

# 2

## Combined Management Report\_

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## 2.1 Background to the Group

- Zalando is Europe's leading online platform for fashion
- ZALANDO SE and its 40 subsidiaries thus cover the entire supply chain of an online retailer
- Continued strategic investments to cement partnerships with customers and suppliers and in infrastructure
- Targeted investments in logistics infrastructure are an essential part of this
- Sustainability is integrated in Zalando's daily business

### 2.1.1 Business Model

Zalando is Europe's leading online fashion platform for women, men and children. The Berlin-based company offers its customers a one-stop convenient shopping experience with an extensive selection of fashion articles including shoes, apparel and accessories, with free delivery and returns.

Zalando's assortment of almost 2,000 international brands ranges from popular global brands, fast-fashion and local brands, and is complemented by private label products. Zalando's offering has been extended and enhanced with Zalando Lounge, which offers registered members special offers at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt and Cologne opened between 2012 and 2016 and serve as additional sales channels for excess inventory. The parent company, ZALANDO SE, was founded in 2008 and has its registered offices in Berlin. Zalando's localized offering addresses the distinct preferences of its customers in each of the 15 European markets being served: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Poland, Spain, Sweden, Switzerland and the United Kingdom. The logistics network with five centrally located fulfillment centers allows Zalando to efficiently serve its customers throughout Europe, supported by fulfillment centers in Northern Italy, France and Sweden with a focus on local customer needs. Zalando's management believes that the integration of fashion, operations and online technology provides the capability to deliver a compelling value proposition to both customers and fashion brand partners.



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GRI 102-2  
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[zln.do/en-business-fields](https://zln.do/en-business-fields)

### 2.1.2 Group Structure

#### Governance and Control

The Zalando group is managed by its ultimate parent company, ZALANDO SE, based in Berlin, Germany, which bundles all management functions and generates the vast majority of group revenues. In addition to the parent company, Zalando is comprised of 40 subsidiaries that operate in the areas of fulfillment, customer service, product presentation, advertising, marketing, and private labels developed in-house. ZALANDO SE and its subsidiaries represent the entire value chain of an online retailer. ZALANDO SE has control over all subsidiaries, either indirectly or directly.

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GRI 102-7  
GRI 102-18  
GRI 102-45

As a result, group reporting essentially corresponds to the reporting for ZALANDO SE. Supplementary information concerning the separate financial statements is presented in section 2.6.

The Management Board of ZALANDO SE comprises three members, who are responsible for the group's strategy and management. Rubin Ritter is responsible for the Zalando online shop, finance, corporate governance, and corporate communication. Robert Gentz is responsible for the off-price and emerging businesses, and for human resources, strategy, and technology infrastructure. David Schneider's area of responsibility comprises the Partner Solutions and zLabels businesses, and the Zalando brand. Consisting of nine members, the Supervisory Board advises the Management Board and monitors its management activities. The Supervisory Board is directly involved in decisions of fundamental importance to the company. In particular, it reviews the financial statements and management reports and it reports on the audit to the annual general meeting. Zalando's Supervisory Board represents long-term investors, employees and independent experts. The remuneration of the Management Board and the Supervisory Board as well as the incentive schemes are detailed in the remuneration report. The remuneration report and takeover disclosures pursuant to Sections 289 (4) and 315 (4) HGB, which are components of the combined management report, are presented in the corporate governance report. The corporate governance report also includes the declaration of conformity.



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### Group Segments

ZALANDO SE's internal reporting structure is primarily based on a sales-channel-related perspective. The Management Board monitors the development of the business for the main sales channel, Zalando online shop, by breaking it down geographically into the regions DACH (Germany, Austria and Switzerland) and Rest of Europe. All other sales channels are grouped under the Other segment, which mainly comprises revenues generated by the Zalando Lounge and outlet sales channels and the new platform initiatives.

#### 2.1.3 Corporate Strategy

With EUR 423bn<sup>14</sup> in annual retail spent in 2016, the European fashion market is one of the largest and most attractive consumer markets in the world. In the last few years, we have witnessed a digitalization wave sweep over the entire fashion industry. A wide variety of industry players have embraced digital platforms and strategies in order to seize the opportunities arising from double-digit online growth rates. While the size of the overall fashion industry in Europe remained largely stable between 2010 and 2016, online fashion sales have more than doubled during the same period, expanding from EUR 24bn to EUR 51bn<sup>15</sup>. Growth has been driven by new technology, as it plays a key role in matchmaking supply- and demand-side players in the fashion industry. This has made it possible to connect the entire fashion ecosystem: customers, brands, retailers, manufacturers, stylists, content creators, logistics, and service providers. But most importantly, by opening up new opportunities to co-create value, technology is establishing new and more efficient ways to consume, produce, and invest in fashion.



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[zln.do/en-strategy](http://zln.do/en-strategy)

14) Euromonitor, Europe excl. Russia; fashion excl. beauty category

15) Euromonitor, Europe excl. Russia; fashion excl. beauty category

## Our Opportunity to Reimagine Fashion for the Good of All

The fashion market presents an exciting and attractive opportunity, but it is also a market that is characterized by specific challenges that create structural inefficiencies, raising operational costs and introducing pain-points throughout the entire customer shopping journey:

- Limited end-to-end transparency on inputs and production processes
- Faster fashion cycles
- Growing complexity of global supply chains
- Increasing importance of sustainability compliance practices
- Rapidly changing customer preferences
- Lack of accurate sizing and fitting solutions

We strive to find solutions that produce the best results for all in the fashion industry, be it customers, fashion brands, manufacturers, stylists, content creators, logistics or service providers. Every single stakeholder plays an important role – directly or indirectly – in Zalando's growing ecosystem.

We are well positioned to meet the challenges and seize the opportunities in the fashion industry. With a robust and growing presence in 15 markets, Zalando has become Europe's leading online fashion destination to more than 23m active customers. Our expanding technology and logistics infrastructure, combined with our customer reach – now surpassing 2.5bn visits per year – grant us access to almost 2,000 brands, for many of which we are their largest retail account. Our fashion competence is virtually unmatched, enabling us to position ourselves as brands' most trusted partner and customers' go-to fashion companion.

More specifically, we rely on the following strengths:

### Our Focus on the Fashion Category and Localized Solutions

Given the idiosyncratic nature of the fashion ecosystem, successful industry players are required to build unique capabilities at each stage of the value chain. In this regard, our focus on the fashion category and strong partnerships with multiple fashion stakeholders has enabled us to develop a broad and comprehensive understanding of the needs of the fashion ecosystem. In turn, we leverage this expertise to design unique and compelling fashion experiences that delight customers and to develop industry-specific solutions that help brand partners grow.

To maintain a competitive edge in our home market, we leverage our central core strengths – advanced technological capabilities, vast fulfillment network, and direct relationship with suppliers – and focus on building highly localized solutions for each of our 15 European markets. We are committed to tailoring our services to local tastes and to making Europe accessible for fashion brands and retailers. Our thorough understanding of local specificities will continue to be a core differentiator.

### Our Value Proposition for Customers

Zalando has gained customers' trust by consistently offering a unique fashion experience that provides inspiration, empowers customers, caters to their different needs, and gives them confidence in their personal fashion choices. A fashion companion that connects customers with fashion in new, fun, and inspiring ways by:



[zln.do/en-profile](https://zln.do/en-profile)

- Offering an up-to-date, unique, and comprehensive assortment of in-season fashion merchandise
- Building the most fashion-competent destination via discovery and inspiration, catalog curation, as well as content and selection freshness
- Providing unique and vivid storytelling behind trends, brands, and products
- Delivering an unmatched level of personalization and relevance
- Offering a smooth, better-than-offline experience: the most convenient way to discover, check-out, pay, receive, and return fashion items

### Our Value Proposition for Fashion Brands and Suppliers

Zalando has built credibility among fashion brands as a trusted fashion-competent and technology partner. We help fashion brands and retailers grow and tackle some of the most challenging and complex issues inherent in online fashion by:

- Providing technology and operations infrastructure that enables brands and retailers to optimize results across the entire value chain (e.g. through more accurate sales forecasts, insights into customer buying behavior, targeted advertising, and smart fulfillment services)
- Empowering brands to present themselves in a brand equity accretive, engaging way and enabling them to localize their content in every single country in which we operate
- Granting brands access to a vibrant fashion ecosystem where they can connect, create, and share value with different fashion stakeholders
- Offering instant access to the European fashion market through our unprecedented customer reach across Europe

### Zalando's Platform Vision

Our platform strategy outlined in 2016 remains largely unchanged. We remain convinced that a platform business model provides the best approach to becoming the operating system of the fashion world, with multiple ways of integrating numerous fashion contributors and stakeholders, catering to their specific needs. We are dedicated to making sure our platform enables fashion stakeholders to grow with us and reach their full potential by offering them a wide array of digital and infrastructure services such as analytics, advertising, and fulfillment.



[zln.do/en-platform-strategy](https://zln.do/en-platform-strategy)

By moving towards a platform business model, we acknowledge that the best and most sustainable business solutions are being built jointly between multiple stakeholders in the fashion industry, and not solely within the walled gardens of a single company. From this perspective, we believe that by attracting a diverse set of key players active in the fashion ecosystem (e.g. fashion brands, manufacturers, stylists, content creators, logistics, and service providers), we can enhance our inspiration capabilities and convenience proposition at scale through:

- Overall increased availability of styles and sizes
- Access to the most sought-after brands
- Integration of credible niche/specialty players with unique content and assortment
- Long-tail and local inventory with volumes catering for the needs of specific fashion lovers
- Scalable personalization and more inspiring content, not limited to Zalando's production capacity (e.g. media partners, stylists)
- Tailored sizing and fitting advice provided by innovative technology partners
- Additional options to access local inventory and fast delivery solutions

Our strategy focuses on igniting and sustaining self-reinforcing network effects on the Zalando platform. By facilitating partners' ability to connect to our platform, we increase our merchandise selection and offering, inspirational content and curation, access to fashion expertise, and the range of delivery options available to customers. This, in turn, expands our customer reach, and vice-versa. The greater the number of players plugged into our platform, the better our ability to match and facilitate interactions between customers and partners at scale. Interactions and the subsequent data generated are at the heart of our platform business model.

## Our Strategic Investment Areas

### Investment in Our Customer Proposition

We will continue investing in four key customer propositions to strengthen our positioning as the most fashion-competent destination.

#### Assortment

In pursuit of our mission to offer a "one-stop" shopping experience for all, we will expand into the beauty category to ensure that our customers can truly buy a complete look across all price points and from head to toe. Furthermore, to remain customers' preferred fashion companion, we will continue to invest in ensuring that we always offer the broadest assortment selection, latest fashion trends, sustainable options, and the widest range of in-season fashion brands to cater to our customers' diverse fashion tastes and budgets. Additionally, we leverage zLabels, our private label offering, to create inspiring fashion brands and products to meet customers' specific demands and further enhance our product selection. We combine our assortment offer with continual inspiration and personalization to help our customers navigate the ever-changing world of fashion.

#### Convenience

We continue to invest in more personalized delivery experiences to take our customers on the smoothest fashion purchase journey possible with ultra-fast delivery, flexible payment options, and a hassle-free return process.

#### Brand

Our determination to enhance our brand equity is closely intertwined with our commitment to further strengthen our relationships with customers and suppliers. We invest in expanding our capabilities and boosting our fashion competence and credibility in order to ensure that we consistently meet our customers' and suppliers' expectations. Building stronger customer and supplier relationships is at the core of our brand equity, and it is what makes us one of the leading fashion destinations in Europe. We are also investing in strategic brand marketing initiatives to increase customer engagement. One such initiative is the Bread & Butter event, which acts as a platform for brands and consumers to directly interact with each other during the event and digitally.

#### Multiple Channels/Apps/Devices

As a customer-centric company, we invest in our capabilities to be present where the customer is, to innovate in order to tackle emerging and foreseeable customer needs and pain-points. It is about meeting the customer anytime, anywhere: be it on our mobile app, our desktop site, social apps, or other connected devices.



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[zln.do/en-assortment](https://zln.do/en-assortment)



[zln.do/en-post-order-experience](https://zln.do/en-post-order-experience)



[zln.do/en-bold](https://zln.do/en-bold)

### Investment in Our Supplier Proposition

To maintain our position as our fashion suppliers' preferred and most trusted e-commerce partner, we will continue investing in the following areas.

#### Wholesale Solutions

We invest in optimizing our wholesale capabilities by driving innovations through data and automation, and empowering our fashion partners to take more active ownership in selecting and pushing the right merchandise on the Zalando platform.

#### Partner Program

We invest in providing our fashion partners with an alternative solution through which they own inventory and retain control over pricing and assortment. Our goal is to reach a 20% – 30% share of enabled transactions.



[zln.do/en-partner-solutions](https://zln.do/en-partner-solutions)

#### Off-Price Solutions

We invest in developing both online and offline distribution channels to help brands effectively manage excess inventory across Europe without diminishing their brand equity.

#### Digital Services

We invest in providing a one-stop shop with end-to-end e-commerce services to help our partners connect with customers and successfully navigate the complex fashion ecosystem through advertising and media products, stock integration, payment solutions, customer analytics, and content management.



[zln.do/en-zms](https://zln.do/en-zms)

#### Fulfillment Services

We invest in expanding our fulfillment infrastructure to provide our brand partners with highly customized and reliable solutions through Zalando Fulfillment Solutions (ZFS), enabling them to sell their merchandise through our platform without having to worry about logistics concerns.



[zln.do/en-zfs](https://zln.do/en-zfs)

### Investments in Our Supporting Infrastructure: Technology and Operations

Our investments in technology and operations infrastructure strengthen our core foundation on which we develop compelling customer and supplier propositions.

#### Technology

We are investing in optimizing our logistics operations, enhancing our technology capabilities, and expanding our services powered by artificial intelligence (AI). Proprietary technology solutions form the backbone of Zalando and drive all workflows from purchasing to ordering processes and fulfillment.



[zln.do/en-gift-finder](https://zln.do/en-gift-finder)

The technology underpinning our warehouse processes is constantly being upgraded to ensure that we stay ahead of the competition. We are committed to building some of the most-sophisticated fulfillment centers dedicated to online fashion. Accordingly, we are investing heavily to automate order fulfillment processes and to scale up our "Hub & Spoke" system in order to optimize performance and reduce delivery times. We are also investing to leverage the wealth of data available to us. For instance, fast replenishment algorithms are being introduced to provide recommendations on what fashion items to replenish and in what quantity.

