Termination of Employment of its Participants, and such other pertinent information as the Committee or Administrator may reasonably require.

**ARTICLE 12**  
**Other Benefits and Agreements**

- 13.1 **Coordination with Other Benefits**. The benefits provided for a Participant and Participant' s Beneficiary under the Plan are in addition to any other benefits available to such Participant under any other plan or program for employees of the Participant' s Employer. The Plan shall supplement and shall not supersede, modify or amend any other such plan or program except as may otherwise be expressly provided.
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**ARTICLE 14**  
**Claims Procedures**

14.1 **Presentation of Claim.** Any Participant or Beneficiary of a deceased Participant (such Participant or Beneficiary being referred to below as a "Claimant"), or his or her duly authorized representative, may deliver to the Committee a written claim for a determination with respect to the amounts distributable to such Claimant from the Plan. If such a claim relates to the contents of a notice received by the Claimant, the claim must be made within 60 days after such notice was received by the Claimant. All other claims must be made within 180 days of the date on which the event that caused the claim to arise occurred. The claim must state with particularity the determination desired by the Claimant.

14.2 **Notification of Decision.** Upon receipt of a claim, the Committee shall advise the Claimant that a reply will be forthcoming within a reasonable period of time, but ordinarily not later than 90 days, and shall, in fact, deliver such reply within such period. However, the Committee may extend the reply period for an additional ninety days for reasonable cause. If the reply period will be extended, the Committee shall advise the Claimant in writing during the initial 90-day period indicating the special circumstances requiring an extension and the date by which the Committee expects to render the benefit determination. The Committee shall notify the Claimant in writing:

- (a) that the Claimant's requested determination has been made, and that the claim has been allowed in full; or
- (b) that the Committee has reached a conclusion contrary, in whole or in part, to the Claimant's requested determination, and such notice must set forth in a manner calculated to be understood by the Claimant:
  - (i) the specific reason(s) for the denial of the claim, or any part of it;
  - (ii) specific reference(s) to pertinent provisions of the Plan upon which such denial was based;
  - (iii) a description of any additional material or information necessary for the Claimant to perfect the claim, and an explanation of why such material or information is necessary;
  - (iv) appropriate information as to the steps to be taken if the Claimant wishes to submit the claim for review, including a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following an adverse benefit determination on review; and
  - (v) the time limits for requesting a review of the denial under Section 14.3 hereof and for the actual review of the denial under Section 14.4.



- Review of a Denied Claim.** Within 60 days after receiving a notice from the Committee that a claim has been denied, in whole or in part, a Claimant (or the Claimant's duly authorized representative) may file with the Committee a written request for a review of the denial of the claim. The Claimant or his or her duly authorized representative may submit written comments, documents, records or other information relating to the denied claim, which such information shall be considered in the review under this subsection without regard to whether such information was submitted or considered in the initial benefit determination. The Claimant or his or her duly authorized representative shall be provided, upon request and free of charge, reasonable access to, and copies of, all non-privileged documents, records and other information which (i) was relied upon by the Committee in making its initial claims decision, (ii) was submitted, considered or generated in the course of the Committee making its initial claims decision, without regard to whether such information was actually relied upon by the Committee in making its decision or (iii) demonstrates compliance by the Committee with its administrative processes and safeguards designed to ensure and to verify that benefit claims determinations are made in accordance with governing Plan documents and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants. If the Claimant does not request a review of the Committee's determination within such 60-day period, he or she shall be barred and estopped from challenging such determination.
- (a)

- Decision on Review.** Within a reasonable period of time, ordinarily not later than 60 days, after the Committee's receipt of a request for review, the Committee will review its prior determination. If special circumstances require that the 60-day time period be extended, the Committee will so notify the Claimant within the initial 60-day period indicating the special circumstances requiring an extension and the date by which the Committee expects to render its decision on review, which shall be as soon as possible but not later than 120 days after receipt of the request for review. In the event that the Committee extends the determination period on review due to a Claimant's failure to submit information necessary to decide a claim, the period for making the benefit determination on review shall not take into account the period beginning on the date on which notification of extension is sent to the Claimant and ending on the date on which the Claimant responds to the request for additional information. The Committee has discretionary authority to determine a Claimant's eligibility for benefits and to interpret the terms of the Plan. Benefits under the Plan will be paid only if the Committee decides in its discretion that the Claimant is entitled to such benefits. The decision of the Committee shall be final and non-reviewable, unless found to be arbitrary and capricious by a court of competent review. Such decision will be binding upon the Employer and the Claimant. If the Committee makes an adverse benefit determination on review, the Committee will render a written opinion, using language calculated to be understood by the Claimant, setting forth:
- 14.4
- (a) specific reasons for the decision;
- (b) specific reference(s) to the pertinent Plan provisions upon which the decision was based;
- (c) a statement that the Claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all non-privileged documents, records and
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other information which (i) was relied upon by the Committee in making its decision, (ii) was submitted, considered or generated in the course of the Committee making its decision, without regard to whether such information was actually relied upon by the Committee in making its decision or (iii) demonstrates compliance by the Committee with its administrative processes and safeguards designed to ensure and to verify that benefit claims determinations are made in accordance with governing Plan documents, and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants; and

- (d) a statement of the Claimant's right to bring a civil action under Section 502(a) of ERISA following the adverse benefit determination on such review.

#### **14.5 Special Disability Provisions.**

Notwithstanding anything herein, if a Claimant is denied a benefit because he or she is determined not to be Disabled (other than any such determination by the Social Security Administration or in accordance with any disability insurance program of the Claimant's Employer) and he or she makes a claim pursuant to such denial, the provisions of this Section 14.5 shall apply. Upon receipt of a claim, the reply period shall be forty-five (45) days. If, prior to the end of such 45-day period, the Committee determines that, due to matters beyond the control of the Plan, a decision cannot be rendered, the period for making the determination may be extended for up to thirty (30) days, and the Committee shall notify the Claimant, prior to the expiration of such 45-day period, of the circumstances requiring an extension and the date by which the Plan expects to render a decision. If, prior to the end of the first 30-day extension period, the Committee determines that, due to matters beyond the control of the Plan, a decision cannot be rendered within that extension period, the period for making the determination may be extended for up to an additional thirty (30) days, and the Committee shall notify the Claimant, prior to the expiration of the first 30-day extension period, of the circumstances requiring the extension and the date by which the Plan expects to render a decision. In the case of any extension described in this paragraph, the notice of extension shall specifically explain the standards on which entitlement to a benefit is based, the unresolved issues that prevent a decision on the claim and the additional information needed to resolve those issues, and the Claimant shall be afforded forty-five (45) days within which to provide the specified information. If information is requested, the period for making the benefit determination shall be tolled from the date on which notification of an extension is sent to the Claimant until the date on which the Claimant responds to the request for information.

- (a)
- (b) Within one hundred eighty (180) days after receiving the written notice of an adverse disposition of the claim, the Claimant may request in writing, and shall be entitled to, a review of the benefit determination. In deciding an appeal of any adverse benefit determination that is based in whole or in part on a medical judgment, the Plan shall consult with a health care professional who has appropriate training and experience in the field of medicine involved in the medical

judgment. Such health care professional shall be an individual who is neither an individual who was consulted in connection with the adverse benefit determination that is the subject of the appeal nor the subordinate of any such individual. The medical or vocational experts whose advice was obtained on behalf of the Plan in connection with the Claimant's adverse benefit determination will be identified to the Claimant. If the Claimant does not request a review within one hundred eighty (180) days after receiving written notice of the original's disposition of the claim, the Claimant shall be deemed to have accepted the original written disposition.

- (c) A decision on review shall be rendered in writing by the Plan within a reasonable period of time, but ordinarily not later than forty-five (45) days after receipt of the Claimant's request for review by the Plan, unless the Plan determines that special circumstances require an extension of time for processing the claim. If the Plan determines that an extension of time for processing is required, written notice of the extension shall be furnished to the Claimant prior to the termination of the initial forty-five (45) period. In no event shall such extension exceed a period of forty-five (45) days from the end of the initial period. The extension notice shall indicate the special circumstances requiring an extension of time and the date by which the Plan expects to render the determination on review. In the event the extension is due to a Claimant's failure to submit information necessary to decide the claim, the Claimant shall be afforded forty-five (45) days within which to provide the specified information, and the period for making the benefit determination on review shall be tolled from the date on which notification of the extension is sent to the Claimant until the date on which the Claimant responds to the request for additional information.

- (d) In the case of an adverse benefit determination on review, in addition to the information described above, the notice shall state: "You and your Plan may have other voluntary alternative dispute resolution options, such as mediation. One way to find out what may be available is to contact your local U.S. Department of Labor Office and your State insurance regulatory agency."

- 14.6 **Legal Action.** A Claimant's compliance with the foregoing provisions of this Article 14 is a mandatory prerequisite to a Claimant's right to commence any legal action with respect to any claim for benefits under this Plan.
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## ARTICLE 15

### Trust

- Establishment of the Trust.** The Company shall establish the Trust, and each Employer shall at least annually transfer over to the Trust such assets as the Employer determines, in its sole discretion, are necessary to provide, on a present value basis, for its respective future
- 15.1 liabilities created with respect to the Annual Deferral Amounts, Company Contribution Amounts and Company Matching Amounts for such Employer' s Participants for all periods prior to the transfer, as well as any debits and credits to the Participants' Account Balances for all periods prior to the transfer, taking into consideration the value of the assets in the trust at the time of the transfer.
- Interrelationship of the Plan and the Trust.** The provisions of the Plan shall govern the rights of a Participant to receive distributions
- 15.2 pursuant to the Plan. The provisions of the Trust shall govern the rights of the Employers, Participants and the creditors of the Employers to the assets transferred to the Trust. Each Employer shall at all times remain liable to carry out its obligations under the Plan.
- Distributions From the Trust.** Each Employer' s obligations under the Plan may be satisfied with Trust assets distributed pursuant to
- 15.3 the terms of the Trust, and any such distribution shall reduce the Employer' s obligations under this Plan.
- Stock Transferred to the Trust.** Subject to the shareholders of the Company approving the use of Stock under the Plan,
- 15.4 notwithstanding any other provision of this Plan or the Trust, if Trust assets are distributed to a Participant in a distribution which reduces such portion of the Participant' s Variable Account invested in the Stock Fund, such distribution must be made in the form of Stock.

## **ARTICLE 16**

### **Miscellaneous**

**Status of Plan.** The Plan is intended to be a plan that is not qualified within the meaning of Code Section 401(a) and that is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees within the meaning of ERISA Sections 201(2), 301(a)(3) and 401(a)(1). The Plan shall be administered and interpreted to the extent possible (i) in a manner consistent with that intent, and (ii) in accordance with Code Section 409A and related Treasury guidance and Regulations.

**16.1** **Unsecured General Creditor.** Participants and their Beneficiaries, heirs, successors and assigns shall have no legal or equitable rights, interests or claims in any property or assets of an Employer. For purposes of the payment of benefits under this Plan, any and all of an Employer's assets shall be, and remain, the general, unpledged unrestricted assets of the Employer. An Employer's obligation under the Plan shall be merely that of an unfunded and unsecured promise to pay money in the future.

**16.2** **Employer's Liability.** An Employer's liability for the payment of benefits shall be defined only by the Plan. An Employer shall have no obligation to a Participant under the Plan except as expressly provided in the Plan.

**16.3** **Nonassignability.** Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, transfer, hypothecate, alienate or convey in advance of actual receipt, the amounts, if any, payable hereunder, or any part thereof, which are, and all rights to which are expressly declared to be, unassignable and non-transferable. No part of the amounts payable shall, prior to actual payment, be subject to seizure, attachment, garnishment or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency or be transferable to a spouse as a result of a property settlement or otherwise. Notwithstanding the foregoing, all or part of the amounts payable hereunder to a Participant may be paid to an individual other than the Participant to the extent necessary to fulfill, and in accordance with the terms of, a domestic relations order as defined in Code Section 414(p)(1)(B).