Our focus is on expanding our technology talent pool by providing an attractive and innovative work environment. We recently announced the opening of our third technology hub outside of Germany, in Lisbon. The Lisbon Team will focus on developing an enhanced digital experience for customers visiting Zalando. This follows the expansion of our Technology Teams in Dublin, Helsinki, Dortmund, and Berlin. The focus of operations in Ireland is deep-data science and engineering, involving the development of measures related to building a real-time insight platform around fashion. In Finland, the Technology Team works on many of the cornerstones of the Zalando platform, including personalization and innovative customer-facing products. While in Germany, our Dortmund hub is working on optimizing the payment flow from checkout to refund, and the small-but-excellent Zalando Research Team in Berlin is focused on applying cutting-edge research to tackle challenges that customers face throughout the shopping journey.



[zln.do/en-lisbon](https://zln.do/en-lisbon)

Our investments in artificial intelligence are geared towards strengthening our search, personalization, and sizing capabilities. We are striving to enhance our understanding of user intention in order to improve sorting and personalized search. The focus of personalization is on building the infrastructure needed to extend product recommendations to personalized fashion advice. Furthermore, we have set up a dedicated Sizing Team to develop AI methods to improve sizing advice for customers and generate sizing insights for brand partners.



[zln.do/en-sizing](https://zln.do/en-sizing)

### Operations

Our focus is on enhancing our pan-European fulfillment network by opening up new facilities. Over the coming year, we plan to quickly ramp-up our new fulfillment center in Poland and to initiate new warehouse projects in Poland and Italy. Additional capacity will enable us to fuel our wholesale growth and further enable the Partner Program ramp-up through the scale up of our Zalando Fulfillment Solutions (ZFS). ZFS will in turn improve our delivery speed and help our partners to maintain or improve customer experience standards in all of our 15 markets across Europe. Our employees are the key to our operational success. Our commitment to create a healthy corporate culture and fair working conditions will continue to guide us as we strive to expand our European footprint.

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GRI 102-10



[zln.do/en-logistics-network](https://zln.do/en-logistics-network)

We are confident that our platform strategy provides a systematic approach to building sustainable and differentiating advantages throughout the online fashion value chain. In the coming years, we will continue our efforts to further scale up our platform by connecting more fashion stakeholders, developing new technology solutions to tackle current and emerging fashion needs, and increasing our level of personalization to address customers' growing expectations.

Given the rapid pace and scale of transformation in the online fashion industry, we are aware that our vision and strategy will need to evolve accordingly. The magnitude of the opportunities and challenges ahead is great, but we trust that our relentless customer-centric focus combined with our demonstrated ability to learn and innovate will enable us to stay ahead of the curve.

#### 2.1.4 Corporate Responsibility

Our purpose "Reimagine fashion for the good of all," is based on our ambition to tackle the endemic challenges that our industry is facing. These challenges include a lack of transparency in increasingly complex supply chains and related risks for people and the environment. As a company, we want to do



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[zln.do/en-responsibility](https://zln.do/en-responsibility)



our bit for a more sustainable fashion industry by providing a systemic contribution beyond our own business. We believe that our contribution is most effective if we combine our strengths in technology, fashion, and logistics and actively engage our customers, partners and employees.

Of course, at first we had to do our homework to get the basics right. However, we feel that we have reached a point where we could go one step further with our sustainability strategy (do.STRATEGY) and have defined additional strategic visions and targets in four key areas:

- Employees: we want to provide a workplace for the future and impact the future of work. This implies offering our employees a culture of continuous growth and development as well as an innovative and attractive work environment.
- Fashion: we want to contribute to a more sustainable fashion industry. It is our ambition to develop our online shop into a leading online destination for sustainable fashion and to further improve the social and environmental footprint of our private label products.
- Environment: we want to decouple our ecological footprint from our economic growth. To this end, we developed our first climate protection strategy and strive to take sustainable packaging to the next level.
- Corporate citizenship: we want to reimagine how corporates contribute to solving societal challenges. In line with the social Zalando principle, we intend to strategically invest 1% of our EBT in existing solutions for societal impact, e.g. to increase transparency in the supply chain, and help them scale.

We see a pressing urgency in addressing the challenges of our industry together with our partners, and we are eager to learn and iterate while striving towards a systemic contribution. At the same time, we are convinced that our sustainability strategy is also a key element for our future business success.

Additional information regarding our sustainability strategy and our separate combined non-financial report in accordance with Section 289b (1) and (3) and Section 315b (1) and (3) HGB (German Commercial Code) which is published together with the combined management report on the Company's website (<https://corporate.zalando.com/en/>) is provided in the separate section 1.2 Corporate Responsibility<sup>16</sup> of the annual report.

### 2.1.5 Management System

In addition to revenue, EBIT, adjusted EBIT and capex, other key financial performance indicators for corporate management include EBIT margin, adjusted EBIT margin, the adjusted fulfillment and marketing cost ratios, along with EBITDA and adjusted EBITDA. Operating and free cash flows are also taken into account. The Management Board steers the company at a consolidated group level.

In addition to these financial indicators, Zalando also uses a range of non-financial performance indicators to manage the company.

- **Ratio of mobile site visits to total site visits:** users are making greater use of mobile devices to access the internet. In our effort to offer customers the opportunity to enjoy high-quality shopping on their mobile devices, Zalando continues to develop and refine its mobile websites



[zln.do/en-do-strategy](https://zln.do/en-do-strategy)



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<sup>16)</sup> The sustainability report is not part of the audited combined management report.

## 2.1 BACKGROUND TO THE GROUP

and apps. As a result, the ratio of shop visits from mobile devices to the total number of shop visits increased by around 5.1 percentage points in 2017, rising from 65.6 in 2016 to 70.7.

- **Number of active customers:** the Zalando group measures its success by the number of active customers. Each customer that has placed at least one order within the preceding 12 months (based on the reporting date) is considered active. Compared to the prior year, the number of active customers increased by 3.2m, rising from 19.9m to 23.1m in 2017.
- **Number of orders:** in addition to revenue, the number of orders placed is a key performance indicator for the management of the group. This indicator is monitored independently from the value of merchandise and is a key driver of growth. In 2017, the number of orders placed increased from 69.2m in 2016 to 90.5m.
- **Average number of orders per active customer:** the average number of orders placed by active customers during the last twelve months totaled 3.9 as of December 31, 2017 (prior year: 3.5). This KPI is an important indicator of the trust customers place in the company and is also influenced by customer age and shopping channel.
- **Average basket size:** similar to the number of orders placed, the average basket size has a direct effect on the revenue of the group. The average basket size (after returns) decreased slightly in fiscal year 2017 from EUR 66.6 to EUR 64.5. It is influenced by assortment composition, customer age, and shopping channel. Young customers who prefer fast fashion articles and shopping mobile tend to shop more frequently, but with a lower basket size.

### 2.1.6 Research and Development

Zalando develops key components of its software internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes in particular are supported using internally developed software. Important technical developments in 2017 included: on-site personalization initiative, Fashion Insights Platform, Smart Product Platform, Fashion Content Platform, product availability, Search & Personalization, same day delivery, and many more.



[zln.do/en-personalization](https://zln.do/en-personalization)

Software development at Zalando relates to the structured, labor-intensive phase of programming and implementing significant system upgrades, further developing components and enhancing functionalities along the entire value and process chain.

Development work at Zalando is performed by teams of developers that are organized by the respective function or line, for example Fashion Store, Payments, Partner Solutions, Zalon, zLabels, Off-Price.

In 2017, the group recognized development costs of EUR 51.2m (prior year: EUR 57.7m), of which EUR 36.8m relate to prepayments and assets under development (prior year: EUR 36.4m). The increase in development costs is attributable to the enhancement of the above-mentioned software and new technical projects.

Research costs were immaterial.

## 2.2 Report on Economic Position

- European internet retailing and online fashion sales once again grow considerably more strongly than the economy as a whole
- Zalando closes a successful fiscal year and captures shares in all markets
- Revenue growth of 23.4% to EUR 4,489m is driven by all segments
- EBIT stands at EUR 187.6m, the EBIT margin at 4.2%
- Cash flow from operating activities comes to EUR 193.7m

### 2.2.1 Macroeconomic and Sector-Specific Environment

The online shopping mega-trend continued in 2017. The European online retail sector grew by 13.5% in 2017, while the general retail industry grew just 3.0%<sup>17</sup>. A similar trend was found in the fashion sector.

The European fashion retail sector closed 2017 with a trading volume of around EUR 422bn, up 1.4%<sup>18</sup> nominally. This was outperformed by the online fashion market, which grew much faster (11.9%) compared to the previous year, closing at EUR 56bn.

Consistent with the European landscape, the German overall retail market grew at 2.0% with online sales increasing by 10.7% in 2017<sup>19</sup>. Fashion trading volumes increased by a mere 0.6%<sup>20</sup> as a result of a decline in consumer footfall in brick-and-mortar stores to a volume of EUR 76bn<sup>21</sup>. It is reported that footfall dropped by 2.0% in 2017 from 2016<sup>22</sup>. Nevertheless, online fashion retail sales grew by almost 15.0% in 2017, to a market value of around EUR 14bn<sup>23</sup>.

Due to the positive outlook for European fashion and online retail, we believe our business model is in a favorable position. This advantage can be attributed to some sector-specific factors.

- Technological advancements are the key drivers behind the second wave of e-commerce. Advancements especially in machine learning will lead to a further increase in the online fashion business. Market penetration of internet fashion is expected to continue to increase at the expense of traditional brick-and-mortar retailers.
- Moreover, the increased usage of mobile devices and their extended range of applications have influenced the strong growth in online retail trade, including online fashion. Smartphones and tablets provide retail access anytime and nearly anywhere. Due to this convenience, consumers increasingly use them to shop for fashion. Forecasts for mobile commerce demonstrate that this trend is likely to continue. The annual growth rate for mobile retailing in Europe is expected to be 18.4% in the coming year and about 15.2% for the coming five years<sup>24</sup>.
- Europe remains a very attractive fashion market with a high concentration of affluent customers. In Europe, purchasing power increased by 1.9%<sup>25</sup> in 2017 compared to 2016. Moreover, in our key market Western Europe the per capita spending on fashion amounted to EUR 764 in 2017<sup>26</sup>, which is significantly higher than in most places in the world.
- Lastly, average gross margins for online fashion retailers range between 40% and 60%<sup>27</sup>, considerably more attractive than average margins in other online product categories, such as electronics.



[www.euromonitor.com](http://www.euromonitor.com)

17) Euromonitor, Europe excl. Russia  
 18) Euromonitor, Europe excl. Russia  
 19) Euromonitor, Europe excl. Russia  
 20) Euromonitor, Europe excl. Russia  
 21) Euromonitor, Europe excl. Russia  
 22) Textilwirtschaft  
 23) Euromonitor, Europe excl. Russia  
 24) Euromonitor, Europe excl. Russia  
 25) GfK, Europe  
 26) Euromonitor, Western Europe  
 27) Company information, average gross margins of selected publicly listed e-commerce companies in 2014 including Asos, Yoox and Boohoo based on publicly available information.

### 2.2.2 Business Development

ZALANDO SE, Europe's leading online platform for fashion, looks back on a successful business performance in fiscal year 2017. Compared to 2016, the group reported 23.4% revenue growth in the period to EUR 4,489m (prior year: EUR 3,639m). All segments contributed to revenue growth: revenues in the DACH region increased by 18.3%, in Rest of Europe by 25.7% and in the Other segment by 45.0%. Zalando continued to gain market share in all its markets.

Apparel remained Zalando's biggest product category, followed by shoes and sports. The customer base continued to grow strongly, reaching 23.1 million active customers at the end of 2017 (19.9 million at the end of 2016). In 2017, Zalando continued to invest in the three areas that are essential for the company's success: customers, partners and infrastructure.

As in previous years, Zalando put customer satisfaction as its main objective and invested significantly in its customer proposition, including assortment, convenience, brand and multiple channels, apps and devices.

Throughout the year, notable additions to Zalando's brand portfolio included Oysho, Stradivarius, Pull&Bear (Inditex), Nudie Jeans and Armani. The Zalando brand raised its visibility and reach, supported for example by the "Man Box"/James Franco and the "Remix Fashion" campaigns. The number of available items increased to more than 300,000, further enriching the breadth and depth of Zalando's well-curated offering.

Zalando introduced Zalando Plus, a new program that offers customized premium services like faster delivery and pickup of returns on demand. The first phase ran by invite only in four different cities in Germany: Berlin, Leipzig, Frankfurt and Hannover. Zalando Plus introduced benefits along the entire customer journey: members get early access to sales and benefit from faster delivery, including same day, and from the new return on demand service, which enables customers to have their returns picked up within two hours at a time and location of their convenience.

Zalando also strengthened the Partner Program, in which brands can integrate their stock directly into the Zalando Fashion Store. Partners now have access to the Zalando customers in 13 countries where the Partner Program operates. In 2017, Zalando introduced Zalando Fulfillment Solutions, a service through which our partners have the option to handle their entire logistics through us. This service allows partners to leverage Zalando's logistics expertise and network, improving customer satisfaction and scaling their business internationally.

Investment in infrastructure underpins Zalando's strength in technology and enables the expansion of its platform strategy. Almost 2,000 brands have found a home at Zalando. Our technology provides the tools for the brands to design and control the content of their shops and obtain feedback and insights from their customers. Zalando has a team of almost 2,000 dedicated technology engineers who develop and drive all critical processes in-house. Among other achievements, this allowed Zalando to significantly improve its mobile offering. An impressive 70.7% of visits to the Zalando Fashion Store were conducted from a mobile device in 2017.



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[zln.do/en-investment-and-growth](https://zln.do/en-investment-and-growth)



[zln.do/en-plus](https://zln.do/en-plus)



[zln.do/en-zfs](https://zln.do/en-zfs)

Zalando's operational structure provides the best fulfillment experience for online fashion in Europe. In 2017, the company successfully launched a fulfillment center in Szczecin (Gryfino, Poland) and satellite warehouses in Paris (Moissy-Cramayel) and Stockholm (Brunna).

Similar to existing locations in Mönchengladbach, Erfurt and Lahr, the new fulfillment center in Szczecin (Gryfino) has around 130,000 square meters of space. The location is operated by a third-party service provider. Once fully ramped up, it will supply all 15 markets of the Zalando Logistics network but especially customers in Poland, Germany and the Nordics.

A new satellite warehouse near Paris was put into operation in March 2017. This fulfillment center caters to the needs of Zalando's French customers and fulfills the increasing demands of one of the biggest fashion markets in Europe. In addition to reducing delivery times, the new fulfillment center enables a more efficient management of the distribution chain in France.

The new Stockholm fulfillment center, which is still under construction, started first test operations in the fourth quarter of 2017 and will ensure that Zalando's strong and growing Nordic customer base experiences a more convenient consumer journey and receives orders faster. The fulfillment center in the Stockholm area will decrease lead times significantly. Once the fulfillment center is fully ramped up, Zalando will be able to cut lead times in half across the Nordic region (to 1–2 days for Sweden and Denmark, and 1–3 days for Norway and Finland).

Zalando now has seven fulfillment centers, including three outside Germany. New sites in the logistics network are also planned near Verona, Italy, and close to Lodz, Poland.

The number of employees increased by about 26%, strongly driven by the headcount increase in Operations to more than 9,289 employees. This reflects the growth of our logistics infrastructure.

In order to align employees' interests even more with the long-term strategic goals of the company, Zalando offers several employee participation programs. Management also strongly encourages an outspoken and direct feedback culture, further strengthened by a 360-degree performance review system.

The Zalando share is listed in various important domestic and foreign indices, including the German MDAX, the STOXX Europe Mid 200 Index and the broader European STOXX Europe 600 Index. The Zalando share closed 2017 at EUR 44.12.



[zln.do/en-logistics-network](https://zln.do/en-logistics-network)



Further Information  
The Zalando Share –  
2017 in Review p. 73

## 2.2.3 Economic Situation

**Financial Performance of the Group**

The consolidated income statement for 2017 shows strong revenue growth above prior year's level, coupled with solid profitability. We believe investing in growing our market share now is the value-maximizing strategy for the company.

GRI 103-1/-2/-3 MA  
Economic Performance  
GRI 201-1

## Consolidated Income Statement

→ 22

IN EUR M	Jan 1 – Dec 31, 2017	As % of revenue	Jan 1 – Dec 31, 2016	As % of revenue	Change
Revenue	4,489.0	100.0%	3,639.0	100.0%	0.0pp
Cost of sales	-2,529.6	-56.4%	-2,029.6	-55.8%	-0.6pp
<b>Gross profit</b>	<b>1,959.4</b>	<b>43.6%</b>	<b>1,609.4</b>	<b>44.2%</b>	<b>-0.6pp</b>
Selling and distribution costs	-1,530.8	-34.1%	-1,223.7	-33.6%	-0.5pp
Administrative expenses	-242.9	-5.4%	-191.3	-5.3%	-0.2pp
Other operating income	11.8	0.3%	16.7	0.5%	-0.2pp
Other operating expenses	-9.9	-0.2%	-4.1	-0.1%	-0.1pp
<b>Earnings before interest and taxes (EBIT)</b>	<b>187.6</b>	<b>4.2%</b>	<b>207.0</b>	<b>5.7%</b>	<b>-1.5pp</b>



Further Information  
Consolidated Statement of  
Comprehensive Income p. 135

## Other Consolidated Financial Information

→ 23

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
EBIT margin (as % of revenue)	4.2%	5.7%	-1.5pp
Adjusted EBIT (excl. equity-settled share-based payments and non-operative one-time effects)	215.1	216.3	-1.2
Adjusted EBIT margin (as % of revenue)	4.8%	5.9%	-1.2pp
EBITDA* (in EUR m)	246.4	255.3	-8.9
EBITDA margin (as % of revenue)	5.5%	7.0%	-1.5pp
Adjusted EBITDA (excl. equity-settled share-based payments and non-operative one-time effects)	273.8	264.5	9.3
Adjusted EBITDA margin (as % of revenue)	6.1%	7.3%	-1.2pp

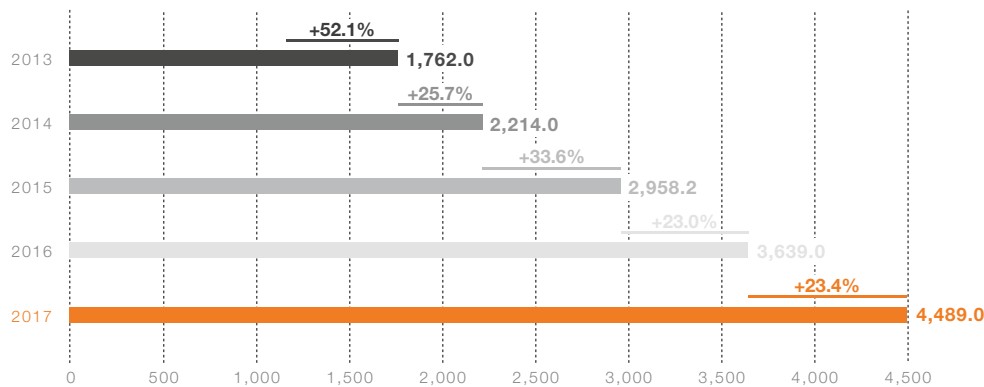
\*) EBITDA is the EBIT before depreciation and amortization of property, plant and equipment and intangible assets. Depreciation and amortization of property, plant and equipment and intangible assets amounts to EUR 58.7m in 2017 (prior year: EUR 48.2m).

## Development of Revenue

Annual Revenue Growth (2013 – 2017)

→ 15

IN EUR M

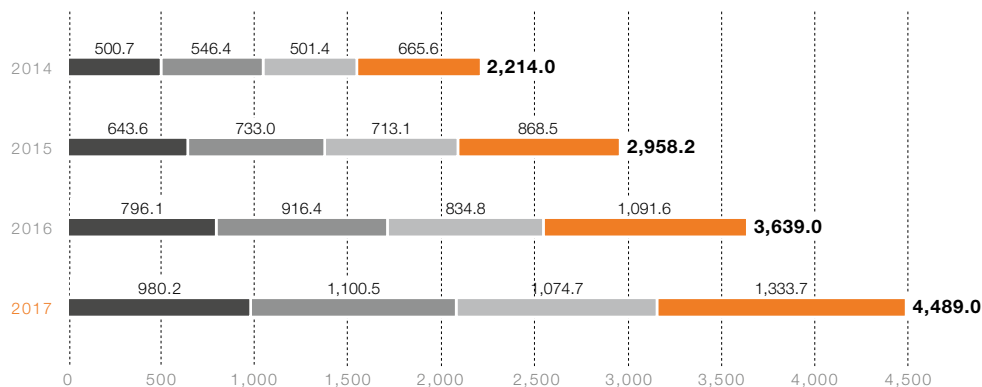


In 2017, Zalando increased its revenue by 23.4% or EUR 850.0m from EUR 3,639.0m to EUR 4,489.0m.

Revenue by Quarter (2014 – 2017)

→ 16

IN EUR M



The variance in revenue over the course of the year reflects the seasonality of the business. Typically, the fall and winter collections are sold at higher prices than the spring and summer goods. This means that revenue levels tend to be higher in the second half of the fiscal year than the first half. In addition, the second and fourth quarters tend to be stronger than the first and third quarters as they do not contain the sale periods that are typically towards season end. At EUR 1,333.7m, group revenue in the fourth quarter was up 22.2% on the comparable period of the prior year (Q4 2016: EUR 1,091.6m).

The key performance indicators developed as follows in the reporting period.

## Key Performance Indicators

→ 24



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KEY PERFORMANCE INDICATORS*	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
Site visits (in millions)	2,563.5	1,991.6	28.7%
Mobile visit share (as % of site visits)	70.7	65.6	5.1pp
Active customers (in millions)	23.1	19.9	16.2%
Number of orders (in millions)	90.5	69.2	30.8%
Average orders per active customer	3.9	3.5	12.6%
Average basket size (in EUR)	64.5	66.6	-3.2%
Revenue (in EUR m)	4,489.0	3,639.0	23.4%
Adjusted fulfillment cost ratio (as % of revenue)	25.9	23.2	2.7pp
Adjusted marketing cost ratio (as % of revenue)	7.9	10.3	-2.4pp
EBIT (in EUR m)	187.6	207.0	-9.4%
EBIT margin (as % of revenue)	4.2	5.7	-1.5pp
Adjusted EBIT (in EUR m)	215.1	216.3	-0.6%
EBITDA (in EUR m)	246.4	255.3	-3.5%
EBITDA margin (as % of revenue)	5.5	7.0	-1.5pp
Adjusted EBITDA (in EUR m)	273.8	264.5	3.5%
Adjusted EBITDA margin (as % of revenue)	6.1	7.3	-1.2pp
Net working capital (in EUR m)	-62.4	-127.6	-51.1%
Cash flow from operating activities (in EUR m)	193.7	275.8	-29.8%
Capex (in EUR m)	-243.9	-181.7	34.2%
Free cash flow (in EUR m)	-85.0	63.7	<-100.0%

\*) For an explanation of the performance indicators please refer to the glossary.

Zalando's most important performance indicators are revenue, EBIT, adjusted EBIT, capex, the number of active customers and the average number of orders per active customer. These are forecast for fiscal year 2018 in section 2.5 Outlook.

The rise in revenue is mainly attributable to a larger customer base and an increase in the number of orders. As of December 31, 2017, the group had 23.1 million active customers. This corresponds to an increase of 16.2% compared to the prior year. The larger customer base ordered more frequently compared to the prior year with the average number of orders per active customers rising 12.6%. The higher number of customer orders, which increased by 30.8%, was driven in particular by a 28.7% increase in site visits. The considerable rise in these revenue drivers was enabled



## 2.2 REPORT ON ECONOMIC POSITION

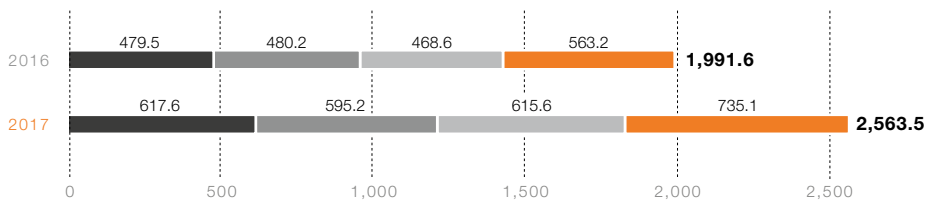
through our continued focus on investing in the consumer and brand proposition as well as in our technology and operations infrastructure.

The higher traffic on the website also relates to a significant increase in the share of visitors who access the website on mobile devices. Compared to the prior year, the share of site visits via mobile devices rose by 5.1 percentage points to 70.7% in 2017.

## Site Visits by Quarter (2016–2017)

→ 17

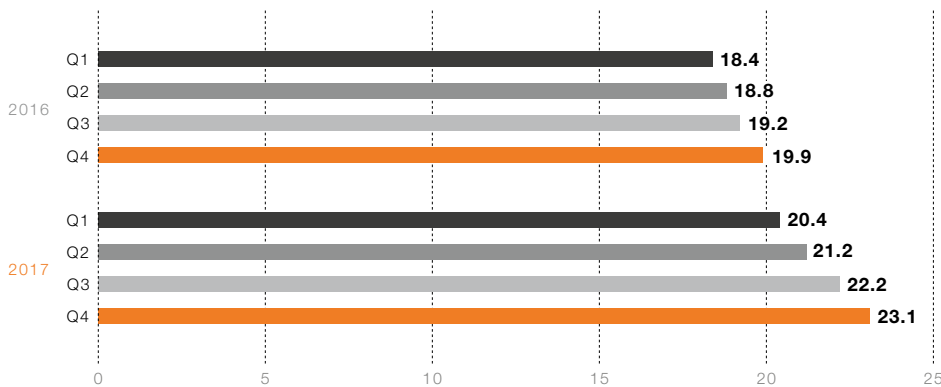
IN M



## Number of Active Customers by Quarter (2016–2017)

→ 18

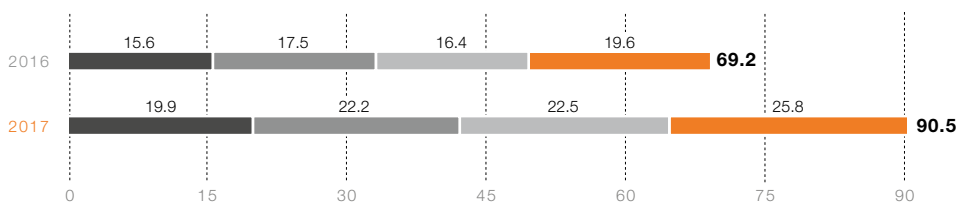
IN M



## Number of Orders by Quarter (2016–2017)

→ 19

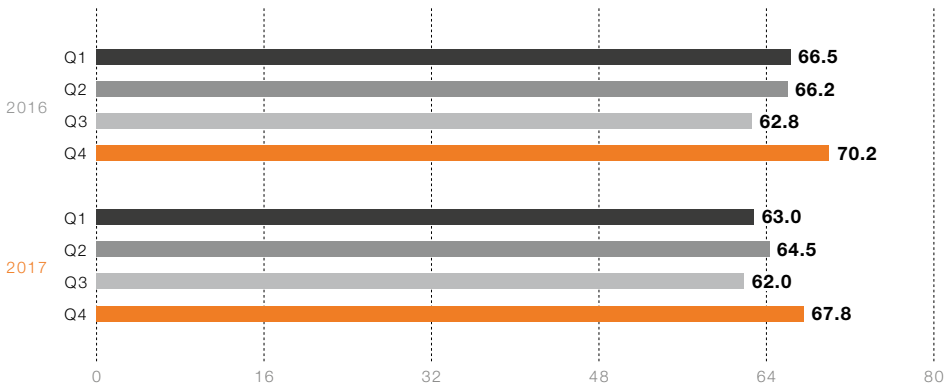
IN M



## Average Basket Size by Quarter (2016–2017)

→ 20

IN EUR



Zalando is benefiting from a strong increase in active customers by offering better and faster services to its customers, especially in the DACH region and France. An additional driver is the disproportionate growth in male customers as Zalando puts continued focus on communicating to male customers through brand marketing campaigns.

Revenue by segment breaks down as follows:

## Revenue by Segment

→ 21

IN %

**8.2** [2016: 7.0]

Other



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In fiscal year 2017, DACH countries generated around half of the total annual revenue. At the same time, revenue recorded in the Rest of Europe and Other segments increased significantly, also contributing strongly to the overall revenue growth.

In the DACH segment, revenue reached EUR 2,145.6m in 2017 (prior year: EUR 1,813.8m), equivalent to an increase of 18.3% compared with 2016, thereby strongly re-accelerating growth as compared to 2016 (prior year growth rate: 14.8%).

The Rest of Europe segment generated revenue of EUR 1,973.6m in 2017 (prior year: EUR 1,570.2m). This corresponds to a 25.7% increase in revenue compared to 2016.