**16.4** **Not a Contract of Employment.** The terms and conditions of this Plan shall not be deemed to constitute a contract of employment between any Employer and the Participant. Such employment is hereby acknowledged to be an "at will" employment relationship that can be terminated at any time for any reason, or no reason, with or without cause, and with or without notice, unless expressly provided in a written employment agreement. Nothing in this Plan shall be deemed to give a Participant the right to be retained in the service of any Employer, either as an Employee or a director, or to interfere with the right of any Employer to discipline or discharge the Participant at any time.

**16.5** **Furnishing Information.** A Participant or his or her Beneficiary will cooperate with the Committee by furnishing any and all information requested by the Committee and take such other actions as may be requested in order to facilitate the administration of the Plan

**16.6**

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and the payments of benefits hereunder, including but not limited to taking such physical examinations as the Committee may deem necessary.

**16.7** **Terms.** Whenever any words are used herein in the masculine, they shall be construed as though they were in the feminine in all cases where they would so apply; and whenever any words are used herein in the singular or in the plural, they shall be construed as though they were used in the plural or the singular, as the case may be, in all cases where they would so apply.

**16.8** **Captions.** The captions of the articles, sections and paragraphs of this Plan are for convenience only and shall not control or affect the meaning or construction of any of its provisions.

**16.9** **Governing Law.** Subject to ERISA, the provisions of this Plan shall be construed and interpreted according to the internal laws of the State of Kansas without regard to its conflicts of laws principles.

**16.10** **Notice.** Any notice or filing required or permitted to be given to the Committee under this Plan shall be sufficient if in writing and hand-delivered, or sent by registered or certified mail, to the address below:

Collective Brands, Inc.  
3231 SE Sixth Street  
Topeka, KS 66607-2207

Such notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of the date shown on the postmark on the receipt for registration or certification.

Any notice or filing required or permitted to be given to a Participant under this Plan shall be sufficient if in writing and hand-delivered, or sent by mail, to the last known address of the Participant.

**16.11** **Successors.** The provisions of this Plan shall bind and inure to the benefit of the Participant's Employer and its successors and assigns and the Participant and the Participant's designated Beneficiaries.

**16.12** **Validity.** In case any provision of this Plan shall be illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining parts hereof, but this Plan shall be construed and enforced as if such illegal or invalid provision had never been inserted herein.

**16.13** **Incompetent.** If the Committee determines in its discretion that a benefit under this Plan is to be paid to a minor, a person declared incompetent or to a person incapable of handling the disposition of that person's property, the Committee may direct payment of such benefit to the guardian, legal representative or person having the care and custody of such minor, incompetent or incapable person. The Committee may require proof of minority, incompetence, incapacity or guardianship, as it may deem appropriate prior to distribution

of the benefit. Any payment of a benefit shall be a payment for the account of the Participant and the Participant's Beneficiary, as the case may be, and shall be a complete discharge of any liability under the Plan for such payment amount.

**Court Order.** If a court determines that a spouse, former spouse, child or dependent of a Participant has an interest in the Participant's benefits under the Plan in connection with a property settlement or otherwise, the Committee, in its sole discretion, shall have the right, **16.14** notwithstanding any election made by a Participant, to distribute the spouse's, former spouse's, child's or dependent's interest in the Participant's benefits under the Plan to that spouse, former spouse, child or dependent to the extent necessary to fulfill, and in accordance with the terms of, a domestic relations order as defined in Code Section 414(p)(1)(B).

**Distribution in the Event of Income Inclusion Under 409A.** If any portion of a Participant's Account Balance under this Plan is required to be included in income by the Participant prior to receipt due to a failure of this Plan to meet the requirements of Code Section 409A and related Treasury guidance and Regulations, the Committee may, in its sole discretion, provide for a distribution of that portion of his or her Account Balance that is required to be included in his or her income. In such event, the Participant's **16.15** Employer shall distribute to the Participant immediately available funds in an amount equal to the portion of his or Account Balance required to be included in income as a result of the failure of the Plan to meet the requirements of Code Section 409A and related Treasury guidance or Regulations, which amount shall not exceed the Participant's unpaid vested Account Balance under the Plan. Such a distribution shall affect and reduce the Participant's benefits to be paid under this Plan.

**Insurance.** The Employers, on their own behalf or on behalf of the trustee of the Trust, and in their sole discretion, may apply for and procure insurance on the life of the Participant, in such amounts and in such forms as the Trust may choose. The Employers or the Trust, as the case may be, shall be the sole owner and beneficiary of any such insurance. The Participant shall have no interest **16.16** whatsoever in any such policy or policies, and at the request of the Employers shall submit to medical examinations and supply such information and execute such documents as may be required by the insurance company or companies to whom the Employers have applied for insurance.

**Trust.** If the Trust terminates and benefits are distributed from the Trust to a Participant, the Participant's benefits under this Plan shall **16.17** be reduced to the extent of such distributions.

**Legal Fees To Enforce Rights After Change in Control.** The Company and each Employer is aware that upon the occurrence of a Change in Control, the Board or the board of directors of a Participant's Employer (which might then be composed of new members) or a shareholder of the Company or the Participant's Employer, or of any successor corporation might then cause or attempt to cause **16.18** the Company, the Participant's Employer or such successor to refuse to comply with its obligations under the Plan and might cause or attempt to cause the Company or the Participant's Employer to institute, or may institute, litigation seeking to deny Participants the benefits intended under the Plan. In these circumstances, the purpose of the Plan could be frustrated. Accordingly, if, following a Change in Control, it should appear to any Participant that the Company, the

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Collective Brands, Inc. Deferred Compensation Plan

Participant's Employer or any successor corporation has failed to comply with any of its obligations under the Plan or any agreement thereunder or, if the Company, such Employer or any other person takes any action to declare the Plan void or unenforceable or institutes any litigation or other legal action designed to deny, diminish or to recover from any Participant the benefits intended to be provided, then the Company and the Participant's Employer irrevocably authorize such Participant to retain counsel of his or her choice at the expense of the Company and the Participant's Employer (who shall be jointly and severally liable) to represent such Participant in connection with the initiation or defense of any litigation or other legal action, whether by or against the Company, the Participant's Employer or any director, officer, shareholder or other person affiliated with the Company, the Participant's Employer or any successor thereto in any jurisdiction.

**SIGNATURE ON FOLLOWING PAGE**

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IN WITNESS WHEREOF, the Company has signed this amended and restated Plan document effective as of January 1, 2008.

Collective Brands, Inc., a Delaware corporation

By: \_\_\_\_\_

Title: Senior Vice President, Human Resources



**COLLECTIVE BRANDS, INC.  
INCENTIVE COMPENSATION PLAN**

**SECTION 1. PURPOSES:** The purposes of the Collective Brands, Inc. Incentive Compensation Plan are (i) to provide a means to attract, retain, and motivate talented personnel and (ii) to provide to participating employees added incentive for high levels of performance and for additional effort to improve the Company's financial performance.

**SECTION 2. DEFINITIONS:** As used in this Plan, unless the context otherwise requires, each of the following terms shall have the meaning set forth below.

- (a) "Annual Award" shall mean, for any Plan Year, a payment made to an Annual Award Participant under the terms of this Plan.
- (b) "Annual Award Maximum Amount" shall mean \$5,000,000.
- (c) "Annual Award Participant" shall mean an Eligible Employee selected by the Committee to participate in the Plan pursuant to Section 5.
- (d) "Board of Directors" or "Board" shall mean the Board of Directors of the Company.
- (e) "CEO" shall mean the Chief Executive Officer of the Company.
- (f) "Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, and any references to a particular section of the Code shall be deemed to include any successor provision thereto.
- (g) "Committee" shall mean a committee or subcommittee of the Board of Directors, which shall consist solely of two or more "outside directors" within the meaning of Section 162(m) of the Code.
- (h) "Company" shall mean Collective Brands, Inc., a Delaware corporation (formerly Payless ShoeSource, Inc.).
- (i) "Covered Employee" shall mean the CEO and each other executive of the Company or a Subsidiary whom the Committee determines, in its discretion, is or may be a "covered employee" within the meaning of Section 162(m) of the Code for a Plan Year or Plan Period to which an Annual Award or Long-Term Award, as the case may be, relates.
- (j) "Eligible Employee" shall mean any officers or other key employees of the Company or any Company Subsidiary, as determined by the Committee in its sole discretion.
- (k) "Long-Term Award" shall mean, for any Plan Period, a payment made to a Long-

Term Award Participant under the terms of this Plan.

- (l) “Long-Term Award Maximum Amount” shall mean \$5,000,000.
- (m) “Long-Term Award Participant” shall mean an Eligible Employee selected by the Committee to participate in the Plan pursuant to Section 6.
- (n) “Performance Goal(s)” shall mean the goal or goals established for an Annual Award Participant or a Long-Term Award Participant for a Plan Year or Plan Period, as the case may be, by the Committee pursuant to Section 5 or Section 6, as applicable.

“Performance Measures” shall mean any of the following performance criteria, either alone or in any combination, and may be expressed with respect to the Company or one or more operating units, groups, or any Subsidiary, as the Committee may determine: cash flow; cash flow from operations; total earnings; earnings per share, diluted or basic; earnings per share from continuing operations, diluted or basic; earnings before interest and taxes; earnings before interest, taxes, depreciation, and amortization; earnings from continuing operations; net asset turnover; inventory turnover; net earnings; operating earnings; operating margin; return on equity; return on net assets; return on total assets; return on capital; return on investment; return on sales; revenues; sales; market share; economic value added; expense reduction levels; stock price; and total shareholder return. For any Plan Year or Plan Period, Performance Measures may be determined on an absolute basis or relative to internal goals or relative to levels attained in a year or years prior to such Plan Year or Plan Period or related to other companies or indices or as ratios expressing relationships between two or more Performance Measures. For any Plan Year or Plan Period, the Committee shall provide how any Performance Measure shall be adjusted to the extent necessary to prevent dilution or enlargement of any Annual Award or Long-Term Award as a result of extraordinary events or circumstances, as determined by the Committee, or to exclude the effects of extraordinary, unusual, or non-recurring items; changes in applicable laws, regulations, or accounting principles; currency fluctuations; discontinued operations; non-cash items, such as amortization, depreciation, or reserves; or any recapitalization, restructuring, reorganization, merger, acquisition, divestiture, consolidation, spin-off, split-up, combination, liquidation, dissolution, sale of assets, or other similar corporate transaction, or stock dividends, or stock splits or combinations; provided, however, in the case of a Covered Employee, no such adjustment will be made if the effect of such adjustment would cause the Annual Award or Long-Term Award to a Covered Employee to fail to qualify as “qualified performance-based compensation” within the meaning of Section 162(m) of the Code.
- (o)
- (p) “Plan” shall mean the Collective Brands, Inc. Incentive Compensation Plan, as amended and restated from time to time.

- (q) “Plan Period” shall mean a period of one fiscal year or longer, as determined by the Committee in its sole discretion.
- (r) “Plan Year” shall mean a period of one fiscal year or such shorter period, as determined by the Committee in its sole discretion.
- (s) “Subsidiary” shall mean any corporation, the majority of the outstanding voting stock of which is owned, directly or indirectly, by the Company, and that is not itself a publicly held corporation within the meaning of Section 162(m) of the Code.

**SECTION 3. ADMINISTRATION:** Subject to the express provisions of this Plan, the Committee shall have authority to interpret the Plan, to prescribe, amend, and rescind rules and regulations relating to the Plan, and to make all other determinations deemed necessary or advisable for the administration of the Plan. In exercising its discretion, the Committee may use such objective or subjective factors as it determines to be appropriate in its sole discretion. Except to the extent not permitted for qualification as “qualified performance-based compensation” within the meaning of Section 162(m) of the Code or generally prohibited by applicable law, the Committee may delegate all or a portion of its responsibilities and powers to any one or more of its members or to any other person or persons selected by the Committee. Any such delegation may be revoked by the Committee at any time. The determinations of the Committee pursuant to its authority under the Plan shall be conclusive and binding.

**SECTION 4. ELIGIBILITY:** The Committee shall designate which Eligible Employees will be Annual Award Participants or Long-Term Award Participants in the Plan for a particular Plan Year or Plan Period, as the case may be. Such designation for any Plan Year or Plan Period shall not require designation of such Eligible Employee as an Annual Award Participant or Long-Term Award Participant for any other Plan Year or Plan Period.