The Other segment achieved revenue of EUR 369.9m in 2017 (prior year: EUR 255.1m), increasing by 45.0%. The Other segment mainly comprises the business activities of Zalando Lounge, Outlet sales channels and projects derived from our platform initiatives. The revenue from the Zalando Lounge stems from additional sales campaigns for selected products at reduced prices for registered users.

### Development of EBIT

The group recorded an EBIT of EUR 187.6m in 2017 (prior year: EUR 207.0m) which corresponds to an EBIT margin of 4.2% (prior year: 5.7%) and represents a decrease of 1.5 percentage points. The decrease in EBIT margin is mainly driven by a higher fulfillment cost ratio that could not be fully offset by a lower marketing cost ratio. This is the result of a strong focus on revenue growth and continued investments in our consumer experience, brand proposition and expanding infrastructure.

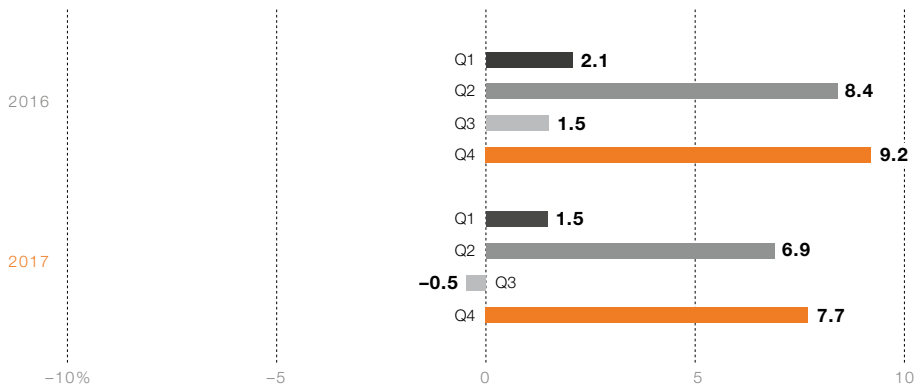


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### EBIT Margin by Quarter (2016–2017)

→ 22

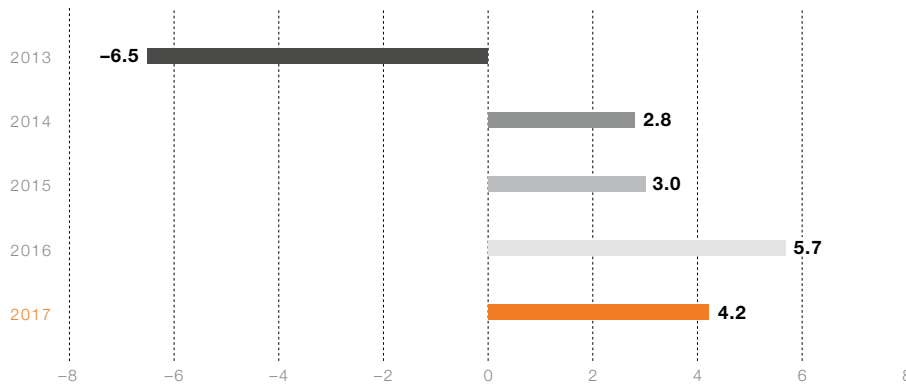
IN %



## Yearly EBIT Margin (2013–2017)

→ 23

IN %

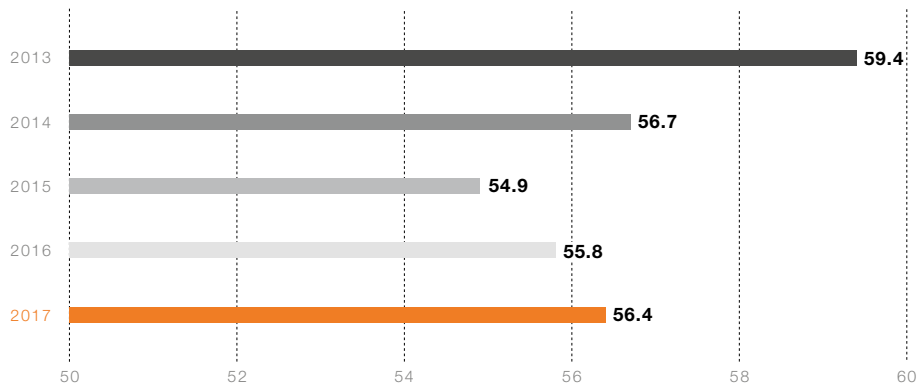


## Five-Year Summary of Cost Items (Non-Adjusted)

## Cost of Sales (2013–2017)

→ 24

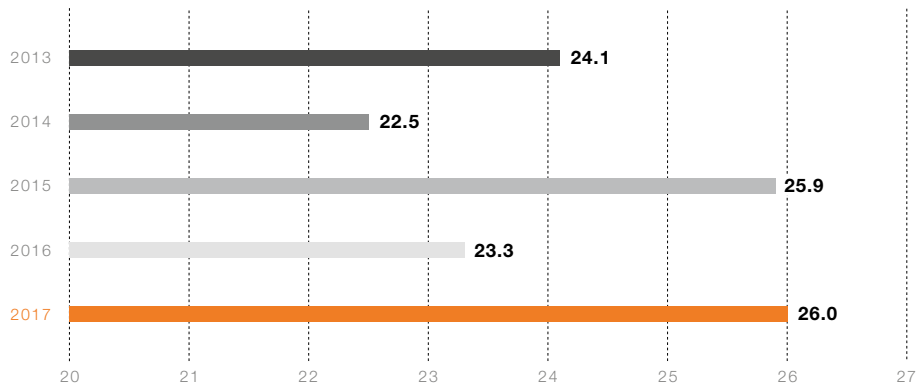
AS % OF REVENUE



## Fulfillment Costs (2013–2017)

→ 25

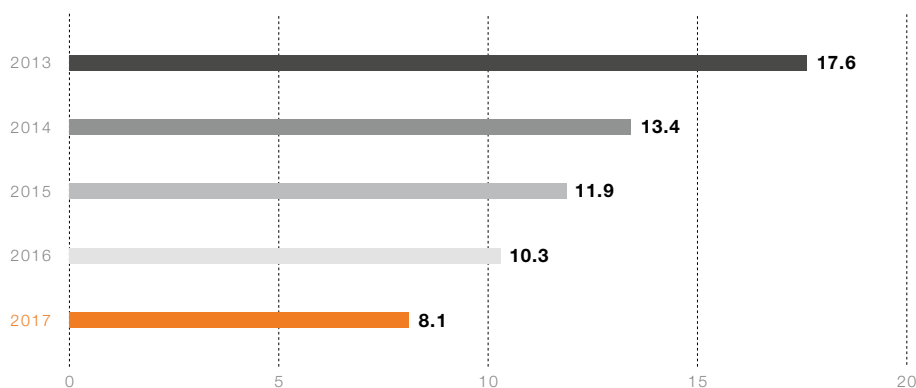
AS % OF REVENUE



## Marketing Costs (2013–2017)

→ 26

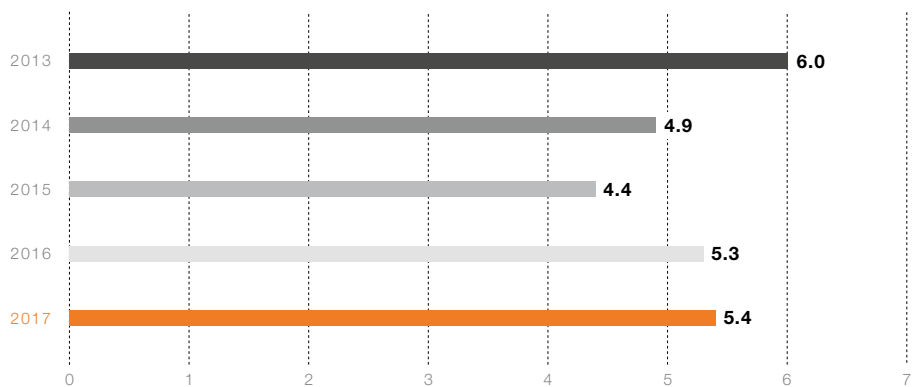
AS % OF REVENUE



## Administrative Expenses (2013–2017)

→ 27

AS % OF REVENUE



Cost of sales rose by 24.6% year on year from EUR 2,029.6m to EUR 2,529.6m with the gross margin decreasing slightly by 0.6 percentage points from 44.2% to 43.6%, mostly due to a slightly higher discount level, which experienced a mix effect with the more discount-oriented Rest of Europe segment growing faster than DACH. Furthermore, Zalando attracts a growing number of younger customers who prefer to shop for fast fashion articles at lower gross margin levels. Economies of scale from continued negotiation successes with brand partners and a growing Partner Program share partially offset the aforementioned effects.

Selling and distribution costs rose by 25.1% year on year from EUR 1,223.7m to EUR 1,530.8m. This corresponds to an increase of 0.5 percentage points as a percentage of revenue, an increasing ratio from 33.6% in 2016 to 34.1% in 2017. Selling and distribution costs consist of fulfillment and marketing costs.

The fulfillment cost ratio as a percentage of revenue increased by 2.7 percentage points from 23.3% in 2016 to 26.0% in 2017. The increase in the fulfillment cost ratio is primarily attributable to higher logistics costs as Zalando is building up a diverse logistics network and continues its investments in the customer and brand proposition. Noteworthy developments include the ramp-up of new fulfillment centers in southern Germany, France, Italy, Sweden and Poland, continued investments in convenience to enhance our customer experience like same day delivery, and the ramp-up of our Zalando Fulfillment Solutions service for brand partners, where we take on the fulfillment services for brands that are selling in our Partner Program. Through those investments in convenience, we were able to achieve a very high service level and fast delivery times, even at peak times around Black Friday and Christmas. The investments in convenience also include Zalando Plus, a new membership program that offers additional benefits such as faster delivery as well as customized premium services like the pickup of returns on demand. Payment costs are included in fulfillment costs; they remained overall in line with the prior year. Zalando continued to put a strong focus on optimizing and improving its steering of payment options and thus reducing the risk of fraudulent activities.



[zln.do/en-plus](https://zln.do/en-plus)

Marketing costs decreased by EUR 13.4m to EUR 362.5m compared to the prior year. Relative to revenue, marketing costs decreased by 2.3 percentage points, resulting primarily from savings and efficiency gains, in particular within performance marketing. Nevertheless, the number of active customers grew strongly by 16.2% to 23.1m. Overall, Zalando continued to shift marketing spending to fulfillment investments as a higher long-term return is expected on these investments. Marketing spend included the "Man Box" campaign with US actor James Franco and the "Remix Fashion" campaign with US rapper A\$AP Rocky as well as our second Bread & Butter event.



[zln.do/en-bold](https://zln.do/en-bold)

Administration expenses increased from EUR 191.3m in 2016 to EUR 242.9m in 2017. The increase mainly results from the higher headcount to strengthen the Zalando platform and the associated office expenses.

The EBIT margin decreased by 1.5 percentage points in comparison to the prior year, from 5.7% in 2016 to 4.2% in 2017. In absolute terms, EBIT decreased by EUR 19.4m from EUR 207.0m to EUR 187.6m. The main driver was the increase of 2.7 percentage points in the fulfillment cost ratio, which could not be fully offset by an improvement of 2.3 percentage points in the marketing cost ratio. With a net income of EUR 101.6m, Zalando remains overall sustainably profitable.

### Adjusted EBIT

In order to assess the operating performance of the business, Zalando management also considers adjusted EBIT and the adjusted EBIT margin before expenses for equity-settled share-based payments and potential further non-operating one-time effects, if applicable.

Zalando recorded an adjusted EBIT of EUR 215.1m in 2017 (similar to the prior-year amount of EUR 216.3m), which translates into an adjusted EBIT margin of 4.8% in 2017 (prior year: 5.9%).

EBIT comprises the following expenses from equity-settled share-based payments.

#### Share-Based Compensation Expenses per Functional Area

→ 25

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
<b>Expenses for equity-settled share-based payments</b>	<b>27.5</b>	<b>19.9</b>	<b>7.6</b>
Cost of sales	6.9	5.0	1.9
Selling and distribution costs	13.7	9.9	3.8
thereof marketing costs	6.9	5.0	1.9
thereof fulfillment costs	6.9	5.0	1.9
Administrative expenses	6.9	5.0	1.9

EBIT contains no non-operating one-time effects in 2017. The prior year's EBIT included a non-operating one-time effect of EUR 10.6m in other operating income (see section 3.5.7 (13.)). This was eliminated from adjusted EBIT accordingly.

Expenses for equity-settled share-based payments increased by EUR 7.6m compared to the prior-year period. As no non-operating one-time effects were recorded in 2017, but non-operating other income of EUR 10.6m was included in the prior-year period, adjusted EBIT decreased by only 1.2 percentage points compared to the prior-year period, whereas unadjusted EBIT decreased by 1.5 percentage points.

## Results by Segment

The development of revenue and earnings reported by the segments of the Zalando group can be summarized as follows:

### Consolidated Segment Results

→ 26

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
<b>Revenues</b>		
DACH	2,145.6	1,813.8
Rest of Europe	1,973.6	1,570.2
Other	369.9	255.1
<b>Earnings before interest and taxes (EBIT)</b>		
DACH	175.6	221.4
Rest of Europe	9.6	-6.2
Other	2.5	-8.1
<b>Adjusted EBIT</b>		
DACH	188.5	226.3
Rest of Europe	21.6	-3.3
Other	5.0	-6.7

EBIT comprises the following expenses for equity-settled share-based payments and from non-operating one-time effects:

### Share-Based Compensation Expenses per Segment

→ 27

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
<b>Equity-settled share-based compensation expenses</b>			
	<b>27.5</b>	<b>19.9</b>	<b>7.6</b>
DACH	12.9	9.9	3.0
Rest of Europe	12.1	8.2	3.9
Other	2.5	1.9	0.7



EBIT contains no other non-operating one-time effects in 2017. The prior year's EBIT included non-operating one-time effects of EUR 4.9m in the DACH segment, EUR 5.3m in the Rest of Europe segment and EUR 0.4m in the Other segment.

Zalando's revenue growth was generated across all segments, thereby further expanding its market position.

In 2017, revenue grew by 18.3% in the DACH segment, by 25.7% in the Rest of Europe and by 45.0% in the Other segment, compared to the prior year.

Although revenue growth re-accelerated in the DACH segment in 2017, it showed good profitability with an EBIT margin of 8.2%. Compared to the prior year, EBIT margin decreased by 4.0 percentage points, which results from increased fulfillment costs, especially logistics costs, from a slightly decreased gross margin and from non-operating one-time effects in other operating income in the prior year, partly offset by an improvement in the marketing cost ratio. The increased volume of our curated shopping service, Zalon, which is especially strong in the DACH segment, also contributes to increasing fulfillment costs.

The EBIT margin in the Rest of Europe segment recorded an increase of 0.9 percentage points resulting in an EBIT margin of 0.5%. The EBIT margin increased primarily due to savings and efficiency gains in marketing costs, outweighing higher fulfillment costs. The EBIT margin in the Other segment improved by 3.9 percentage points from -3.2% to 0.7% in 2017, thereby reaching profitability in 2017. The increase mainly results from a gross margin uplift due to profitable sourcing deals.

#### Adjusted EBIT by Segment

In order to assess the operating performance of the segments, Zalando management also considers EBIT and EBIT margin before expenses for equity-settled share-based payments and non-operating one-time effects, if applicable. The DACH segment generated an adjusted EBIT margin of 8.8% in 2017. Compared to the prior year, the adjusted EBIT margin decreased by 3.7 percentage points. The Rest of Europe segment recorded an improvement in the adjusted EBIT margin compared to the prior year, which rose by 1.3 percentage points from -0.2% to 1.1%. The Other segment's profitability significantly increased, as adjusted EBIT margin improved by 4.0 percentage points from -2.6% in 2016 to 1.3% in 2017.

## Cash Flows

The liquidity and the financial development of the Zalando group are presented in the following condensed statement of cash flows:

### Condensed Statement of Cash Flows

→ 28

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
<b>Cash flow from operating activities</b>	<b>193.7</b>	<b>275.8</b>
<b>Cash flow from investing activities</b>	<b>-88.3</b>	<b>-277.1</b>
<b>Cash flow from financing activities</b>	<b>-10.6</b>	<b>-2.9</b>
Change in cash and cash equivalents	94.8	-4.1
Exchange-rate related and other changes in cash and cash equivalents	-1.9	0.5
Cash and cash equivalents at the beginning of the period	972.6	976.2
<b>Cash and cash equivalents as of December 31</b>	<b>1,065.5</b>	<b>972.6</b>



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Consolidated Statement  
of Cash Flows p. 140

In fiscal year 2017, Zalando generated a positive cash flow from operating activities of EUR 193.7m (prior year: EUR 275.8m). Further to a decrease in pre-tax income (which decreased from EUR 192.9m in the prior year to EUR 175.2m in the reporting year), cash flow from operating activities decreased largely due to a higher cash outflow from working capital (prior year: cash inflow). This was partly offset by the increase in cash inflows for VAT receivables and VAT payables and prepayments received.

The capital employed in net working capital increased compared to the prior year and thus negatively impacts the cash flow. Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities, increased from a low level of EUR -127.6m in the prior year to EUR -62.4m as of December 31, 2017 (also see section 2.2.3 Financial Position for details on net working capital development).

The cash outflow from investing activities mainly results from investments in the logistics infrastructure relating primarily to the fulfillment centers in Mönchengladbach, Lahr and Szczecin and capital expenditures on internally developed software as well as furniture and fixtures. Capex, being the sum of the payments for investments in fixed and intangible assets excluding payments for acquisitions, amounted to EUR 243.9m (prior year: EUR 181.7m). Cash flow from investing activities further consists of cash disinvested in term deposits with an original term of more than three months and is therefore presented in cash flow from investing activities. As of December 31, 2017, an amount of EUR 40.0m was still invested in such term deposits (December 31, 2016: EUR 220.0m). In 2017, an amount of EUR 34.9m was invested in corporate acquisitions (prior year: EUR 30.4m).

Free cash flow decreased by EUR 148.7m from EUR 63.7m to EUR -85.0m compared to the prior year. The main factor for the decrease is the lower cash inflow from operating activities and the higher capex.

As a result, cash and cash equivalents increased by EUR 92.9m during the year, resulting in Zalando carrying cash and cash equivalents of EUR 1,065.5m as of December 31, 2017.

Zalando's liquidity position – as the sum of cash and cash equivalents plus term deposits with an original term of more than three months but less than twelve months – declined by EUR 87.1m in 2017.

### Credit Facility

On December 15, 2016, ZALANDO SE concluded a revolving credit facility in the amount of EUR 500m with a group of banks, renewing its EUR 200m revolving credit facility secured in 2014. This facility can be drawn in various currencies. The revolving credit facility can be utilized for general business purposes (including acquisitions) as well as for guarantees. The facility expires on December 15, 2022, and may be extended until December 15, 2023. As of December 31, 2017, an amount of EUR 61.9m was utilized by bank guarantees and letters of credit.

### Financial Position

The group's financial position is shown in the following condensed statement of financial position.

#### Assets

→ 29

IN EUR M	Dec 31, 2017		Dec 31, 2016		Change	
Non-current assets	569.6	19.1%	392.6	15.5%	177.0	45.1%
Current assets	2,410.7	80.9%	2,145.6	84.5%	265.0	12.4%
<b>Total assets</b>	<b>2,980.3</b>	<b>100.0%</b>	<b>2,538.2</b>	<b>100.0%</b>	<b>442.1</b>	<b>17.4%</b>

#### Equity and Liabilities

→ 30

IN EUR M	Dec 31, 2017		Dec 31, 2016		Change	
Equity	1,538.9	51.6%	1,407.5	55.5%	131.4	9.3%
Non-current liabilities	71.9	2.4%	32.5	1.3%	39.3	120.9%
Current liabilities	1,369.5	46.0%	1,098.2	43.3%	271.3	24.7%
<b>Total equity and liabilities</b>	<b>2,980.3</b>	<b>100.0%</b>	<b>2,538.2</b>	<b>100.0%</b>	<b>442.1</b>	<b>17.4%</b>

In 2017, total assets increased by 17.4%. The statement of financial position is dominated by working capital, cash and cash equivalents and equity.

In 2017, investments in intangible assets amounted to EUR 108.7m (prior year: EUR 80.0m), while investments in property, plant and equipment totaled EUR 189.7m (prior year: EUR 135.7m).

Key components of the software used by the group are developed internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes are supported using internally developed software. In fiscal year 2017,



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Financial Position p. 136

additions related to capitalized development costs of EUR 51.2m (prior year: EUR 57.7m), of which EUR 36.8m is contained in prepayments and assets under development (prior year: EUR 36.4m).

Inventories in 2017 mainly represent goods required for Zalando's wholesale business. The EUR 201.9m increase in inventories to EUR 778.9m resulted from the increased business volume and from holding larger amounts of inventory in stock in order to increase availability and thus customer satisfaction.

Trade and other receivables as reported on December 31, 2017, are all current. The increase of EUR 62.7m to EUR 278.7m is primarily attributable to the higher volume in business.

Equity rose from EUR 1,407.5m to EUR 1,538.9m in the fiscal year. The EUR 131.4m increase primarily stems from the net income in the period. In the reporting period, the equity ratio fell from 55.5% at the beginning of the year to 51.6% as of December 31, 2017, on account of the rise in total assets.



Further Information  
Consolidated Statement of  
Changes in Equity p. 138

Current liabilities increased by EUR 271.3m in the reporting period. This increase is mainly attributable to trade payables and similar liabilities, which rose by EUR 199.5m from EUR 920.5m last year to EUR 1,120.0m in the reporting period. The increase is largely due to deliveries of merchandise in light of the higher business volume and longer payment terms. Moreover, under reverse factoring agreements, suppliers' claims against Zalando totaling EUR 328.9m were transferred to various factors as of December 31, 2017 (December 31, 2016: EUR 282.3m). These items were recognized in the statement of financial position under trade payables and similar liabilities.

Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities, increased from a low EUR -127.6m in the prior year to EUR -62.4m as of December 31, 2017. The increase results mainly from the increase in inventories, which reflects the higher business volume and the holding of larger amounts of inventory in stock in order to improve availability and thus customer satisfaction.

### Overall Assessment

The Management Board views the business development in 2017 as positive. Zalando consciously focused on growth opportunities, made key strategic investments and yet remained clearly profitable in the process. The Zalando group increased its revenue markedly in fiscal year 2017 and captured additional market share. As Zalando continued to push forward with growth investments in the consumer and brand proposition plus infrastructure, the EBIT margin decreased slightly.

The company's revenue target was fully met in 2017, whereas the EBIT and EBIT margin targets had to be slightly adjusted during the year. The 2016 group management report anticipated revenue growth in 2017 in the corridor between 20% and 25% and an adjusted EBIT margin between 5.0% and 6.0%. In the second quarter of 2017, Zalando specified its guidance for revenue growth to the upper half of its guided range of 20% to 25% and for adjusted EBIT margin to the lower half of the range. In a challenging market environment, we had a weaker-than-expected October in 2017, which resulted in a slight guidance adjustment for adjusted EBIT margin in the fourth quarter. The modified guidance for an adjusted EBIT margin of slightly below 5% was met by year-end. In this context, a strong increase in the number of orders and a similar level of average basket size

was expected. Sales growth met our guidance as sales increased by 23.4%. Thus, the group achieved its growth target for the third year in a row and delivered solid profitability slightly below the target set in the 2016 group management report.

#### 2.2.4 Employees

At the end of 2017, Zalando had 15,091 employees (prior year: 11,998), representing an increase of 25.8% on the prior year. The average headcount grew by 2,904 to 13,940. The significant growth was strongly driven by the increasing headcount in the Operations Department.

Additional information regarding our sustainability strategy is provided separately in section 1.2 Corporate Responsibility.<sup>28</sup>



Further Information  
Corporate Responsibility  
p. 12

<sup>28)</sup> The sustainability report is not part of the audited combined management report.

## 2.3 Subsequent Events

There were no significant events occurring after the end of the fiscal year that could materially affect the presentation of the financial performance and position of the group.

## 2.4 Risk and Opportunity Report

- Comprehensive risk and opportunity management implemented throughout the group
- Risks and opportunities are continuously monitored and managed
- The risk matrix clusters risks by probability of occurrence and qualitative impact
- Zalando wants to use the opportunities to create added value
- There is no indication in the current opportunity and risk situation that the existence of ZALANDO SE as a going concern is jeopardized

Zalando is permanently confronted with risks and opportunities that may negatively or positively impact the group's financial performance and market position. The risk and opportunity report outlines our company's most important risks and opportunities.

### 2.4.1 Integrated Risk and Opportunity Management System

The Management Board of ZALANDO SE assumes overall responsibility for setting up and operating an effective risk and opportunity management system for the Zalando group.

GRI 102-11

Successful risk management depends on group-wide standards for systematically handling risks and opportunities. For this purpose, Zalando created the Governance, Risk & Compliance (GRC) Department which identifies risks and opportunities at an early stage. The GRC function continuously refines the implemented risk management instruments and methodology and coordinates the defined core process (GRC cycle). The GRC cycle is designed to support the decision-making process with consistent, comparable and transparent information via standardized procedures to identify, assess, monitor, document and report on risks and the measures implemented. These standards are defined in the GRC manual and aligned with the Management Board.

The GRC function reports on the overall risk situation to the Management Board and to the Supervisory Board's audit committee on a biannual basis. If needed, the regular reporting process is supplemented by ad-hoc reporting. All employees of Zalando are requested to manage risks in their activities adequately and prevent or mitigate risks that could jeopardize the company's ability to continue as a going concern. The Internal Audit Team reviews the functional capacity and appropriateness of the risk management system regularly. In addition, the audit committee of the Supervisory Board, with the involvement of the statutory auditor, also monitors the effectiveness of the internal control, risk management and audit systems.

### 2.4.2 Countermeasures and Internal Control System

Zalando reviews all identified risks and opportunities at least twice a year to determine whether they are still valid and assessed correctly. The documentation is updated during each GRC cycle in the comprehensive risk catalog, which is set up as a risk control matrix (RCM). Relevant countermeasures, controls and responsibilities are assigned to each risk. The adherence and effectiveness of the relevant countermeasures and controls is assessed on a risk-based approach by the Internal Audit Team as part of their scheduled audits throughout the Zalando group.

#### System of Internal Financial Reporting Controls

In addition to the overall risk and opportunity management system described above, Zalando has implemented a more detailed system of internal financial reporting controls. Pursuant to Section 315 (4) HGB the key features of this system are explained below. It aims to identify, assess and manage all risks that could have a significant impact on the proper preparation of the separate and consolidated financial statements. As an integral component of the accounting and reporting process, the system of internal financial reporting controls comprises preventive, monitoring and investigative control measures in accounting and operational functions which ensure a methodical process for preparing the financial statements. The control system is based on the various company processes that have a significant impact on financial reporting.

These processes and the relevant risk for the financial reporting are analyzed and documented. A cross-process risk control matrix contains all controls, including a description of the control, type of control, frequency with which it is carried out, the covered risk and the person responsible. The control mechanisms implemented affect multiple processes and thus frequently overlap. These mechanisms, among other things, include determining principles and procedures, defining processes and controls, introducing approval and testing plans and guidelines. The group-wide accounting manual provides detailed accounting instructions; the processes for assessing inventories and receivables are central components. The system of internal controls is subject to regular reviews by the Accounting Department and modifications resulting from risk workshops conducted by the GRC Department or risk-based assessments performed by Internal Audit.

### 2.4.3 Risk Methodology and Reporting

All risks identified are assessed based on their probability of occurrence and their potential impact within a one-year time horizon after the assessment date.

The impact assessment is conducted either on a quantitative scale (preferred) or a qualitative scale. The quantitative classes are based on a scale relating to the potential financial impact on profit (EBIT). Qualitative classes are based on criteria considering the impact on the company's reputation or the effect of criminal prosecution (with special focus on compliance risks). The risks are presented net, meaning the risk-minimizing measures implemented are considered in the scoring of risks.