**SECTION 5. ANNUAL AWARDS:**

- (a) The Committee may make Annual Awards to Annual Award Participants with respect to each Plan Year, subject to the terms and conditions set forth in the Plan.
- (b) Within 90 days after the commencement of each Plan Year (or such other date as required by Section 162(m) of the Code and the regulations promulgated thereunder), the Committee shall, in writing, select which Eligible Employees will be Annual Award Participants for such Plan Year and determine for each such Plan Year the following:
  - (i) The Performance Goal or Performance Goals applicable to each Annual Award Participant for the Plan Year based on one or more Performance Measures; and

- (ii) The payment schedule detailing the total amount which may be available for payment to each Annual Award Participant as an Annual Award based upon the relative level of attainment of the Performance Goal or Performance Goals.
- (c) Upon completion of a Plan Year, the Committee shall:
  - (i) Certify, in writing, prior to payment of any Annual Award, whether and to what extent the Performance Goal or Performance Goals for the Plan Year were satisfied;
  - (ii) Determine the amount available for each Annual Award Participant's Annual Award pursuant to the payment schedule established in Section 5(b)(ii);  
  
Determine any increase or reduction in the amount of an Annual Award Participant's available Annual Award, as determined pursuant to Section 5(c)(ii), (including a reduction to zero) based on any subjective or objective factors that it determines to be appropriate in its sole discretion; provided, however, in the case of a Covered Employee, the Committee may reduce (including a reduction to zero) but may not increase the amount of an available Annual Award; and provided further that the exercise of such discretion to reduce an Annual Award with respect to any Annual Award Participant shall not have the effect of increasing an Annual Award that is payable to a Covered Employee; and
  - (iv) Authorize payment subject to Section 7 of such amounts determined under Section 5(c)(iii).
- (d) Notwithstanding any other provision of this Plan, in no event shall the Annual Award earned by any Covered Employee for a Plan Year exceed the Annual Award Maximum Amount.

#### **SECTION 6. LONG-TERM AWARDS:**

- (a) The Committee may make Long-Term Awards to Long-Term Award Participants with respect to each Plan Period, subject to the terms and conditions set forth in the Plan.  
  
Within 90 days after the commencement of each Plan Period (or such other date as required by Section 162(m) of the Code and the regulations promulgated thereunder), the Committee shall, in writing, select the length of such Plan Period, select which Eligible Employees will be Long-Term Award Participants for such Plan Period, and determine for each such Plan Period the following:
- (b)

- (i) The Performance Goal or Performance Goals applicable to each Long-Term Award Participant for the Plan Period based on one or more Performance Measures; and
  - (ii) The payment schedule detailing the total amount which may be available for payment to each Long-Term Award Participant as a Long-Term Award based upon the relative level of attainment of the Performance Goal or Performance Goals.
- (c) Upon completion of a Plan Period, the Committee shall:
- (i) Certify, in writing, prior to payment of any Long-Term Award, whether and to what extent the Performance Goal or Performance Goals for the Plan Period were satisfied;
  - (ii) Determine the amount available for each Long-Term Award Participant's Long-Term Award pursuant to the payment schedule established in Section 6(b)(ii);  
  
Determine any increase or reduction in the amount of a Long-Term Award Participant's available Long-Term Award, as determined pursuant to Section 6(c)(ii), (including a reduction to zero) based on any subjective or objective factors that it determines to be appropriate in its sole discretion; provided, however, in the case of a Covered Employee, the Committee may reduce (including a reduction to zero) but may not increase the amount of an available Long-Term Award; and provided further that the exercise of such discretion to reduce a Long-Term Award with respect to any Long-Term Award Participant shall not have the effect of increasing a Long-Term Award that is payable to a Covered Employee; and
  - (iv) Authorize payment subject to Section 7 of such amounts determined under Section 6(c)(iii).
- (d) Notwithstanding any other provision of this Plan, in no event shall the Long-Term Award earned by any Covered Employee for a Plan Period exceed the Long-Term Award Maximum Amount.

**SECTION 7. PAYMENT OF AWARDS:** Annual Awards and Long-Term Awards under this Plan shall be made in a lump sum payment in cash to the Annual Award Participant or Long-Term Award Participant, as the case may be, or to the beneficiary, as designated under procedures established by the Committee, of such Annual Award Participant or Long-Term Award Participant as soon as practicable following the Plan Year or Plan Period, as the case may be, or shall be deferred under such plan as the Company may have established for such purposes. Unless provided otherwise in an employment agreement, severance agreement or other written agreement between the Company and an Annual Award Participant or Long-Term Award Participant, as the case may be, no Annual Award or Long-Term Award shall be paid to any

Annual Award Participant or Long-Term Award Participant under this Plan unless such Annual Award Participant or Long-Term Award Participant is employed by the Company or a Subsidiary on the last day of the Plan Year or Plan Period, as the case may be, for which such Annual Award or Long-Term Award is payable. The Company may deduct from any Annual Award payment or Long-Term Award payment such amounts as may be required to be withheld under any federal, state, or local tax laws.

**SECTION 8. NO CONTINUED EMPLOYMENT:** Nothing in this Plan shall give any person any right to continue in the employ of the Company or any Company Subsidiary or constitute a contract or agreement of employment or interfere in any way with the right of the Company or any Company Subsidiary to terminate or change the conditions of employment.

**SECTION 9. NONASSIGNABILITY:** Except as otherwise required by applicable law, any rights of an Annual Award Participant or Long-Term Award Participant or a beneficiary of an Annual Award Participant or Long-Term Award Participant under this Plan shall not be anticipated, sold, assigned, transferred, encumbered, hypothecated, or pledged nor subject to any levy or charge and shall not be subject in any manner to the claims of any creditor of an Annual Award Participant or Long-Term Award Participant or a beneficiary of an Annual Award Participant or Long-Term Award Participant; and any attempt to take such action shall be null and void.

**SECTION 10. TERMINATION AND AMENDMENT:** Subject to the approval of the Board, where required, the Committee may at any time and from time to time alter, amend, suspend, or terminate the Plan in whole or in part; provided, however, that no amendment which requires shareholder approval in order for the Plan to continue to comply with Section 162(m) of the Code with respect to a Covered Employee shall be effective unless such amendment is approved by the shareholders of the Company. Notwithstanding the foregoing, no termination or amendment of the Plan may, without the consent of an Annual Award Participant or Long-Term Award Participant to whom an Annual Award or Long-Term Award, as the case may be, has been determined for a completed Plan Year or Plan Period, as the case may be, but not yet paid, adversely affect the rights of such Annual Award Participant or Long-Term Award Participant in such Annual Award or Long-Term Award.

**SECTION 11. INTERPRETATION:** Except in connection with a change in control of the Company, as determined by the Committee in its sole discretion, it is the intent of the Company that Annual Awards and Long-Term Awards made to Covered Employees shall constitute “qualified performance-based compensation” satisfying the requirements of Section 162(m) of the Code. Accordingly, the provisions of the Plan shall be interpreted in a manner consistent with Section 162(m) of the Code. If any other provision of the Plan, an Annual Award, or a Long-Term Award is intended to but does not comply or is inconsistent with the requirements of Section 162(m) of the Code, such provision shall be construed or deemed amended to the extent necessary to conform to and comply with such requirements.

**SECTION 12. UNFUNDED STATUS:** Annual Awards and Long-Term Awards shall be made from the general funds of the Company, and no special or separate fund shall be established or other segregation of assets made to assure payment. No Annual Award Participant



or Long-Term Award Participant or other person shall have under any circumstances any interest in any particular property or assets of the Company.

**SECTION 13. APPLICABLE LAW:** This Plan shall be governed by and construed in accordance with the laws of the State of Kansas, without regard to its principles of conflict of laws.

**SECTION 14. EFFECTIVE DATE:** This Plan was effective as of February 3, 2002, and was amended effective February 4, 2007, subject to stockholder approval on May 24, 2007; provided, however, that no Annual Award or Long-Term Award will be made to a Covered Employee under the Plan unless prior to such payment, the holders of a majority of the shares of the Company' s common stock actually voting on the matter approve this Plan at a meeting of the shareholders of the Company. The Plan was further amended on August 17, 2007 to reflect a change in the Company and Plan name.



**2006 COLLECTIVE BRANDS, INC. STOCK INCENTIVE PLAN**  
**AMENDED AUGUST 17, 2007**

**Section 1: Purpose**

The purpose of the 2006 Collective Brands, Inc. Stock Incentive Plan as amended and restated (the “Plan”) is to promote the interests of Collective Brands, Inc. (the “Company”), its Subsidiaries and stockholders by (i) attracting and retaining individuals eligible to participate in the Plan; (ii) motivating such individuals by providing incentive compensation; and (iii) aligning the interests of such individuals with the interests of the Company’s stockholders.

**Section 2: Definitions**

The following terms, as used in the Plan, shall have the meanings specified below. Other capitalized terms shall have the meanings specified in the Plan.

- a. **“Appreciation Value Award Vehicle”** means an Award type structured to correlate the realization of gains based on absolute Stock price appreciation. May include but not be limited to Options, cash-settled stock appreciation rights and stock-settled stock appreciation rights.
- b. **“Award”** means an award granted pursuant to Section 4.
- c. **“Award Agreement”** means a document described in Section 7 setting forth the terms and conditions applicable to the Award granted to the Participant.
- d. **“Board of Directors”** means the Board of Directors of the Company, as it may be comprised from time to time.
- e. **“Change of Control”** means Change of Control as defined in Section 11.
- f. **“Code”** means the Internal Revenue Code of 1986, and any successor statute, as it or they may be amended from time to time.
- g. **“Committee”** means the Compensation, Nominating & Governance Committee of the Board of Directors or such other committee as may be designated by the Board of Directors from time to time. To the extent that compensation realized in respect of Awards is intended to be “performance based” under Section 162(m) of the Code and the Committee is not comprised solely of individuals who are “outside directors” within the meaning of section 162(m) of the Code, or that any member of one Committee is not a “non-employee director” within the meaning of Rule 16b-3 under the Exchange Act, the Committee may from time to time delegate some or all of its functions under the Plan to a committee or subcommittee composed of members that meet the relevant requirements. The term “Committee” includes only such committee or subcommittee, to the extent of the Committee’s delegation.
- h. **“Company”** means Collective Brands, Inc., a Delaware corporation, and any successor thereto.

- “Confidential Information”** means any and all non-public information pertaining to the Company’s business. Confidential Information includes information disclosed by the Company and its subsidiaries or affiliates to Participants, and information developed or learned by Participants during the course of or as a result of employment with the Company, or one of its subsidiaries. The Confidential Information includes, without limitation, information and documents concerning the Company’s processes; suppliers (including terms, conditions and other business arrangements with suppliers); supplier and customer lists; advertising and marketing plans and strategies; profit margins; seasonal plans, goals, objectives and projections; compilations, analyses and projections regarding the Company and/or its subsidiaries divisions, stores, product segments, product lines, suppliers, sales and expenses; files; trade secrets and patent applications (prior to their being public); salary, staffing and employment information (including information about performance of other employees); and “know-how,” techniques or any technical information not of a published nature relating, for example, to how the Company and its subsidiaries or affiliates conducts its business.
- i. **“Covered Employee”** means a covered employee within the meaning of Code section 162(m)(3).
- k. **“Disability”** means a permanent and total disability which enables the Participant to be eligible for and receive a disability benefit under the Federal Social Security Act.
- l. **“Dividend Equivalent”** means an amount equal to the amount of cash dividends, if any, payable with respect to a share of Stock after the date an Award is granted.
- m. **“Employee”** means any person employed by Collective Brands, Inc. or any of its Subsidiaries and classified as a common law employee. Employee does not include independent contractors or leased employees from third parties.
- n. **“Exchange Act”** means the Securities Exchange Act of 1934, and any successor statute, as it may be amended from time to time.
- o. **“Fair Market Value”** of a Stock (as defined below) means:
- For Awards granted on or after May 25, 2007, the closing price of the Stock on the New York Stock Exchange Composite Transaction Tape on the date in question, (or if the Stock is not then traded on the New York Stock Exchange, the closing price of the Stock on the stock exchange or over-the-counter market on which the Stock is principally trading on such date) or, if no sale of the Stock occurred on such exchange on that day, the closing price of the Stock on the last preceding day when the Stock was sold on such exchange. In the event that no sale of the Stock occurred on such exchange or over the counter market on that day because the exchange was closed, then Fair Market Value shall be the closing price of the Stock on the next day the exchange is open for trading; or
- (i) For Awards granted prior to May 25, 2007, the average of the high and low prices of the Stock on the New York Stock Exchange Composite Transaction
- (ii)

Tape on the date in question, (or if the Stock is not then traded on the New York Stock Exchange, the average of the high and low prices of the Stock on the stock exchange or over-the-counter market on which the Stock is principally trading on such date) or, if no sale of the Stock occurred on such exchange on that day, the average of the high and low prices of the Stock on the last preceding day when the Stock was sold on such exchange. In the event that no sale of the Stock occurred on such exchange or over the counter market on that day because the exchange was closed, then Fair Market Value shall be the average of the high and low prices of the Stock on the next day the exchange is open for trading; or

- (iii) If the Stock is no longer traded on the New York Stock Exchange and if there is no public market for the Stock, "Fair Market Value" shall be determined in good faith by the Committee using other reasonable means.