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Each risk is positioned in the risk matrix using the following approach:

Zalando Risk Matrix

→28

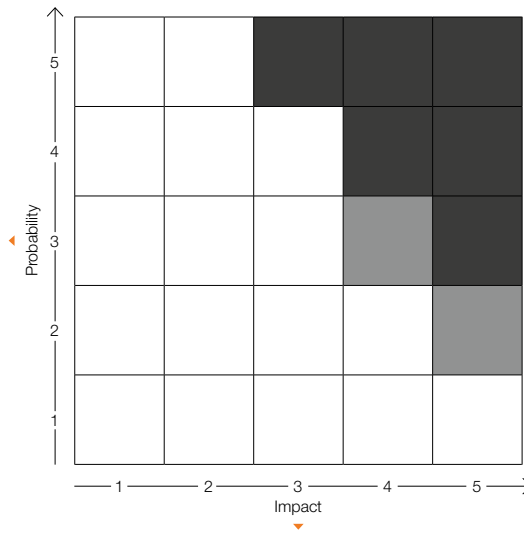


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Probability of occurrence (within the following year)

Class	Probability	Average
1	very low (0%–5%)	2.5%
2	low (5%–25%)	15%
3	medium (25%–50%)	37.5%
4	high (50%–75%)	62.5%
5	very high (75%–100%)	87.5%

- Zalando top risks
- Zalando expanded risk focus



Quantitative impact (preferred)

Class	Loss amount
1	EUR 0.075m–EUR 0.2m
2	EUR 0.2m–EUR 1.5m
3	EUR 1.5m–EUR 10m
4	EUR 10m–EUR 75m
5	> EUR 75m

Qualitative impact (alternative)

Class	Reputational effect	Criminal prosecution
1	very low	very low
2	low	low
3	medium	medium
4	high	high
5	very high	very high



In addition, risks in impact class 5 (quantitative) that exceed EUR 250m are denoted as risks that could jeopardize the company's ability to continue as a going concern.

All single risks and opportunities assessed as significant (Zalando top risks; Zalando expanded risk focus) using this methodology are described in detail in the section below. Overarching market opportunities and general opportunities are described in a separate section.

#### 2.4.4 Overview of Current Risks and Opportunities

In general, it cannot be ruled out that potential risks that are currently unknown or considered as insignificant may negatively impact the business in the future. Despite all countermeasures implemented to manage the identified risks, residual risks for all corporate activities that cannot be completely eliminated by a comprehensive risk management system still remain. Altogether, the risks are to be regarded as customary to an online retail business.

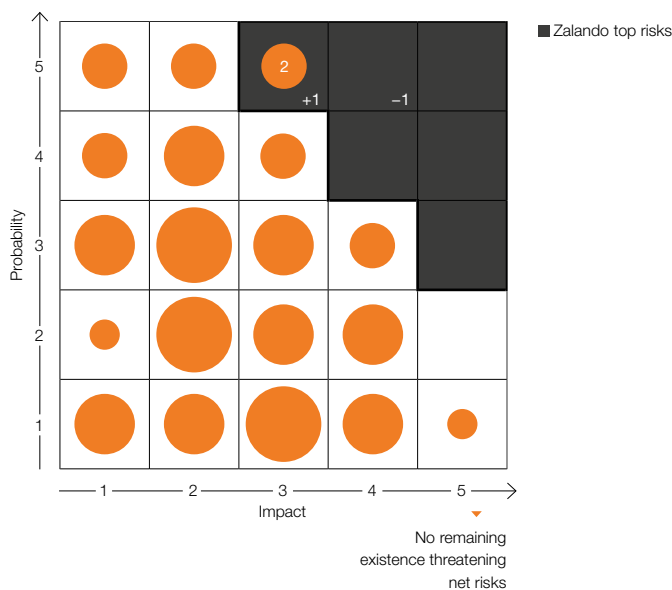
There are currently no net risks that would jeopardize the company's ability to continue as a going concern. Nevertheless, we deem two risks to be significant (top risks described below).

#### Risks with a Crucial Combination of Probability and Impact (Top Risks)

Based on the net risk view, risks are defined as top risks if they display a crucial combination of probability and impact (denoted by the dark grey-shaded area in the matrix).

Number of Top Risks (Net)

→ 29



Currently, risks from bad debt loss/external fraud and risks from overall outages with customer impact are considered as top risks for Zalando. Both risks were also part of the top risk section in fiscal year 2016 and are outlined below.

### Risks of Payment Default / External Fraud (Focus on Payment Transactions in the Retail Business)

The business concept of Zalando includes the offering of deferred payments (invoice) to its customers. Inherent to this payment method is a certain default quota that is to some extent anticipated by Zalando. The default risk is the risk that customers do not fulfill their contractual obligations and receivables remain unpaid. This can be the result of customers' payment habits or financial situation, or can be the result of fraud. Although applying multiple measures including a comprehensive payment and fraud management system to cope with the financial risk from default, the risk's probability remains at a high level. The size of Zalando's overall business produces large absolute deviations even with minor deviations from the planned relative ratios.

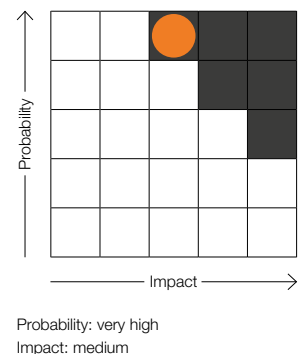
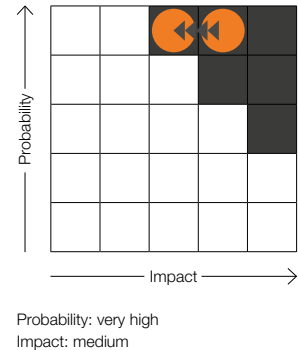
For the assessment of the risk, we considered a deviation from the anticipated level of bad debt loss. This anticipated bad debt loss is budgeted in our planning. In previous years, a general assessment of the bad debt loss was applied where the risk represented the full amount of defaults. As we anticipate the majority of the bad debt loss actually occurring as part of Zalando's business model and provide for it in the planning process, the risk assessment has been revised. Hence, the displayed risk shows the probability and deviation from the anticipated bad debt loss.

### Risks from Overall Outages with Customer Impact (Focus on Technology)

As an e-commerce company, Zalando is dependent on the functionality and stability of various online sites and services. Disruptions or outages would lead directly to revenue losses. The risk of unstable IT systems also applies to merchandise management and logistics. Interrupted workflows or inconsistent updates of stock may also result in considerable short-term revenue losses.

Monitoring systems are used, and incident management processes are established and documented. Incident management includes monitoring the financial impact and enables material incidents to be prioritized and solved. A system dashboard, which is continuously being improved, is utilized. Outsourced services (e.g. data center) are integrated in the monitoring processes, and adequate service level agreements are contracted. The Platform Infrastructure Team is responsible for ensuring these standards are in place throughout the development and deployment processes. Moreover, a "lessons-learned" process is implemented that, in case of system breakdowns, ensures that adequate measures derived from each incident are taken.

Preventive measures are implemented, and, in most cases, redundant systems are implemented, depending on the respective system. The group-wide incident management process was optimized with the implementation of a new automated incident management solution. To enable the teams to react faster, 24/7 availability of the teams was rolled out for approx. 60% of the technical engineers. To further improve monitoring and incident management, it is planned that SLI (service level indicators) & SLO (service level objectives) for each application are defined based on criticality, interdependencies to other systems, and customer impact.

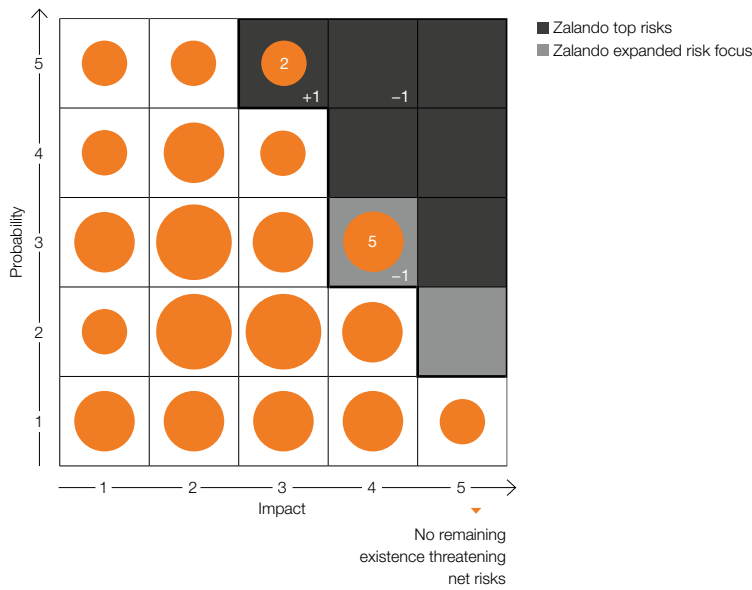


**Expanded Risk and Opportunity Area**

Risks and opportunities delineated by the light grey margin as shown in the matrix are considered to be significant risks due to the combination of a certain level of probability and a certain level of impact.

Number of Significant Net Risks

→ 30

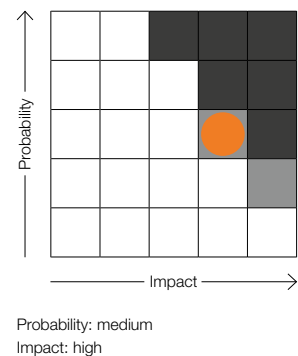


The number of risks within the Zalando expanded risk focus was reduced from six to five compared with fiscal year 2016, as additional implemented countermeasures are mitigating the “risk of missing market opportunities due to insufficient branding of private labels.” Despite the fact that the risk is no longer part of the expanded risk area, it is still closely monitored by the respective department, and additional countermeasures are planned for implementation.

**Risk of Strike**

Risks may emerge from strikes by workers employed in our warehouse facilities. The risk depends on various internal and external factors, including the degree to which the workforce is organized (membership in unions), the satisfaction of the workforce with the working conditions as well as activities of the unions regarding the industry in general or Zalando in particular. Strikes can lead to increased fulfillment costs, e.g. from dealing with backlogs and delays.

Zalando invests into good relationships with its employees. Zalando implements social standards audited by an external audit company and an open and continuous dialogue with its employees. The comprehensive wage strategy is guided by the relevant regional collective agreements for the logistics industry. Furthermore, Zalando strives to offer a good working environment and conditions, offers comprehensive employee development programs, and nurtures open and constructive communication with employees and their representatives.



## 2.4 RISK AND OPPORTUNITY REPORT

**Opportunities from Improved Forecasts Planning and Alignment of the Categories and Assortment**

Opportunities may be put at risk due to insufficient coordination of higher-level sales and sourcing planning. Lack of coordination and changes to plans may lead to planning errors. Furthermore, there is a risk that forecasts may be incorrect, meaning that predetermined budgets were calculated inaccurately. This, in turn, could lead to suboptimal budgeting in the different categories and unfavorable sourcing activities as well as missing logistics capacities.

Likewise, a forecast that delivers reliable predictions in combination with adequate coordination of higher-level sales and sourcing planning will enable Zalando to generate additional value through the budgeting and sourcing activities.

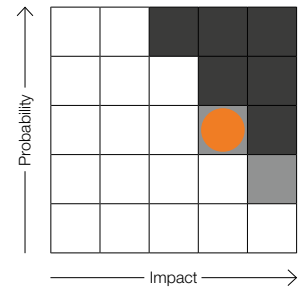
Zalando has set up a planning process on a rolling basis, which is carried out twice a year. The process is supported by the Merchandise Financial Planning function (MFP) and is managed overall by Category Controlling. Pre-season planning is prepared by the teams responsible for country clusters in cooperation with the individual Category Management Teams and brought into line with the higher-level category management planning. The plans are continuously refined with regular updates during the seasons (in-season planning). As deviations from the planned budget are likely to occur, adjustments in budgets are possible at short notice. Regular meetings on updates of plans take place, and the plans are aligned between category managers and other relevant departments.

The product-specific sales risk is countered by continuous sales analyses and budget planning. Zalando uses a detailed indicator system to identify negative discrepancies at an early stage and to implement appropriate measures in order to monitor and manage sales and stock levels. Additional flexibility can be achieved through follow-up orders. Returns to the supplier are negotiated and contracted to further mitigate the risk. In addition, Zalando recognizes write-downs on inventories to a sufficient extent. Inventory risk is an inherent risk to our business model and can have an impact anywhere along the supply chain.

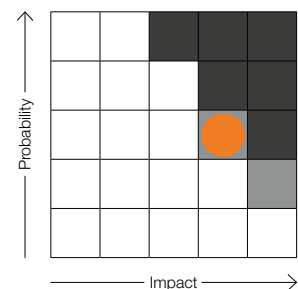
**Risks from Lack of "State of the Art" Shop and Service**

In order to meet the rising and changing demands on lifestyle products and service and to realize market opportunities, innovative and appropriate adjustments constantly have to be made to the shops. Neglecting the necessary adjustments or inadequate implementation of such measures can lead to customer migration away from Zalando, followed by significant revenue losses.

A significant overarching countermeasure is the establishment of the Digital Experience Team for the Fashion Store with dedicated ownership for the evolution of the Fashion Store on-site experience. The team identifies and suggests relevant developments and adjustments and coordinates implementation with stakeholders, thus ensuring the continuous development of the shops.



Probability: medium  
Impact: high



Probability: medium  
Impact: high

### Risks from Changing Regulatory Requirements within the Markets

With business activities in various countries, risks can arise from the quickly changing regulatory environments in many of them. Potential risk scenarios involve additional costs for necessary adjustments (customs, product safety, working conditions, product offering, consumer protection, etc.). In addition, subsequent events (exchange rate changes, unexpected customer behavior, reputational risks) can lead to increased damage. The risk exposure is mainly driven by anticipation of near-future to mid-term regulatory instruments in the context of the Digital Single Market initiative (DSM), the e-commerce sector inquiry of the EU Commission and the ePrivacy legislation. Risks might also arise due to legal uncertainties with regard to the implementation of recent enacted regulatory changes, such as the General Data Protection Regulation (GDPR) becoming applicable in May 2018. Attempts to address related issues within the member states or by events subsequent to Brexit are another risk factor. Changes in the regulatory framework can necessitate amendments to processes and business cases entailing an increase of costs or reduction of sales.

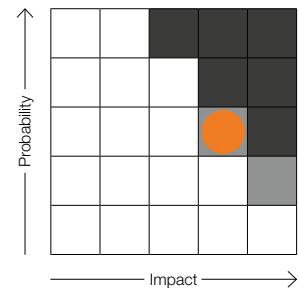
To reduce negative impact from regulatory changes, the GRC Department has implemented a Regulatory Watch process. This process ensures that relevant regulatory and legal topics are additionally allocated to the individual internal functions (e.g. Tax) that ensure the monitoring of changes throughout the markets by mandatory regular reports from these functions. The implementation of appropriate measures is initiated by the department to which responsibility for the respective topic is assigned.

The Regulatory Watch process is supported by Zalando's Legal Teams, who monitor regulatory changes by utilizing different channels (e.g., conferences and seminars, cooperation with external law firms, latest specialist literature) and initiate appropriate countermeasures together with the departments affected.

With regard to the main risk drivers, Zalando initiated the following mitigation measures:

**DSM:** Zalando's Public Affairs Team has started a dialogue with external stakeholders at EU level to give feedback and receive updates concerning planned regulations. Developments are being monitored and examined by the Legal Team for possible effects on Zalando's business case.

**GDPR:** The Data & IT Law Team, in close cooperation with the teams in Digital Foundation and Tech-Security, have set up and are executing a GDPR project, implementing previously identified new and changed regulatory requirements arising under the GDPR. In the process, the teams are reviewing, updating and refining the overarching privacy design and information security setup at Zalando.



Probability: medium  
Impact: high

**ePrivacy:** The Data & IT Law Team performed an in-depth analysis of the regulatory changes set out in the drafts of the ePrivacy regulation (ePrivacy Drafts) published by EU policy makers during the 2017 fiscal year. Together with relevant internal stakeholders, potentially affected business cases have been identified, and the risks emanating from the ePrivacy Drafts have been assessed, qualified and prioritized. Subsequently, mitigation measures were put into action. These include engagement with policy makers on the national and EU levels in close coordination with the Public Affairs Team and the preparation and roll-out of innovative solutions, workarounds and initiatives with external business partners, each with a view to reducing the potential impact on the identified business cases.

**EU e-commerce sector inquiry:** Zalando cooperated with the EU Commission and provided appropriate information following a request for information. The EU Commission adopted the final report on its inquiry and subsequent enforcement measures are being monitored closely by Zalando.

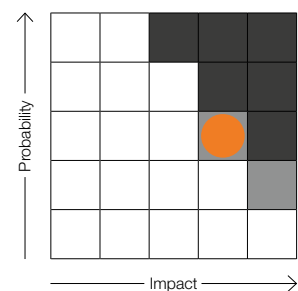
**Brexit:** a task force has been set up by the Legal Team to gather and evaluate Zalando-specific risks as a result of Brexit.

#### Risks from a Lack of Innovation Capabilities

The ability to promptly implement innovations as well as products catering to current market trends is a precondition for sustainable success. A strong innovation culture needs to exist throughout the company. Structures, decision making and budgets need to ensure the desired innovation capability.

To ensure innovativeness, the management ensured that a number of management principles were implemented to foster an innovative culture, such as the concept of agile software development (radical agility) and the concept of de-centralized decision making (dedicated ownership).

Project proposals are continuously being prepared and validated by dedicated owners, and projects concerning customer benefits are being prioritized.



Probability: medium  
Impact: high

## Financial Risks

Zalando is required to describe its financial risks pursuant to Section 289 (2) No. 1b HGB. In the course of its ordinary activities, Zalando is exposed to counterparty risk, liquidity risk, and currency and interest-rate risks. The aim of financial risk management is to limit the risks resulting from operating activities through the use of selected derivative and non-derivative hedging instruments. Derivative financial instruments are used solely for the purpose of risk management.

### Counterparty Risk

Counterparty risk refers to the risk that a counterparty may default on its obligation to Zalando. The default risk mainly arises from trade receivables and, to a lesser extent, in terms of probability of occurrence from claims originating from financial contracts with other parties, e.g. term deposits, derivative financial assets and bank account balances.

The company addresses this exposure by distributing its derivative financial instruments and cash held at banks over multiple financial institutions to minimize risk exposure to a single counterparty (also by setting maximum investment amounts). In addition, counterparty credit rating criteria are applied as well.

### Liquidity Risk

The liquidity risk is defined as a possible lack of cash funds to fulfill the financial obligations of the company. This risk may arise from insufficient centralization of cash where it is needed, imprecise liquidity forecasting or unbalanced investment strategy for the company's cash reserves.

Zalando manages its exposure to liquidity risk by regularly monitoring liquidity needs using an integrated platform for short-, medium-, and long-term forecasting of the cash requirements by entity. Additionally, the group invests the cash reserves of the company in term deposits and money market instruments with a target maturity profile, and pools the cash balances centrally on a regular basis to ensure adequate distribution of cash where it is needed.

### Currency and Interest Rate Risk

The currency risk is defined as the risk of differences in actual and planned foreign exchange revenue and cost items as a result of fluctuating exchange rates, with a potential negative impact on the company's financial results. Likewise, the interest rate risk is defined as the risk of changes in interest due on maturing debt as a result of varying reference interest rates, with potential negative implications for interest expenses.

Zalando operates in different markets and is therefore exposed to foreign currency risk generated from revenues and sourcing transactions in foreign currencies. Currency exposure is managed by means of regular cash pooling to the EUR as the functional currency, natural hedging, and forwards hedging.

Forward contracts are recognized as cash flow hedges if the conditions of hedge accounting are fulfilled. Once the hedged item has been realized as a cash flow hedge, the forward exchange contracts are used as fair value hedges to compensate for market value fluctuations of the outstanding trade receivables and trade payables and similar liabilities denominated in foreign currency. Forward exchange contracts are concluded with a term not exceeding 18 months. Derivative financial

instruments are concluded and processed in accordance with internal guidelines that set out binding rules for the scope of action, responsibilities, reporting and controls.

The foreign currency sensitivity of the group is calculated by aggregating all foreign currency items that are not presented in the functional currency of the respective entity. These items are compared with the aggregated hedging transactions. The market values of the hedged items and hedging transactions included are measured at current exchange rates and sensitivity rates. The difference between these measurements represents the effects on earnings and equity.

If the euro had appreciated by 5% against the foreign currencies as of December 31, 2017, earnings before taxes would have been EUR 5.0m lower (prior year: EUR 7.3m). If the euro had depreciated 5% compared with the exchange rate as of December 31, 2017 earnings before taxes would have been EUR 5.6m higher (prior year: EUR 8.1m).

The impact on profit or loss by currency breaks down as follows:

#### Foreign Currency Sensitivity on Profit or Loss 2017

→ 31

IN EUR M	Impact on profit or loss							Total
	CHF	DKK	GBP	NOK	PLN	SEK	USD	
<b>FX rate as Dec 31, 2017</b>	<b>1.1702</b>	<b>7.4449</b>	<b>0.8872</b>	<b>9.8403</b>	<b>4.1770</b>	<b>9.8438</b>	<b>1.1993</b>	
5% increase in FX rate	-1.2	-0.4	0.0	-0.3	-1.9	-0.2	-0.9	-5.0
5% decrease in FX rate	1.3	0.5	0.0	0.3	2.1	0.2	1.0	5.6

The reserve for derivatives in group equity would have been EUR 38.8m higher (prior year: EUR 34.6m higher) if the euro had appreciated 5% compared with the exchange rate as of December 31, 2017. This reserve would have been EUR 42.9m lower (prior year: EUR 38.2m lower) if the euro had depreciated 5%.

The impact on other comprehensive income by currency breaks down as follows:

#### Foreign Currency Sensitivity on Other Comprehensive Income 2017

→ 32

IN EUR M	Impact on other comprehensive income							Total
	CHF	DKK	GBP	NOK	PLN	SEK	USD	
<b>FX rate as Dec 31, 2017</b>	<b>1.1702</b>	<b>7.4449</b>	<b>0.8872</b>	<b>9.8403</b>	<b>4.1770</b>	<b>9.8438</b>	<b>1.1993</b>	
5% increase in FX rate	26.4	0.0	-0.8	5.1	8.0	7.0	-6.9	38.8
5% decrease in FX rate	-29.2	0.0	0.9	-5.7	-8.9	-7.8	7.7	-42.9



The interest rate risk arises from interest rate fluctuations on the earnings, equity or cash flow for the current or future reporting period. Interest rate risks from financial instruments in the group are mainly related to financial liabilities and liabilities from the reverse factoring programs. These risks are partly reduced by entering into interest rate swap.



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The interest rate risk for floating-rate financial instruments does not represent a material risk for the group.

## Market Opportunities

### Macroeconomic Development

The European Commission projects eurozone growth of 1.8% in 2018 and EU growth of 1.8%<sup>29</sup>. Private consumption is expected to be one of the main drivers of growth during the forecast period. Labor market gains across important European economies will also contribute to an increase of disposable income in real terms. The World Bank's forecast is also optimistic, with growth in the region predicted to accelerate to 2.1% in 2018 – and an average of 1.6% between 2019–2020<sup>30</sup>, driven by a recovery in commodity-exporting economies and improved confidence. This outlook is predicated on the basis of a continued, but modest, recovery in commodity prices and easing geopolitical tension.

In Germany, it is expected that growth momentum will continue. The solid labor market, resilient exports and booming construction investment are expected to provide a boost to growth and drive private consumption. These developments give Zalando a favorable economic and consumer market to reinforce its market position and increase its revenue.

### Growing Fashion Market in Europe

European online fashion sales amounted to roughly EUR 55.6bn in 2017, making up 13%<sup>31</sup> of all fashion retail<sup>32</sup>. While the overall market for fashion in Europe (excluding Russia) remained virtually unchanged between 2016 and 2017, online fashion sales grew at a considerably faster rate with average annual growth (CAGR) of approximately 12% during the past 5 years.<sup>33</sup> This trend is forecasted to continue as the percentage of people in the overall population who became familiar with digital technology at a young age continues to rise.

Europe is a highly attractive fashion market with concentrated wealth and a high population density. These factors work to the advantage of online fashion sales.

Zalando is well positioned to benefit from these favorable market conditions due to the strength of its fashion brand, its consumer reach, its brand partner relationships, the scale of its technology and fulfillment operations across European markets, and its deep understanding of the digital economy.

The online retail market in Europe reported revenue totaling EUR 55.6bn in 2017, with a CAGR of 12% since 2012.<sup>34</sup> While the online share of retail trade in the United States came to 20% in 2017<sup>35</sup>, the online share of retail trade in Zalando's target market, Europe, rose from 13% in 2016 to 15% in 2017<sup>36</sup>.

As the online retail market continues to grow, Zalando's focus on providing customers with unique fashion experiences, convenient delivery services, and a leading digital shopping experience puts the group in a favorable position to further expand its revenue and market share. As Zalando

29) European Commission 2017

30) World Bank 2018

31) Euromonitor, Europe excl. Russia

32) Euromonitor, Europe excl. Russia

33) Euromonitor, Europe excl. Russia

34) Euromonitor, Europe excl. Russia

35) Euromonitor, United States of America

36) Euromonitor, 15 countries, in which Zalando operates

further cements its position as a trusted and well-loved fashion companion, we will continue to win new customers and retain existing ones for the long term. Most importantly, the strategic realignment to move towards a platform business model will create new opportunities for growth. It is envisioned that the platform business model brings together different fashion stakeholders, which will in turn help to enhance selection, expand inspiration channels, and improve convenience services. Moreover, Zalando can continue to exploit the high online market potential for European fashion through its presence, which now extends to 15 European countries, and the constant expansion of its own product range.

### Mobile Commerce

Mobile commerce provides a significant opportunity. Retail sales generated via mobile devices have risen significantly within Europe, amounting to EUR 85.56bn in 2017 compared to EUR 67.31bn in 2016<sup>37</sup>. Moreover, a further growth at a 13% CAGR is expected in the upcoming years.<sup>38</sup> This growth has been driven by the ubiquity of mobile device usage. Today's customers use their mobile devices on a daily basis to engage in a wide variety of activities ranging from browsing and shopping for products, interacting with brands on social media channels, scheduling deliveries, to tapping their smart assistants for product and sizing recommendations.

As the number of mobile commerce use cases continues to multiply, we see a parallel trend whereby users are starting to rely on a smaller number of apps to power their mobile channel experiences. At Zalando, we are aware that in order to differentiate ourselves and stay relevant, we need to leverage our mobile channels to connect customers with the right information in order to help them make informed shopping decisions. With this goal in mind, Zalando's focus is on designing superior mobile experiences to meet the customer anytime, anywhere: be it on its mobile app, its mobile site, social apps, or other connected devices. As a customer centric-company, Zalando is constantly looking for innovative ways to leverage mobile channels to interact with customers, empower them, and help them discover fashion in new and inspiring ways. During 2017, Zalando set up a dedicated team around mobile apps to gain speed on the development of mobile products, to improve the technical foundation and the ways to market apps on different channels (e.g. Facebook, Google, Snapchat).

## General Opportunities Arising from Zalando's Business Activities

### Innovative and Scalable Logistics

Over the past few years, Zalando has made significant investments to expand and automate its pan-European logistics network – now consisting of seven fulfillment centers in four countries – such as implementing and ramping up a bag-sorter in Mönchengladbach, bringing our warehouse operation to a new level of automation. In 2017, a new fulfillment center in France near Paris went live, and another one in Sweden commenced operations but is still under construction. Another new fulfillment center in Poland started initial operations in fall 2017, while two additional new fulfillment center projects have been initiated – one in Poland and another in Italy. All these efforts are aimed on getting closer to Zalando's customers, thus providing an opportunity to further reduce lead times as well as preparing our network for further growth.

Scalable and innovative logistics provide a source of new growth opportunities for Zalando. They not only enable the company to expand its coverage of convenience benefits, but they also enhance Zalando's attractiveness as an essential and effective logistic partner for fashion brands and retailers.



[zln.do/en-logistics-network](http://zln.do/en-logistics-network)

<sup>37)</sup> Euromonitor, Europe excl. Russia

<sup>38)</sup> Euromonitor, Europe excl. Russia

In 2017, Zalando extended the service Zalando Fulfillment Solutions (ZFS), making logistics infrastructure and know-how available to brand partners. Through this new service, partners such as Bestseller can now leverage Zalando's logistic capabilities to scale up their businesses internationally and provide the highest delivery standards for their customers across Europe. Currently, ZFS is supported by one dedicated fulfillment center, but the goal is to roll out this offering to more fulfillment centers. ZFS will play a critical role in supporting the growth of Zalando's Partner Program.



[zln.do/en-zfs](https://zln.do/en-zfs)

Innovative logistics are a crucial component behind Zalando's convenience proposition as they enable the company to meet customers' heightened convenience expectations. Faster deliveries and a growing number of delivery options tailored to customer needs would not be possible without innovative logistics, e.g. new services such as same day delivery and return on demand in selected cities. These initiatives are then also leveraged to bring to life services such as "From Store to Door" – direct deliveries from retail stores of selected brand partners to their customers' homes. Zalando is committed to enhancing its innovative and scalable logistics in order to help brand partners grow and to ensure that customers' shopping experience becomes even easier, faster, and more convenient.



[zln.do/en-post-order-experience](https://zln.do/en-post-order-experience)

### Smart Data

Data is at the core of Zalando's platform. By combining data with appropriate technology tools, Zalando is able to effectively play a matchmaking role and facilitate frictionless interactions between supply- and demand-side players in the fashion ecosystem. In this regard, the Zalando platform is geared towards increasing legally compliant data flows between platform stakeholders (e.g. fashion brands, manufacturers, stylists, content creators, logistics, and service providers) in order to unlock new growth opportunities and generate additional value for everyone.