**"Full Value Award Vehicle"** means an Award type structured to provide equivalent value of a share of Stock based on a ratio of 1:1.

- p. Full Value Award Vehicles may include but not be limited to restricted Stock, Stock Equivalent Units and other Stock Awards such as unrestricted Stock, restricted Stock unit grants and performance based shares.

- q. **"Incentive Stock Option"** means an Option that is intended to qualify as an "incentive stock option" under Section 422 of the Code and which is so designated in the applicable Award Agreement. Under no circumstances shall an Option that is not specifically designated as an Incentive Stock Option be considered an Incentive Stock Option.

- r. **"Insider"** means any person who is subject to Section 16 of the Exchange Act, and any successor statutory provision, as it may be amended from time to time.

- s. **"Non-Qualified Stock Option"** means an Option that is not intended to qualify as an "incentive stock option" under Section 422 of the Code.

- t. **"Option"** means an option granted pursuant to Section 4(a).

- u. **"Participant"** means any Employee who has been granted an Award.

- v. **"Performance Goal"** means with respect to the Performance Measure(s) selected by the Committee, the goal or goals established by the Committee, for an Award, for a Performance Period. Performance Goals may vary from Performance Period to Performance Period and from Participant to Participant and may be established on a stand-alone basis, in tandem or in the alternative.

- w. **"Performance Measure"** means one or more of the following, either alone or in combination, selected by the Committee to measure individual Participant, Company or one or more operating units, groups or any Subsidiary performance for a Performance Period, whether in absolute or relative terms: cash flow; cash flow from operations; total earnings; earnings per share, diluted or basic; earnings per share from continuing operations, diluted or basic; earnings before interest and taxes; earnings before interest, taxes, depreciation, and amortization; earnings from continuing operations; net asset turnover; inventory turnover; net earnings; operating

earnings; operating margin; return on equity; return on assets or net assets; return on total assets; return on capital; return on investment; return on investment capital; return on sales; revenues; sales; store for store sales; net or gross sales; income or net income; operating income or net operating income; operating profit or net operating profit; gross margin; operating margin or profit margin; market share; economic value added; expense reduction levels; cost of capital; change in assets; stock price; total shareholder return; capital expenditures; debt; debt reduction; working capital, completion of acquisitions; business expansion; product diversification; productivity; new or expanded market penetration and other financial and non-financial operating and management performance objectives. For any Performance Period, Performance Measures may be determined on an absolute basis or relative to internal goals or relative to levels attained in a year or years prior to such Performance Period or relative to other companies or indices or as ratios expressing relationships between two or more Performance Measures. For any Performance Period, the Committee shall provide how any Performance Measure shall be adjusted to the extent necessary to prevent dilution or enlargement of any Award as a result of extraordinary events or circumstances, as determined by the Committee, or to exclude the effects of extraordinary, unusual, or non-recurring items; changes in applicable laws, regulations, or accounting principles; currency fluctuations; discontinued operations; non-cash items, such as amortization, depreciation, or reserves; or any recapitalization, restructuring, reorganization, merger, acquisition, divestiture, consolidation, spin-off, split-up, combination, liquidation, dissolution, sale of assets, or other similar corporate transaction, or stock dividends, or stock splits or combinations. Unless otherwise specified by the Committee, each such measure shall be determined in accordance with generally accepted accounting principles as consistently applied by the Company. Performance Measures may vary from Performance Period to Performance Period and from Participant to Participant and may be established on a stand-alone basis, in tandem or in the alternative. Other Performance Measures may be used by the Committee in its sole discretion, except that the Performance Measures set forth above in this paragraph v shall be used if the compensation under the Award (other than an Option) is intended to qualify as performance based under Section 162(m) of the Code.

- x. **“Performance Period”** means one or more periods of time (of not less than 364 calendar days), as the Committee may designate, over which the attainment of one or more Performance Goals will be measured for the purpose of determining a Participant’s rights in respect of an Award.
- y. **“Plan”** means the 2006 Collective Brands, Inc. Stock Incentive Plan, as amended from time to time.
- z. **“Retirement”** means a Participant’s termination of employment on or after age 55 and after completing at least five (5) years of service with the Company or a Subsidiary of the Company.
- aa. **“Stock”** means common stock of the Company, \$ .01 par value, or any other equity securities of the Company designated by the Committee, including any attached rights.

- bb. **“Stock Award”** means a grant of Stock or the right to receive Stock or its cash equivalent (or both).
- “Subsidiary”** means (i) any corporation or other entity in which the Company, directly or indirectly, controls fifty percent (50%) or more of the total combined voting power of such corporation or other entity or (ii) any other corporation or other entity in which the Company has a significant equity interest, in either case as determined by the Committee.
- cc. **“Ten-percent Stockholder”** means any person who owns, directly or indirectly, on the relevant date, securities having ten percent (10%) or more of the combined voting power of all classes of the Company’s securities or of its parent or subsidiaries. For purposes of applying the foregoing ten percent (10%) limitation, the rules of Code section 424(d) shall apply.

### **Section 3: Eligibility**

The Committee may grant one or more Awards to any Employee designated by it to receive an Award as the Committee shall select in its sole discretion. To the extent permitted under Delaware law, the Committee may delegate to any Employee or Director of the Company the authority to grant Awards to any Employee; provided, however, any grant to a Covered Employee must satisfy the requirement of Code section 162(m).

### **Section 4: Awards**

The Committee may grant any one or more of the following types of Awards, either singly, in tandem or in combination with other types of Awards:

#### **Appreciation Value Award Vehicles**

- a. **Options.** An Option is a right or rights (either an Incentive Stock Option or a Non-Qualified Stock Option) to purchase a specific number of shares of Stock exercisable at such time or times and subject to such terms and conditions as the Committee may determine in its sole discretion subject to the Plan, including but not limited to the achievement of specific Performance Goals. Options may be settled in cash or stock.
  - (1) Incentive Stock Options shall be subject to the following provisions:
    - The aggregate Fair Market Value (determined on the date that such Option is granted) of the shares of Stock subject to Incentive Stock Options which are exercisable by one person for the first time during a particular calendar year shall not exceed \$100,000. To the extent that the aggregate Fair Market Value (determined at the time of grant) of Stock with respect to which Incentive Stock Options are exercisable for the first time by any Option holder during any calendar year (under all plans of the Company and its Subsidiaries) exceeds \$100,000, or such other limit as may be set by applicable law, the Options or portions thereof which exceed such limit (according to the order in which they were granted) shall be treated as Non-Qualified Stock Options.

- B. Each Award Agreement with respect to an Incentive Stock Option shall set forth the periods during which the Option shall be exercisable, whether in whole or in part. Such periods shall be determined by the Committee in its discretion. No Incentive Stock Option may be exercisable more than:

- (i) in the case of an Employee who is not a Ten-Percent Stockholder on the date that such Option is granted, seven (7) years from the date the Option is granted or such earlier period as otherwise specified in the Plan or an Award Agreement, and
- (ii) in the case of an Employee who is a Ten-Percent Stockholder on the date such Option is granted, five (5) years from the date the Option is granted.

- C. Each Award Agreement with respect to an Incentive Stock Option shall set forth the price at which a share of Stock may be acquired under the Option (the "Exercise Price"), which shall be at least 100% of the Fair Market Value of a share of Stock on the date the option is granted (except as permitted under Section 424(a) of the Code with respect to Acquisition Awards (as defined in Section 4(i)). In the case of an Employee who is a Ten-Percent Stockholder on the date that such Option is granted, the Exercise Price of any Incentive Stock Option shall not be less than 110% of the Fair Market Value of the Stock subject to such Option on such date.

- D. No Incentive Stock Option may be granted to an Employee who is not a Employee of the Company or a Subsidiary (as defined in Section 2(bb) on the date that such Option is granted.

- E. Notwithstanding any other provision of the Plan to the contrary, the maximum aggregate number of shares of Stock that may be issued under the Plan pursuant to Incentive Stock Options is 2 million shares of Stock (the "ISO Limit"), subject to adjustments provided for in Section 10 of the Plan.

- b. **Appreciation Rights.** An Appreciation Right is a right to receive an amount that is based on the increase in the Stock's Fair Market Value after the grant date, and that is payable entirely in cash, entirely in Stock or partly in cash and partly in Stock and exercisable at such time or times and subject to such conditions as the Committee may determine in its sole discretion subject to the Plan, including but not limited to the achievement of specific Performance Goals.

- c. **Other Awards.** Subject to limitations under applicable law, the Committee may from time to time grant other Awards under this Plan, using Appreciation Value Award Vehicles, that provide the Participant with Stock or the right to purchase Stock, or provide other incentive Awards that have a value derived from the value of Stock, or an exercise or conversion privilege at a price related to Stock, or that are otherwise payable in or convertible into shares of Stock. These Awards shall be in a form and based upon the terms and conditions determined by the Committee (including but not limited to the achievement of specific Performance Goals if determined by the



Committee), provided that the Award shall not be inconsistent with the other terms of this Plan.

#### **Full Value Award Vehicles**

- Stock Award.** Stock Awards may include shares with or without restrictions. Restricted Stock is Stock that is issued to a Participant subject to restrictions on transfer and such other restrictions on incidents of ownership, and/or other terms and conditions as the Committee may determine, including but not limited to the achievement of specific Performance Goals. A certificate for the shares of Restricted Stock, which certificate shall be registered in the name of the Participant, shall bear an appropriate restrictive legend and shall be subject to appropriate stop-transfer orders; provided, however, that the certificates representing shares of Restricted Stock shall be held in custody by the Company until the restrictions relating thereto otherwise lapse, and the Participant shall deliver to the Company a stock power endorsed in blank relating to the Restricted Stock or other form as appropriate.
- d.
- Stock Equivalent Units.** A Stock Equivalent Unit is an Award based on the Fair Market Value of one share of Stock. All or part of any Stock Equivalent Units Award may be subject to conditions and restrictions established by the Committee, including but not limited to the achievement of specific Performance Goals. Stock Equivalent Units may be settled in Stock or cash or both as determined by the Committee.
- e.
- Other Awards.** Subject to limitations under applicable law, the Committee may from time to time grant other Full Value Awards under this Plan that provide the Participants with Stock or the right to purchase Stock, or provide other incentive Awards that have a value derived from the value of Stock, or an exercise or conversion privilege at a price related to Stock, or that are otherwise payable in or convertible into shares of Stock. These Awards shall be in a form and based upon the terms and conditions determined by the Committee (including but not limited to the achievement of specific Performance Goals if determined by the Committee), provided that the Award shall not be inconsistent with the other terms of this Plan.
- f.

#### **Other Award Vehicles**

- Performance Units.** A Performance Unit is an Award denominated in cash or shares of Stock, the amount of which may be based on the achievement of specific Performance Goals subject to terms and conditions established by the Committee. The maximum number of Performance Units that may be granted to a single Participant in any one calendar year may not exceed the limits established under Section 6a., Stock Available Under Plan, below. Performance Units may be settled in Stock or cash or both.
- g.

h. **Performance Compensation Awards.**

- The Committee may, at the time of grant of an Award (other than an Option), designate such Award as a Performance Compensation Award in order that such Award constitute qualified performance-based compensation under Code section 162(m). With respect to each such Performance Compensation Award, the Committee shall (on or before the ninetieth (90th) day of the applicable Performance Period), establish, in writing, the Performance Goal or Goals.
- (1)
- (2) A Participant shall be eligible to receive payment in respect of a Performance Compensation Award only to the extent that the Performance Goal(s) for such Award are achieved as certified by the Committee.

- i. **Acquisition Awards.** An Acquisition Award is an Award granted under this Plan in substitution for options, rights, and such other awards with respect to the capital stock of another corporation which is merged into, consolidated with, or all or a substantial portion of the property or stock of which is acquired by, the Company or one of its Subsidiaries.

- j. **Other Awards.** Subject to limitations under applicable law and the Plan, the Committee may from time to time grant other Awards under this Plan that provide the Participants with Stock or the right to purchase Stock, or provide other incentive Awards that have a value derived from the value of Stock, or an exercise or conversion privilege at a price related to Stock, or that are otherwise payable in or convertible into shares of Stock. The Awards shall be in a form and based upon the terms and conditions determined by the Committee (including but not limited to the achievement of specific Performance Goals), provided that the Awards shall not be inconsistent with the other terms of this Plan.

**Section 5: Other General Terms and Conditions for Awards**

The term of an Award shall not exceed seven (7) years.

- a. Unless otherwise provided under the Plan or by the Committee, no Award (or any rights or obligations thereunder) may be sold, exchanged, transferred, assigned, pledged, hypothecated hedged, or otherwise disposed of (other than upon the death of the Participant, by beneficiary designation, by last will and testament or by the laws of descent and distribution) and shall be exercisable and subject to receipt during the Participant's lifetime only by the Participant.

- b. The Award price for each Award that allows for the purchase of a share of Stock under an Award shall be specified in an Award Agreement containing the terms and conditions as determined by the Committee and subject to the provisions of Section 10, shall not be less than Fair Market Value on the date the Award is granted; provided, however, that in no event shall the Award price per share be less than the par value thereof. The Exercise Price, as applicable, of an Award shall not be less than 100% of the Fair Market Value of the Stock on the date such Award is granted and the exercise opportunity may be capped if the Committee determines appropriate and so specifies in the Award Agreement pertaining thereto.

- c. There shall be no grant of an Appreciation Value Award to a Participant in exchange for a Participant's agreement to the cancellation of a higher-priced Appreciation Value Award that was previously granted to such Participant. Re-pricing of Appreciation Value Awards is prohibited.

- d. The Exercise Price, as applicable, of an Award may be paid in cash, personal check (subject to collection), bank draft or such other method as the Committee may determine from time to time. The Exercise Price may also be paid by the tender, by either actual delivery or attestation, of Stock acceptable to the Committee and valued at its Fair Market Value on the date of exercise; through a combination of Stock and cash. Without limiting the foregoing, to the extent permitted by applicable law: the Committee may, on such terms and conditions as it may determine, permit a Participant to elect to pay the Exercise Price by authorizing a third party, pursuant to a brokerage or similar arrangement approved in advance by the Committee, to simultaneously sell all (or a sufficient portion) of the Stock acquired upon exercise of such Award and to remit to the Company a sufficient portion of the proceeds from such sale to pay the entire Exercise Price of such Award and any required tax withholding resulting therefrom.

- e. No Award may be granted under this Plan on or after the tenth anniversary of the date this Plan is approved by stockholders.

- f. The exercise or delivery of Stock or payment of cash pursuant to an Award shall be subject to the condition that if at any time the Company shall determine in its discretion that the satisfaction of withholding tax or other withholding liabilities under any state or Federal law, or that the listing, registration or qualification of any shares of Stock otherwise deliverable upon any securities exchange or under any state or Federal Law, or that the consent or approval of any regulatory body, is necessary or desirable as a condition of, or in connection with, such exercise or the delivery or purchase of shares thereunder, then in any such event such exercise or delivery shall not be effective unless such withholding, listing, registration, qualification, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Company.

- g. Each Participant shall agree that, subject to the provisions of Section 5(i) below,

- (1) no later than the date as of which the restrictions mentioned in the instrument evidencing the Award shall lapse, such Participant will pay to the Company in cash, or, if the Committee approves, in Stock or make other arrangements satisfactory to the Committee regarding payment of, any Federal, state or local taxes of any kind required by law to be withheld with respect to such Award, and

- (2) the Company and its Subsidiaries shall, to the extent permitted by law, have the right to deduct from any payment of any kind otherwise due to the Participant any Federal, state or local taxes of any kind required by law to be withheld with respect to the Award.

- h. If any Participant properly elects, as permitted by Code Section 83b (or any successor Code provisions) within thirty (30) days of the date of the grant, to include in gross income for Federal income tax purposes, an amount equal to the Fair Market Value of the shares of Stock granted pursuant to an Award, such Participant shall pay to the Company, or make arrangements satisfactory to the Committee to pay to the Company, any Federal,

state or local taxes required to be withheld with respect to such shares. If such Participant shall fail to make such payments, the Company and its Subsidiaries shall, to the extent permitted by law, have the right to deduct from any payment of any kind otherwise due to the employee any Federal, state or local taxes of any kind required by law to be withheld with respect to such shares.

Dividends or Dividend Equivalents may be granted with respect to all or part of an Award. If dividends are granted they may be paid, as determined by the Committee (i) in cash, (ii) in Dividend Equivalents or (iii) accumulated or reinvested in Stock and held subject to the same restrictions as the Stock under the Award.

i.

j.

Unless expressly provided otherwise in the Award Agreement (and as provided in Section 4d) no Participant shall have any rights as a stockholder with respect to any Stock covered by an Award until the date the Participant becomes the holder of record thereof.

With respect to each type of Award, the Committee may establish such Performance Goals it deems appropriate, in its sole discretion. For each Award established with Performance Goals, as soon as practicable after the close of each Performance Period, the Committee shall review and certify in writing whether, and to what extent, the Performance Goals(s) for the Performance Period have been achieved and, if so, determine and certify in writing the amount of the Performance Compensation Award earned by the Participant for such Performance Period based upon such Participant's achievement of the Performance Goals. The Committee shall then determine the actual amount of the Performance Compensation Award to be paid to the Participant. In so doing, the Committee may use negative discretion to decrease any Participant Award based upon such performance, but may not increase, the amount of the Award otherwise payable to a Covered Employee based upon such performance. The maximum Performance Compensation Award for any one Participant for any one Performance Period shall be determined in accordance with Sections 4 and 6. If Performance Goals are established for an Award to a Covered Employee, once established for a Performance Period, such Performance Goals shall not be amended or otherwise modified to the extent such amendment or modification would cause the compensation payable pursuant to the Award to fail to constitute qualified performance-based compensation under Code section 162(m).

k.

Unless an Award Agreement specifies otherwise, the Committee may cancel at any time any Award or rescind any prior delivery of shares or value of shares, cash or property, if the Participant is not in compliance with all other applicable provisions of the Award Agreement or the Plan or if, within sixth months or such longer period as specified with respect to the Participant, in any noncompetitiveness entered into between the Participant and the Company, after exercise, as applicable, the Participant:

l.

- (1) engages in a Competing Business, as such term is defined in the Award Agreement; or
- (2) solicits for employment, hires or offers employment to, or discloses information to or otherwise aids or assists any other person or entity other than the Company in soliciting for employment, hiring or offering employment to, any employee of the Company; or

- takes any action which is intended to harm the Company or its reputation, which the Company reasonably concludes could
- (3) harm the Company or its reputation or which the Company reasonably concludes could lead to unwanted or unfavorable publicity to the Company; or
  - (4) discloses to anyone outside of the Company, or uses in other than the Company's business, any Confidential Information.

The Company shall immediately notify the Participant in writing of any cancellation of any unexercised or unvested Award. Following such notice, the Participant shall have no further rights with respect to such Award. In the event of the rescission of the exercise of an Award within six months (or such longer period specified in any agreement between Participant and Company) after the activity referred to above in this Section 5(m), the Company shall notify the Participant in writing. Within ten (10) days after receiving such notice from the Company, the Participant shall either (i) pay to the Company the excess of the Fair Market Value of the Stock on the date of exercise of an Award over the exercise price for the Award or the Fair Market Value of the Stock and/or cash distributed to the Participant as a result of the exercise of an Award or (ii) return the Stock received upon the exercise of an Award (in which case the Company will return the exercise price to the Participant) or return the Stock and/or cash delivered upon the exercise of this Award.

m. The Participant shall agree and consent to a deduction from any amounts the Company owes to the Participant from time to time (including amounts owed as wages or other compensation, fringe benefits, or vacation pay, as well as any other amounts owed to the Participant by the Company), to the extent of the amounts the Participant owes the Company under Section 5(m) above. Whether or not the Company elects to make any set-off in whole or in part, if the Company does not recover by means of set-off the full amount owed by the Participant, calculated as set forth in Section 5(m) above, then the Participant agrees to pay immediately the unpaid balance to the Company.

n. The Committee may establish such other terms and conditions for an Award as it deems appropriate.

o. The Committee may, at any time and in its sole discretion, determine that any outstanding Awards granted under the Plan will be canceled and terminated and that in connection with such cancellation and termination the holder of such Awards may receive for each share of Stock subject to such Award a cash payment (or the delivery of shares of stock, other securities or a combination of cash, stock and securities equivalent to such cash payment) as follows:

- Appreciation Value Award Vehicles-whether or not exercisable, a cash payment (or the delivery of shares of stock, other securities or a combination of cash, stock, and securities equivalent to such cash payment) equal to the difference, if any,
- (1) between the amount determined by the Committee to be the Fair Market Value of the Stock and the exercise price per share multiplied by the number of shares of Stock subject to such Award; provided that if such product is zero or less or to the extent that the Award is not then exercisable, the Awards will be canceled and terminated without payment therefore.

- (2) Full Value Award Vehicles-a cash payment equal to the Fair Market Value of the shares of Stock under the Award, as designated by the Committee.
- (3) Other Awards-a payment amount as determined in the sole discretion of the Committee.

## Section 6: Stock Available Under Plan

- a. Subject to the adjustment provisions of Section 10, the number of shares of Stock with respect to which Awards may be granted (or, in the cases of Awards that may be settled in cash or Stock) under the Plan shall not exceed 4.3 million shares of Stock (the "Maximum Limit"). The following amounts shall be reserved against the Maximum Limit for each type of Award:

### **RESERVES**

#### Full Value Award Vehicles

The greater of (i) one share of Stock for each Full Value Award or (ii) the maximum potential issuable pursuant to each Award.

#### Appreciation Value Award Vehicle (other than Stock Settled Stock Appreciation Rights)

The amount calculated based on the ratio set forth in the below Exchange Ratio table.

#### Stock Settled Stock Appreciation Rights ("SSSAR")

The lesser of (i) 1 share of Stock for each SSSAR granted under an Award or (ii) the maximum potential of shares issuable upon exercise of a SSSAR.

#### Other Awards

The maximum number of shares of Stock authorized to be issued pursuant to such Other Award Vehicle.

No single Participant shall receive, in any one calendar year, Awards in the form of (i) Appreciation Value Award Vehicles with respect to more than 500,000 shares of Stock, (ii) Full Value Award Vehicles for more than 500,000 shares of Stock, and/or (iii) Other Awards Vehicles with respect to more than 500,000 shares of Stock; provided, however, the aggregate number of Appreciation Value Award Vehicles, Full Value Award Vehicles and Other Award Vehicles that may be granted to a single Participant in one calendar year may not exceed 500,000 shares of Stock. For purposes of calculating the maximum aggregate number of Awards that may be granted under this Plan during a calendar year, shares of Stock will be counted based upon the appropriate reserve under this Plan for the respective Award.

### **EXCHANGE RATIO TABLE**

<u>Term of Grant</u>	<u>5 year</u>	<u>6 year</u>	<u>7 year</u>
<b>Appreciation Value Vehicle Awards (other than SSSAR)</b>	.549	.598	.641

## **ACTUALS**

Upon exercise of each Award, all shares of Stock reserved for such Award shall be released and the Maximum Limit shall be reduced by the number following:

**Full Value Awards & Other Awards-** by the shares of Stock actually issued pursuant to such Award.

**Appreciation Value Awards** (other than a SSSAR) – by the number set forth in the Exchange Ratio table above.

**SSSAR** – by the amount of shares actually issued under the Award.

b. Awards payable entirely in cash shall not be counted against the Maximum Limit.

c. If at the time of payment of dividends or Dividend Equivalents there are shares of Stock available that have not been previously reserved, then upon payment they will be deducted from the Plan Maximum Limit. If such shares to pay dividends are not available because all shares of Stock are currently reserved under the Plan Maximum Limit, then such dividends will be paid in cash.

d. Shares of Stock covered by the unexercised or terminated or forfeited portion of any Award that did not result in the delivery of Stock shall be available for further Awards. Subject to Section 10, additional rules for determining the number of shares of Stock granted under an Award type under the Plan may be adopted by the Committee, as it deems necessary and appropriate and consistent with the overall limits set forth in the Plan.

e. The Stock that may be issued pursuant to an Award under the Plan may be authorized and issued Stock held in the Company's treasury or authorized but unissued Stock, or Stock may be acquired, subsequently or in anticipation of the transaction, in the open market to satisfy the requirements of the Plan.

f. If any stock based award granted under the Company's 1996 Stock Incentive Plan shall for any reason subsequent to April 30, 2006 (i) expire, be cancelled or otherwise terminate, in whole or in part, without having been exercised or redeemed in full, or (ii) be reacquired by the Company prior to issuance without restriction to the holder of such Award will be added to the Maximum Limit and will become available for issuance under this Plan based on the following formula: Full Value Award Vehicles made available under this provision shall increase the Maximum Limit on a ratio of 1:1. Appreciation Value Vehicle Awards, including SSSARs under this provision shall increase the Maximum Limit by 1/3 for each share of Stock covered by an Appreciation Value Vehicle Award.

g. Any shares of Stock delivered by the Company, any shares of Stock with respect to which Awards are made by the Company and any shares of Stock with respect to which the Company becomes obligated to make Awards, through the assumption of, or in substitution for, outstanding awards previously granted by an acquired entity, shall not be counted against the shares of Stock available for Awards under this Plan.

- h. The Committee may direct that any stock certificate evidencing shares issued pursuant to the Plan shall bear a legend setting forth such restrictions on transferability as may apply to such shares pursuant to the Plan.

## **Section 7: Award Agreements**

Each Award granted under the Plan shall be evidenced by an Award Agreement. Each Award Agreement shall set forth the terms and conditions applicable to the Award, as determined by the Committee in its discretion and subject to the Plan, including but not limited to provisions describing the treatment of an Award in the event of the termination of a Participant's status as an Employee for reasons of Retirement, death or otherwise, or in the event of Participant's Disability or in the event the Participant engages in a "competing business" as such term shall be defined in the Award Agreement. The Committee may deliver the Award Agreement by interoffice mail, U.S. mail, email or other electronic means (including posting on a web site maintained by the Company or by a third party under contract with the Company) all documents relating to the Plan or any Award thereunder and other documents that the Company is required to deliver to its security holders unless otherwise prohibited by law. A Participant shall have no rights with respect to an Award unless such Participant accepts the Award within such period as the Committee shall specify by executing an Award Agreement in such form as the Committee shall determine and, if the Committee shall so require, makes payment to the Company in such amount as the Committee may determine.

## **Section 8: Amendment and Termination**

The Board of Directors may at any time amend, suspend or terminate the Plan, in whole or in part, and the Committee may, subject to the Plan, at any time alter or amend any or all Award Agreements to the extent permitted by applicable law and the Plan; provided that no such action shall impair the rights of any holder of an Award without the holder's consent. For purposes of the Plan, any action of the Board of Directors or the Committee that alters or affects the tax treatment of any Award shall not be considered to materially impair any rights of any holder. Notwithstanding the foregoing, neither the Board of Directors nor the Committee shall (except pursuant to Section 10) amend the Plan or any Award Agreement, without the approval of the stockholders of the Company to (i) increase the number of shares of Stock available for Awards as set forth in Section 6 or (ii) decrease the Exercise Price of any Award or (iii) make any other amendments to the Plan or Award Agreement which would require stockholder approval under the General Corporation Law of the State of Delaware, New York Stock Exchange Rules or such other rules as may govern the trading or quotation of the Company's Stock, Rule 16b-3 of the Securities Exchange Act of 1934, as amended, or Section 162(m) of the Code. Notwithstanding the above, the Board may, by resolution, amend the Plan in any way that it deems necessary or appropriate in order to make income with respect to the Plan deductible for Federal income tax purposes under Section 162(m) of the Code and any such amendment shall be effective as of such date as is necessary to make such income under the Plan so deductible. Notwithstanding anything to the contrary in this Section, the Board of Directors or the Committee shall have full discretion to amend the Plan to the extent necessary to preserve fixed accounting treatment with respect to any Award and any outstanding Award Agreement shall be deemed to be so amended to the same extent, without obtaining the consent of any holder, without regard to whether such amendment adversely affects a holder's rights under the Plan or such Award Agreement.



## Section 9: Administration

- a. The Plan and all Awards shall be administered by the Committee, provided that, in the absence of the Committee or to the extent determined by the Board of Directors, any action that could be taken by the Committee may be taken by the non-employee members of the Board of Directors. A majority of the members of the Committee shall constitute a quorum. The majority of non-employee Board of Director members shall constitute a quorum of the Board. The vote of a majority of a quorum shall constitute action by the Committee and/or the Board.

- b. The Committee shall have full and complete authority, in its sole and absolute discretion, (i) to exercise all of the powers granted to it under the Plan, (ii) to construe, interpret and implement the Plan, any Award Agreement and any related document, (iii) to prescribe, amend and rescind rules relating to the Plan including rules governing its own operation, (iv) to make all determinations necessary or advisable in administering the Plan, (v) to correct any defect, supply any omission and reconcile any inconsistency in the Plan, (vi) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Committee, (vii) to impose such restrictions, conditions or limitations as it determines appropriate as to the timing and manner of any resales by a Participant or other subsequent transfers by the Participant of any shares of Stock issued as a result of or under an Award, including without limitation, restrictions under the Company's Trading in Securities Policy as may be amended from time to time, (viii) to amend the Plan to reflect changes in applicable law, and (ix) to determine whether, to what extent and under what circumstances Awards may be settled or exercised in cash, shares of Stock, other securities, other Awards or other property, or canceled, forfeited or suspended and the method or methods by which Awards may be settled, canceled, forfeited or suspended. The actions and determinations of the Committee on all matters relating to the Plan and any Awards will be final and conclusive. The Committee's determinations under the Plan need not be uniform and may be made by it selectively among Employees and Participants who receive, or who are eligible to receive, Awards under the Plan, whether or not such persons are similarly situated.

- c. The Committee and others to whom the Committee has allocated or delegated authority or duties shall keep a record of all their proceedings and actions and shall maintain all such books of account, records and other data as shall be necessary for the proper administration of the Plan.

- d. The Committee may appoint such accountants, counsel, and other experts as it deems necessary or desirable in connection with the administration of the Plan.

- e. The Company shall pay all reasonable expenses of administering the Plan, including, but not limited to, the payment of professional fees.

- f. It is the intent of the Company that this Plan and Awards hereunder satisfy, and be interpreted in a manner that satisfy, (i) in the case of Participants who are or may be Insiders, the applicable requirements of Rule 16b-3 of the Exchange Act, so that such persons will be entitled to the benefits of Rule 16b-3, or other exemptive rules under Section 16, and will not be subjected to avoidable liability thereunder and (ii) in the case of Performance Compensation Awards, the applicable requirements of Code

section 162(m). If any provision of this Plan or of any Award Agreement would otherwise frustrate or conflict with the intent expressed in this Section 9(f), that provision to the extent possible shall be interpreted and deemed amended so as to avoid such conflict. To the extent of any remaining irreconcilable conflict with such intent, such provision shall be deemed void as applicable to Insiders and/or Covered Employees, as applicable.

- g. Except to the extent prohibited by applicable law or otherwise, the Committee may from time to time allocate to one or more of its members and delegate to one or more Employees all or any portion of its authority and duties, provided that the Committee may not allocate or delegate any discretionary authority with respect to substantive decisions or functions regarding the Plan or Awards to the extent inconsistent with the intent expressed in Section 9(f).

- h. No member of the Board of Directors or the Committee or any employee of the Company or any of its subsidiaries or affiliates (each such person a "Covered Person") shall have any liability to any person (including, without limitation, any Participant) for any action taken or omitted to be taken or any determination made in good faith with respect to the Plan or any Award. Each Covered Person shall be indemnified and held harmless by the Company against and from any loss, cost, liability or expense (including attorneys' fees) that may be imposed upon or incurred by such Covered Person in connection with or resulting from any action, suit or proceeding to which such Covered Person may be a party or in which such Covered Person may be involved by reason of any action taken or omitted to be taken under the Plan and against and from any and all amounts paid by such Covered Person, with the Company's approval, in settlement thereof, or paid by such Covered Person in satisfaction of any judgment in any such action, suit or proceeding against such Covered Person, provided that the Company shall have the right, at its own expense, to assume and defend any such action, suit or proceeding and, once the Company gives notice of its intent to assume the defense, the Company shall have sole control over such defense with counsel of the Company's choice. The foregoing right of indemnification shall not be available to a Covered Person to the extent that a court of competent jurisdiction in a final judgment or other final adjudication, in either case, not subject to further appeal, determines that the acts or omissions of such Covered Person giving rise to the indemnification claim resulted from such Covered Person's bad faith, fraud or willful criminal act or omission. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which Covered Persons may be entitled under the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any other power that the Company may have to indemnify such persons or hold them harmless.

## Section 10: Adjustment Provisions

- a. Except as otherwise provided in this Section 10 below, in the event of a (i) stock dividend or multiple stock dividends that, in the aggregate, equal ten percent (10%) or more of the Stock's Fair Market Value on the date such stock dividend is declared (or in the case of multiple stock dividends, the date on which the dividend causing the ten percent (10%) threshold to be met or exceeded is declared), (ii) stock split, (iii) reverse stock split, (iv) recapitalization, (v) reorganization, (vi) exchange or reclassification of shares, (vii) spin-off, (viii) extraordinary dividend, greater than ten percent (10%) of the Fair Market Value of shares of Stock on the date of dividend,

payable in cash or property, or (ix) any similar corporate transaction that affects the value of all outstanding shares of Company Stock and is determined by the Committee to warrant an adjustment under this Section 10, the Committee shall make a corresponding adjustment to (1) the number of shares of Stock (or other securities) then remaining subject to this Plan, including those that are then covered by outstanding Awards, and the maximum number of shares of Stock that may be issued, or with respect to which Awards may be granted, to any single Participant or in the aggregate pursuant to this Plan, (2) the price or exercise price for each share or right then covered by an outstanding Award, and/or (3) the terms and conditions of each outstanding Award, in each case solely to prevent dilution or enlargement of the Participants' rights under this Plan and the value of an Award granted to a Participant. No such adjustment shall be made by the Committee, however, for any of the following corporate transactions:

- (1) The issuance of Stock as compensation to any Company employee, director, consultant or other service provider;
- (2) The issuance of Stock pursuant to an "Incentive Stock Option" under Section 422 of the Code;
- (3) The issuance or sale of Stock to a third-party at an arm's length price that is negotiated and agreed to between the Company and such third-party;
- (4) The issuance or sale of Stock to a Company employee or director at a discount pursuant to a plan maintained in accordance with, and to the extent permitted under, Section 423 of the Code; or
- (5) A redemption of Stock by the Company at a price equal to the Fair Market Value of the Stock on the date of such redemption.

Notwithstanding the forgoing, no such adjustment shall be made or authorized to the extent such adjustment would cause the Plan or any Option or Award to violate Section 422 (in the case of an Incentive Stock Option) or Section 409A of the Code. Any adjustment made pursuant to this Section 10 shall be made in accordance with the rules of any securities exchange, stock market or stock quotation system to which the Company is subject. Any adjustment made by the Committee under this Section shall be final, binding and conclusive on all persons.

- b. The existence of the Plan and the Awards granted hereunder shall not affect or restrict in any way the right or power of the Board of Directors or the stockholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other capital structure of its business, any merger or consolidation of the Company, any issuance of bonds, debentures, preferred or prior preference stock ahead of or affecting the Stock or the rights thereof, the dissolution or liquidation of the Company or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, or any similar transaction.

- c. No fractional shares of Stock will be issued or accepted. Any fractional shares will be paid in the equivalent amount of cash. The Committee may impose such other conditions, restrictions and contingencies with respect to shares of Stock delivered pursuant to the exercise of an Award as it deems desirable.

## Section 11: Change of Control

In the event of a Change of Control, in addition to any action required or authorized by the terms of an Award Agreement, the

a. Committee may, in its sole discretion, take any of the following actions as a result, or in anticipation, of any such event to assure fair and equitable treatment of Participants:

- (1) accelerate time periods for purposes of vesting in, or realizing gain from, any outstanding Award made pursuant to this Plan and/or extend the time during which an Award may be exercised following a Participant's termination of employment;
- (2) offer to purchase any outstanding Award made pursuant to this Plan from the holder for its equivalent cash value, as determined by the Committee, as of the date of the Change of Control; or
- (3) make adjustments or modifications to outstanding Awards as the Committee deems appropriate to maintain and protect the rights and interests of Participants following such Change of Control.

b. "Change of Control" means:

Any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act (a "Person") acquires beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (A) the then-outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or (B) the combined voting power of the then-outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that, for purposes of this Section 11, none of the following shall constitute a Change of Control: (a) any acquisition directly from the Company of 30% or less of Outstanding Company Common Stock or Outstanding Company Voting Securities provided that at least a majority of the members of the Board of Directors of the Company following such acquisition were members of the incumbent Board at the time of the Board's approval

(1) of such acquisition, (b) any acquisition by the Company, (c) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any affiliated company, or (d) any acquisition by the Company which by reducing the number of shares of Outstanding Company Common Stock or Outstanding Company Voting Securities, increases the proportionate number of shares of Outstanding Company Common Stock or Outstanding Company Voting Securities beneficially owned by any Person to 20% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; provided, however, that, if such Person shall thereafter become the beneficial owner of any additional shares of Outstanding Company Common Stock or Outstanding Company Voting Securities and beneficially owns 20% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, then such additional acquisition shall constitute a Change of Control; or

Individuals who, as of the date hereof, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

- (2) A reorganization, merger, consolidation or sale or other disposition of all or substantially all of the assets of the Company (a "Business Combination") is consummated, in each case, unless, immediately following such Business Combination, (A), more than 50%, respectively, of the then-outstanding shares of common stock and the combined voting power of the then-outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of (x) the corporation resulting from such Business Combination or (y) a corporation that, as a result of such transaction, owns the Company or all or substantially all of the Company's assets whether directly or through one or more Subsidiaries, is represented by the Outstanding Company Common Stock and the Outstanding Company Voting Securities (or, if applicable, is represented by shares into which Outstanding Company Common Stock or Outstanding Company Voting Securities were converted pursuant to such Business Combination) in substantially the same proportions as their ownership immediately prior to such Business Combination of the Outstanding Company Common Stock and the Outstanding Company Voting Securities, as the case may be, (B) no Person (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then-outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then-outstanding voting securities of such corporation, except to the extent that such ownership existed prior to the Business Combination, and (C) at least a majority of the members of the Board of Directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement or of the action of the Board providing for such Business Combination; or
- (3) The stockholders of the Company approve of a complete liquidation or dissolution of the Company.
- (4) The stockholders of the Company approve of a complete liquidation or dissolution of the Company.

## Section 12: Miscellaneous

- a. **Other Payments or Awards.** Nothing contained in the Plan shall be deemed in any way to limit or restrict the Company or a Subsidiary from making any award or

payment to any person under any other plan, arrangement or understanding, whether now existing or hereafter in effect.

- b. **Unfunded Plan.** The Plan shall be unfunded. No provision of the Plan or any Award Agreement shall require the Committee, the Company or a Subsidiary, for the purpose of satisfying any obligations under the Plan, to purchase assets or place any assets in a trust or other entity to which contributions are made or otherwise to segregate any assets, nor shall the Company or a Subsidiary maintain separate bank accounts, books, records or other evidence of the existence of a segregated or separately maintained or administered fund for such purposes. Participants shall have no rights under the Plan other than as unsecured general creditors of the Company or a Subsidiary.
- c. **Limits of Liability.** Any liability of the Company or a Subsidiary to any Participant with respect to an Award shall be based solely upon contractual obligations created by the Plan and the Award Agreement.
- d. **Rights of Employees.** Status as an eligible Employee shall not be construed as a commitment that any Award shall be made under this Plan to such eligible Employee or to eligible Employees generally. Nothing contained in this Plan or in any Award Agreement shall confer upon any Employee or Participant any right to continue in the employ or other service of the Company or a Subsidiary or constitute any contract or limit in any way the right of the Company or a Subsidiary to change such person's compensation or other benefits or to terminate the employment or other service of such person with or without cause. Except as provided otherwise in an Award Agreement, an Employee's (i) transfer from the Company to a Subsidiary or affiliate of the Company, whether or not incorporated, or visa versa, or from one Subsidiary to another or (ii) leave of absence, duly authorized in writing by the Company or a Subsidiary, shall not be deemed a termination of such Employee's employment or other service.
- e. **Section Headings.** The section headings contained herein are for the purpose of convenience only, and in the event of any conflict, the text of the Plan, rather than the section headings, shall control.
- f. **Construction.** In interpreting the Plan, the masculine gender shall include the feminine, the neuter gender shall include the masculine or feminine, and the singular shall include the plural unless the context clearly indicates otherwise.
- g. **Invalidity.** If any term or provision contained herein or in any Award Agreement shall to any extent be invalid or unenforceable, such term or provision will be reformed so that it is valid, and such invalidity or unenforceability shall not affect any other provision or part thereof.
- h. **Applicable Law.** The Plan, the Award Agreements and all actions taken hereunder or thereunder shall be governed by, and construed in accordance with, the laws of the State of Delaware without regard to the conflict of law principles thereof.
- i. **Supplementary Plans.** The Committee may authorize Supplementary Plans applicable to Employees subject to the tax laws of one or more countries other than the United States and providing for the grant of Awards to such Employees on terms

and conditions, consistent with the Plan, determined by the Committee which may differ from the term and conditions of such Awards pursuant to the Plan for the purpose of complying with the conditions for qualification of Awards for favorable treatment under foreign tax and/or securities laws. Notwithstanding any other provision hereof, Options granted under any Supplementary Plan shall include provisions that conform with Sections 4(a); and Restricted Stock granted under any Supplementary Plan shall include provisions that conform with Section 4(d).

j. **Effective Date and Term.** The Plan was adopted by the Board of Directors effective as of May 25, 2006, subject to approval by the Company's stockholders. The Committee may grant Awards prior to stockholder approval, provided, however, that Awards granted prior to such stockholder approval are automatically canceled if stockholder approval is not obtained at or prior to the period ending twelve months after the date the Plan is effective and provided further that no Award may be settled prior to the date stockholder approval is obtained. Unless sooner terminated, the Plan shall remain in effect until May 25, 2016. Termination of the Plan shall not affect any Award previously made.

k. **No Third Party Beneficiaries.** Except as expressly provided therein, neither the Plan nor any Award Agreement shall confer on any person other than the Company and the grantee of any Award any rights or remedies thereunder.

l. **Successors and Assigns.** The terms of this Plan shall be binding upon and inure to the benefit of the Company and its successors and assigns.





PRIVILEGED AND CONFIDENTIAL

June 4, 2007

Mr. Matthew E. Rubel,  
2100 West 59th Street,  
Mission Hills, KS 66208-1110

Re: Employment Agreement Amendment

Dear Matt:

This is an **Amendment to Your Employment Agreement** (this "*Amendment*") with **Payless ShoeSource, Inc.**, a Delaware corporation (the "*Company*"). You and the Company entered into an employment agreement, dated May 20, 2005 (your "*Employment Agreement*"). In accordance with the provisions set forth in Section 13(g) of your Employment Agreement, you and the Company hereby amend your Employment Agreement, effective on the date hereof, as set forth below.

1. Section 3(f) of your Employment Agreement is amended in its entirety and replaced with the following:

*"Other Executive Compensation Plans and Additional Compensation.* During your employment, you will be eligible to participate in all of the Group's executive compensation plans, including any management incentive plans, deferred compensation plans (but you will not be entitled to any benefits under the Payless ShoeSource, Inc. Supplementary Retirement Plan, nor any successor plan (the "SRP"), unless you are expressly made eligible by resolution of the Board or a committee thereof), and equity plans, in which senior executives of the Company participate."

2. Section 4(a) of your Employment Agreement is amended in its entirety and replaced with the following:

*"Employee Benefit Plans.* During your employment, you will be eligible to participate in the Group's employee benefit and welfare plans, including plans providing retirement benefits (other than the SRP), medical, dental, hospitalization,

life or disability insurance, on a basis that is at least as favorable as that provided to senior executives of the Company.”

3. Section 6(b)(7) is deleted in its entirety and Section 6(b)(8) is renumbered to be Section 6(b)(7).

All terms and conditions of the Employment Agreement (except as specifically set forth in this Amendment) will remain in full force and effect. This Amendment may be executed in counterparts, each of which will constitute an original and all of which, when taken together, will constitute one agreement.

Very truly yours,

---

Jay A. Lentz

Senior Vice President-Human Resources

**BY SIGNING THIS AMENDMENT, I HEREBY CERTIFY THAT I (A) HAVE RECEIVED A COPY OF THIS AMENDMENT FOR REVIEW AND STUDY BEFORE SIGNING IT, (B) HAVE READ THIS AMENDMENT CAREFULLY BEFORE SIGNING IT, (C) HAVE HAD SUFFICIENT OPPORTUNITY TO REVIEW THE AMENDMENT WITH ANY ADVISOR I DESIRED TO CONSULT, INCLUDING LEGAL COUNSEL, (D) HAVE HAD SUFFICIENT OPPORTUNITY BEFORE SIGNING IT TO ASK ANY QUESTIONS ABOUT THIS AMENDMENT AND HAVE RECEIVED SATISFACTORY ANSWERS TO ALL SUCH QUESTIONS, AND (E) UNDERSTAND MY RIGHTS AND OBLIGATIONS UNDER THIS AMENDMENT.**

Accepted and agreed to:

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Matthew E. Rubel

June 4, 2007



## Second Amendment to Term Loan Agreement

This Second Amendment to Term Loan Agreement, dated as of March 11, 2008 (this "*Second Amendment*"), to the Term Loan Agreement referred to below, among Collective Brands Finance, Inc., a Nevada corporation (formerly known as "*Payless ShoeSource Finance, Inc.*", the "*Borrower*"), Collective Brands, Inc., a Delaware corporation (the "*Parent*"), the Lenders (as defined in the Term Loan Agreement), Citicorp North America, Inc., as administrative agent and collateral agent for the Lenders (in such capacity, the "*Administrative Agent*") and JPMORGAN CHASE BANK, N.A., as a Lender.

### RECITALS

WHEREAS, the Borrower, the Parent, the Administrative Agent and the other Lenders party to the Term Loan Agreement dated as of August 17, 2007 (as amended, the "*Term Loan Agreement*"), desire to amend the Term Loan Agreement as set forth herein; and

NOW THEREFORE, in consideration of the premises and the covenants and agreements contained herein and other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree as follows:

Section 1. Definitions. Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Term Loan Agreement.

Section 2. Amendment. The Term Loan Agreement is, effective as of the Effective Date (as defined below), hereby amended as follows:

(a) *Section 8.4 (Sale of Assets)* of the Term Loan Agreement is hereby amended by deleting the word "Borrower" thereof after the words "except in the case of the" in the fifth line after the inception of Section 8.4 thereof and substituting the word "Parent" thereof.

Section 3. Affirmation and Acknowledgment of the Borrower.

The Borrower hereby ratifies and confirms all of its Obligations to the Administrative Agent and the Lenders, including, without limitation, the Term Loans, and the Borrower hereby affirms its absolute and unconditional promise to pay to the Lenders all indebtedness, obligations and liabilities in respect of the Term Loans and all other amounts due under the Term Loan Agreement and the other Loan Documents as amended hereby. The Borrower hereby confirms that the Obligations are and remain secured pursuant to the Loan Documents and pursuant to all other instruments and documents executed and delivered by the Borrower as security for the Obligations.

Section 4. No Other Waivers, Amendments or Consents.

Except to the extent amended hereby, the Term Loan Agreement shall remain unchanged and in full force and effect. The waiver and consents contained herein shall not extend beyond the terms expressly set forth herein for such waiver and consents, nor impair any right or power accruing to the Administrative Agent or the Lenders with respect to any other Default or Event of Default or any Default or Event of Default which occurs after the date hereof. Nothing in this Second Amendment is intended or shall be construed to be a novation of any Obligations or any part of the Term Loan

Agreement or any of the other Loan Documents or to affect, modify or impair the continuity or perfection of the Lenders' Liens under the Term Loan Agreement and Loan Documents.

Section 5. Representations, Warranties and Covenants.

To induce the undersigned Lenders to enter into this Second Amendment, the Borrower and Parent hereby warrant, represent and covenant to and with to the Lenders and the Administrative Agent that: (a) this Second Amendment has been duly authorized, executed and delivered by the Borrower and Parent; (b) this Second Amendment and the Term Loan Agreement as amended hereby constitute legal, valid and binding obligations of the Borrower and Parent, enforceable in accordance with their respective terms; (c) after giving effect to this Second Amendment, no Default or Event of Default has occurred and is continuing as of this date; and (d) no approval or consent of, or filing with, any governmental agency or authority is required to make valid and legally binding the execution, delivery or performance by the Borrower and Parent of this Second Amendment or the Term Loan Agreement as amended hereby.

Section 6. Conditions to Effectiveness. This Second Amendment shall become effective on the date (the "*Effective Date*") when the Administrative Agent, for the benefit of the Lenders, shall have received one or more counterparts of this Second Amendment, duly executed, completed and delivered by the Borrower, the Parent, the Administrative Agent and the Lenders.

Section 7. Reimbursement of Expenses.

As provided in *Section 11.3 (Costs and Expenses)* of the Term Loan Agreement, the Borrower hereby agrees to reimburse the Administrative Agent on demand for all reasonable fees and reasonable out-of-pocket costs and expenses (including without limitation the reasonable and actual fees and expenses of its counsel) incurred by the Administrative Agent in connection with the negotiation, documentation and consummation of this Second Amendment and the other documents executed in connection herewith and the transactions contemplated hereby.

Section 8. Governing Law.

This Second amendment shall be governed by, and construed in accordance with, the laws of the state of New York for contracts to be performed entirely within said state and any applicable laws of the United States of America.

Section 9. Headings.

Section headings in this Second Amendment are included herein for convenience of reference only and shall not constitute a part of this Second Amendment for any other purposes.

Section 10. Severability of Provisions.

Any provision of this Second Amendment which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of such provision in any other jurisdiction. To the extent permitted by applicable law, the Borrower and Parent hereby waives any provision of law that renders any provision hereof prohibited or unenforceable in any respect.

Section 11. Counterparts.

This Second Amendment may be executed in any number of several counterparts, all of which shall be deemed to constitute but one original and shall be binding upon all parties, their successors and permitted assigns. Delivery of an executed signature page of this Second Amendment by facsimile transmission or electronic transmission shall be as effective as delivery of a manually executed counterpart hereof.

Section 12. Entire Agreement.

The Term Loan Agreement as amended through this Second Amendment embodies the entire agreement between the parties hereto relating to the subject matter thereof and supersedes all prior agreements, representations and understandings, if any, relating to the subject matter thereof.

Section 13. No Strict Construction.

The parties hereto have participated jointly in the negotiation and drafting of this Second Amendment. In the event an ambiguity or question of intent or interpretation arises, this Second Amendment shall be construed as if drafted jointly by the parties hereto and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any provisions of this Second Amendment.

Section 14. Waiver of Jury Trial.

Each of the parties hereto irrevocably waives trial by jury in any action or proceeding with respect to this Second Amendment or any other Loan Document.

Section 15. No Third Party Reliance.

This Second Amendment is solely for the benefit of the parties signatory hereto, their successors and permitted assigns. No waiver, consent or amendment pursuant to this Second Amendment may be relied upon by any third parties.

*[Signature Pages to follow]*

IN WITNESS WHEREOF, the parties hereto have caused this Second Amendment to be executed by their respective officers or representatives thereunto duly authorized, as of the date first above written.

Collective Brands Finance, Inc.  
*as Borrower*

Collective Brands, Inc.  
*as a Loan Party*

Payless ShoeSource, Inc., a Missouri corporation  
*as a Loan Party*

Payless ShoeSource Distribution, Inc.  
*as a Loan Party*

By: /s/ Ullrich E. Porzig  
Name: Ullrich E. Porzig  
Its: Authorized Representative

*[Signature Page to Second Amendment to Term Loan Agreement]*

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Citicorp North America, Inc.,  
*as Administrative Agent and Lender*

By: /s/ Michael M. Schadt

Name: Michael M. Schadt

Title: Director

*[Signature Page to Second Amendment to Term Loan Agreement]*

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JPMORGAN CHASE BANK, N.A.,  
*as Lender*

By: /s/ Patrick.J.Fravel

Name: Patrick.J.Fravel

Title: VP

*[Signature Page to Second Amendment to Term Loan Agreement]*



## 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
Collective Brands 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 NYC, Inc.	Kansas
Payless ShoeSource Andean Holdings	Cayman Islands
PSS Canada Finance, LP	Canada
Payless ShoeSource Uruguay SRL Finance Co.	Uruguay
Payless ShoeSource Spain, S.L.	Spain
Payless ShoeSource of Puerto Rico, Inc.	Puerto Rico
Eastborough, Inc.	Kansas
Payless International Finance BV	Netherlands
Shenzen Footwear Consulting Company	China
Payless ShoeSource Ecuador Cia. Ltda.	Ecuador
Payless ShoeSource Honduras S. De R.L.	Honduras
Payless ShoeSource of El Salvador, Ltda de C.V.	El Salvador
Payless ShoeSource Limitada	Costa Rica
Payless ShoeSource Limitada Compania Limitada	Nicaragua

Name	Jurisdiction in which organized
Payless ShoeSource de Guatemala LTDA	Guatemala
Payless ShoeSource de la Republica Dominicana, S.A.	Dominican Republic
Payless ShoeSource of St. Lucia, Ltd.	St. Lucia
Payless ShoeSource of Trinidad Unlimited	Trinidad & Tobago
Payless ShoeSource Overseas S.R.L.	Panama
PSS Canada Investments, LP	Canada
PSS Canada Financial Services Corp.	Canada
PSS US Investments, LP	Nevada
PSS Canada Holdings Corp.	Canada
PSS US Holdings LLC	Nevada
PSS Canada Financial Management Corp.	Canada
Collective International LP	Delaware
Lifestyle Brands Corporation	Nova Scotia
Collective Licensing International, LLC	Delaware
PSS International Holdings, Limited	Cayman Islands
Collective Brands International Holdings, Limited I	Cayman Islands
Collective Brands Logistics, Limited	Hong Kong
Collective Brands International Holdings, Limited II	Cayman Islands
Collective Brands Services, Limited	Hong Kong
Collective Brands Trust I	People' s Republic of China
Collective Brands Trust II	People' s Republic of China
Payless CO Management Ltd.	British Virgin Islands
The Stride Rite Corporation	Massachusetts
Stride Rite Children' s Group	Massachusetts
The Keds Corporation	Massachusetts
Stride Rite Sourcing International	Massachusetts
Saucony/Ecom, Inc.	Delaware
Sperry Top-Sider, Inc.	Massachusetts
Saucony, Inc.	Massachusetts
STS/ECOM	Delaware
SR/Ecom, Inc.	Massachusetts
Stride Rite International Corp.	Massachusetts
Stride Rite Investment Corp.	Massachusetts
SR Holdings Inc.	Delaware
SRR Inc.	Delaware
SRL, Inc.	Delaware
Tommy Hilfiger Footwear, Inc.	Massachusetts
SRGC/Ecom, Inc.	Delaware
SRCG LLC	Delaware
Stride Rite LLC	Delaware
Keds LLC	Delaware
Saucony UK, Inc.	Massachusetts
Stride Rite Deutschland Vertriebs GmbH	Germany
Robeez Logistic Inc.	Nevada
Robeez US Holdings, Inc.	Nevada
Robeez US Inc.	Washington
Stride Rite International LLC	Delaware
Collective Brands Bermuda Holdings, L.P.	Bermuda

Name	Jurisdiction in which organized
Stride Rite Bermuda, LP	Bermuda
Robeez (UK) Ltd.	United Kingdom
Robeez European Sales Ltd.	United Kingdom
Stride Rite UK Limited	United Kingdom
Stride Rite Europe B.V.	Netherlands
Robeez Australia Pty. Ltd.	Australia
Robeez Ltd.	Ireland
Stride Rite Canada Limited	Canada



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement on Form S-8 (Nos. 333-25877, 333-28483, 333-30371, 333-67684, 333-50671, 333-133098, and 333-134558, 333-143698 and 333-143699) and on Form S-3 (No. 333-126670), of our reports dated March 31, 2008, relating to the consolidated financial statements and financial statement schedule of Collective Brands, Inc. and subsidiaries (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the adoption of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" in 2007 and FASB Statement No. 123(R), "*Share-Based Payment*" and FASB Statement No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*" in 2006), and the effectiveness of Collective Brands, Inc. and subsidiaries internal control over financial reporting, appearing in this Annual Report on Form 10-K of Collective Brands, Inc. and subsidiaries for the fiscal year ended February 2, 2008.

/s/ *DELOITTE & TOUCHE LLP*

Kansas City, Missouri

March 31, 2008





# CERTIFICATIONS

I, Matthew E. Rubel, certify that:

1. I have reviewed this Form 10-K of Collective Brands, Inc., a Delaware corporation;  
Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary
2. 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;  
Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material
3. respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;  
The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures
4. (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 controls over financial reporting, or caused such internal controls 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 1, 2008

/s/ Matthew E. Rubel  
 \_\_\_\_\_  
 Matthew E. Rubel  
 Chief Executive Officer  
 and President  
 (Principal Executive Officer)



# **CERTIFICATION**

I, Ullrich E. Porzig, certify that:

1. I have reviewed this Form 10-K of Collective Brands, Inc., a Delaware corporation;  
Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary
2. 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;  
Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material
3. respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;  
The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures
4. (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 controls over financial reporting, or caused such internal controls 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 1, 2008

/s/ Ullrich E. Porzig

Ullrich E. Porzig  
Senior Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)



**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Annual Report of Collective Brands, Inc. (the "Company") on Form 10-K for the period ending February 2, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Matthew E. Rubel, Chief Executive Officer and President, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (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.

Date: April 1, 2008

/s/ Matthew E. Rubel

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Matthew E. Rubel  
Chief Executive Officer  
and President  
(Principal Executive Officer)



**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Annual Report of Collective Brands, Inc. (the "Company") on Form 10-K for the period ending February 2, 2008, 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:

- (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.

Date: April 1, 2008

/s/ Ullrich E. Porzig

Ullrich E. Porzig  
Senior Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)