Gaining a good understanding of customer preferences and fashion trends is a prerequisite for effectively connecting platform stakeholders and enabling new ways of consuming and producing fashion. Zalando also leverages data to optimize every aspect of the business through more accurate production forecasts, improved personalization, targeted advertising and smart fulfillment services. The company's overarching objective is to develop scalable solutions that can help both brand partners and customers navigate the digital fashion universe.



[zln.do/en-zms](https://zln.do/en-zms)

### Innovative Technology

Technology forms the backbone of Zalando and drives all workflows – from automating wholesale buying, personalizing customer's shopping journey, to seamlessly connecting fashion partners' stock to online platforms. Furthermore, technology not only underpins every internal business process and digital solution offered on the platform, but it is also increasingly leveraged to reduce inefficiencies in the broader fashion ecosystem.

Due to the increased complexity of digital infrastructure, fashion brands and retailers need additional support to digitalize their businesses. In this context, Zalando's ability to combine fashion competence with advanced technological capabilities makes it an attractive partner to help brands and retailers accelerate their online growth. Customers also benefit from technological advances. Zalando is currently building the infrastructure needed to move from recommendations to personalized fashion advice across all customer touch points. New solutions, powered by artificial intelligence (AI), are being implemented to help customers find their unique size and fit preferences.



[zln.do/en-personalization](https://zln.do/en-personalization)

Technology is not only a major driver of efficiencies in the fashion ecosystem, but it is also a source of new models and opportunities to produce, consume, and discover fashion. Through continuous investments and strategic acquisitions, Zalando intends to consolidate its position at the forefront of the technological transformation of the fashion ecosystem.

### Local Alignment

The European market is extremely heterogeneous, with highly localized needs for fashion styles, payment methods, and delivery options. No other online fashion retailer understands the particularities of all European markets as well as Zalando does. The company is able to adapt its customer and partner proposition to every single market in which it operates. Localization is – and will continue to be – one of Zalando’s core differentiators. We will continue building our image of a local fashion specialist through country-specific campaigns and by reflecting local characteristics in our respective sales approach.

At the same time, Zalando uses a central platform and infrastructure to source its merchandise, fulfill orders, and leverage technology solutions across Europe. This approach provides a source of additional competitive advantages since it generates economies of scale that make platform investments possible. These capabilities endow Zalando with first-mover advantages to pursue new opportunities and quickly respond to fast fashion trends emerging across markets in Europe.

### Fashion Expertise

Consumers tend to move towards those shops offering the best selection and the relevant trends. Meeting this challenge requires fashion competence and the ability to design an exciting and personalized fashion experience. To prevail over the competition, Zalando has systematically developed these skills in a number of different ways.

With its internally designed labels, Zalando offers products whose lifecycle is managed under one umbrella from the design phase right through to sale. Zalando has succeeded in creating popular brands with a loyal customer base and has started to also offer the products through additional external distribution channels.

To remain at the cutting edge, Zalando’s trend scouts intensively search the markets and fashion centers to predict and also set the trends for the coming season.

Having built up a base of about 500 freelance stylists under the Zalon brand, Zalando has access to a huge pool of fashion experts willing to build a business together with Zalando and bringing in deep fashion knowledge from a vast number of different fashion markets. At Zalon, the stylists are able to offer a highly personalized experience since not one single box they put together resembles another. Adding additional services to our offering, such as most recently subscription and messaging, Zalando is able to leverage stylists’ skills even more in the future, contributing to an inspiring and convenient customer journey.

### An Attractive Partner

Fashion brands and retailers value Zalando as a preferred partner due to its fashion competency and technological capabilities. Zalando supports partners to connect with customers across Europe and helps them tackle some of the most complex and challenging issues that they face across the



[zln.do/en-assortment](https://zln.do/en-assortment)



[zln.do/en-zalon](https://zln.do/en-zalon)



[zln.do/en-partner-solutions](https://zln.do/en-partner-solutions)

fashion ecosystem. In this sense, Zalando enables brands and retailers within its Partner Program to sell their merchandise via the Zalando platform and provides tools that are necessary for partners to adjust their digital content across the markets. Zalando's online flagship stores are at the heart of this approach, enabling partners to interact directly with customers and build loyalty for their brand.

In response to the rapid pace of transformation in the fashion ecosystem, Zalando has expanded its partner proposition to help brands stay on top of new developments and technologies. The company has moved beyond providing data insights tools to offering holistic technology solutions tailored to partners' specific needs. This includes, but it is not limited to: Zalando Fulfillment Solutions (ZFS), stock integration technologies, and marketing and advertising services. The overarching goal is to help brands grow their online presence by helping them to simplify their e-commerce operations both on and off the Zalando platform. As Zalando continues to innovate its partner offering, new and interesting opportunities emerge to create new fashion products and services on top of the platform.

#### Personnel Opportunities

Zalando's successful growth is based on the competencies and motivation of its employees. Due to the considerable growth of its core business, the penetration of new business areas, and the rapid international expansion, Zalando constantly needs to strengthen its team. This is supported by an improved performance and development approach for all employees and by diverse initiatives to foster our culture at Zalando.

Recruiting plays a key role in human resources work. Recruiting highly skilled employees can help boost efficiency and foster innovation and creativity, thus increasing revenue and profitability. The recruiting process therefore was improved by different tools to speed up the process and to support the hiring of desired talents.

## 2.5 Outlook

- Significant growth is again forecast for internet retailing in Europe and Germany
- For 2018, a 9.7% increase in online fashion sales is forecast for Europe, while 14.8% is forecast for Germany
- Zalando aims to continue its course of profitable growth and capture further market share
- Revenue in 2018 is set to grow by 20%–25%, adjusted EBIT is expected to be between EUR 220m and EUR 270m

### 2.5.1 Future Overall Economic and Industry-Specific Situation

European online retail is expected to see continued strong growth. The European retail industry is expected to achieve year-on-year growth of just 1.5% in 2018, while online retail is expected to grow by 13.2%.<sup>39</sup> Similarly, in Germany the retail forecast is 1.9% growth, whereas internet retailing is set to grow by 10.9% in 2018.<sup>40</sup>

The online fashion industry in Europe and Germany is also predicted to enjoy continued growth. Fashion sales in Europe are expected to grow minimally at 0.8%, while fashion sales in Germany are expected to grow even more slowly at 0.3%.<sup>41</sup> In contrast, online fashion sales are expected to grow significantly faster in both regions. Online fashion sales in Europe are expected to increase by approximately 9.7% in 2018, while predictions for Germany anticipate strong growth of 14.8%<sup>42</sup> compared with the previous year.

Due to its wide brand awareness among European consumers, a large customer base, strong supplier relationships, its infrastructure footprint and its fashion and mobile technology capacity, Zalando is certain that it is well positioned to benefit from these favorable market conditions. The high emotional factor that both brands and customers associate with fashion also provides independent and pure-play fashion e-commerce retailers, like Zalando, a considerable advantage over non-specialized e-commerce retailers.

### 2.5.2 Future Development of the Group

The goal is to grow further significantly faster than the online market, thereby strongly growing the company's market share. This growth will be enabled through continued investments in Zalando's customer proposition. Management believes this is the value-maximizing strategy for the company. As such, investments will continue also throughout 2018 into the most important elements of Zalando's customer proposition:

- Digital experience: we focus on building the leading digital experience in fashion e-commerce. A key driver of customers' experience is the level of personalization. With our ever-increasing assortment, it is important that we tailor the offering towards individual customers. As such, Zalando aims to provide every customer with his or her own personalized Zalando store.
- Convenience: Zalando continues to invest heavily in convenience for its customers. In 2018, Zalando will further automate its existing logistics footprint to increase efficiency and speed.



End of the Quick Reader  
Information

39) Euromonitor, Europe excl. Russia, Germany  
40) Euromonitor, Europe excl. Russia  
41) Euromonitor, Germany  
42) Euromonitor, Europe excl. Russia, Germany

The construction of two fulfillment hubs in Poland and one in Italy as well as a satellite warehouse in Sweden will continue. Additionally, we will build a new fulfillment center for our Lounge business.

- Assortment: Zalando provides customers in 15 European markets with access to more than 300,000 articles from almost 2,000 brands and aims to launch two additional European markets this year. We work towards continued progress through an ongoing expansion of our assortment, including the launch of additional brands, initiation of beauty as a new category, and the further expansion of our Partner Program.
- B2B services: the further build-out of platform initiatives such as Zalando Media Solutions and Zalando Fulfillment Solutions will enable additional growth opportunities.

In short, we will continue to work hard to make our customers' journey even more exciting.

As the European online fashion market is expected to grow at roughly 10% during 2018<sup>43</sup>, Zalando targets to grow significantly faster and further build its markets share: the company forecasts revenue growth within a corridor of 20% to 25% in fiscal year 2018 (fiscal year 2017: 23.4%). The strong revenue growth is expected to be primarily driven by an increase of the active customer base as well as an increase in the number of orders per active customer. As in the past, we expect that both drivers contribute in a balanced way.

Zalando expects to continue to grow profitably, showing growth also in its adjusted EBIT in 2018. The company expects adjusted EBIT of EUR 220.0m to EUR 270.0m (EBIT EUR 185.0m to EUR 235.0m) (fiscal year 2017: adjusted EBIT of EUR 215.1m; EBIT of EUR 187.6m).

Due to continued strong logistics investments, the capex volume is expected to stay at an elevated level of around EUR 350m.

### 2.5.3 Overall Assessment by the Management Board of ZALANDO SE

Overall, the Management Board views the developments in fiscal year 2017 and the economic position of Zalando as positive. The group returned a profit once again at group level in the fiscal year. Zalando showed significant growth, made important long-term investments and achieved a solid level of profitability. The company has grown considerably in all markets and has improved its market position further. In 2018, Zalando expects to be able to continue the strong business performance seen in the past fiscal year.

The comments on future development in this management report are made by the Management Board to the best of their knowledge and belief based on estimates made at the time these financial statements were prepared. The statements are by nature subject to a series of risks and uncertainties. The actual results may therefore deviate from these forecasts should one of these or other uncertainties arise or the assumptions on which the statements are made prove to be inaccurate.

43) Euromonitor, Europe excl. Russia, Germany

## 2.6 Supplementary Management Report to the Separate Financial Statements of ZALANDO SE

The management report of ZALANDO SE as a separate entity and the group management report have been combined. The following notes are based on the annual financial statements of ZALANDO SE, which were prepared in accordance with the provisions of the German Commercial Code and the AktG ["Aktiengesetz": German Stock Corporation Act] in conjunction with Art. 61 EU CR 2157/2001.

### 2.6.1 Business Activity

ZALANDO SE is the parent company of the Zalando group. Its registered office is the corporate headquarters in Berlin. Its operating activities mainly include the development, sourcing, marketing and retail sale of various types of goods, in particular clothing and shoes. Other responsibilities include management of the online shops, HR management, IT, finance management and risk management. The country-specific websites of Zalando as well as the websites of Zalando Lounge are part of ZALANDO SE.

GRI 102-3

As the parent company of the group, ZALANDO SE is represented by its Management Board, which sets the direction of the group and defines the corporate strategy.

The financial statements of ZALANDO SE are prepared in accordance with the German Commercial Code. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the EU. This gives rise to differences in recognition and measurement policies. The differences primarily relate to provisions, fixed assets, financial instruments, deferred taxes.

In addition, ZALANDO SE has extensive supply and service relationships with its subsidiaries. The services purchased essentially encompass fulfillment and distribution services, content creation and customer service as well as procurement services.

The services ZALANDO SE provides to its subsidiaries comprise administrative and IT services.



## 2.6.2 Economic Situation of ZALANDO SE

The results of operations of ZALANDO SE presented in the following condensed income statement broken down by the type of expense reveal revenue growth with solid profitability in the reporting period.

GRI 103-1/-2/-3 MA  
Economic Performance  
GRI 201-1

### Income Statement of ZALANDO SE According to German Commercial Code (Short Version)

→ 33

IN EUR M	Jan 1 – Dec 31, 2017	As % of sales	Jan 1 – Dec 31, 2016	As % of sales	Change in percentage points
Revenue	4,479.6	100.0%	3,650.7	100.0%	0.0pp
Own work capitalized	36.5	0.8%	45.2	1.2%	-0.4pp
Other operating income	48.9	1.1%	50.7	1.4%	-0.3pp
Cost of materials	-2,533.9	-56.6%	-2,043.3	-55.9%	-0.7pp
<b>Gross profit</b>	<b>2,031.1</b>	<b>45.3%</b>	<b>1,703.3</b>	<b>46.7%</b>	<b>-1.3pp</b>
Personnel expenses	-278.8	-6.2%	-227.4	-6.2%	0.0pp
Amortization and depreciation	-37.4	-0.8%	-27.0	-0.7%	-0.1pp
Other operating expenses	-1,545.6	-34.5%	-1,245.9	-34.2%	-0.3pp
<b>Earnings before interest and taxes</b>	<b>169.4</b>	<b>3.8%</b>	<b>203.0</b>	<b>5.6%</b>	<b>-1.8pp</b>
<b>Financial result</b>	<b>0.2</b>	<b>0.0%</b>	<b>-4.4</b>	<b>-0.1%</b>	<b>0.1pp</b>
<b>Results from ordinary business activities</b>	<b>169.6</b>	<b>3.8%</b>	<b>198.6</b>	<b>5.4%</b>	<b>-1.7pp</b>
Income taxes	-64.4	-1.4%	-65.7	-1.8%	0.4pp
<b>Net income for the year</b>	<b>105.1</b>	<b>2.3%</b>	<b>132.9</b>	<b>3.6%</b>	<b>-1.3pp</b>
EBIT margin	3.8%		5.6%		-1.8pp

In the reporting period, Zalando increased its revenue by EUR 829.0m to EUR 4,479.6m. The 22.7% increase in revenue is the result of the higher number of orders (30.8%) and a larger customer base. Zalando continued its positive development in all markets.

In the current fiscal year, the DACH countries generated more than half of the 24 total revenue. At the same time, revenue recorded in the other European countries climbed significantly, contributing substantially to overall growth.

## Revenue of ZALANDO SE by Segment

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IN EUR M	2017		2016		Change	
DACH*	2,350.1	52.5%	1,952.0	53.5%	398.1	20.4%
Rest of Europe**	2,129.5	47.5%	1,698.7	46.5%	430.8	25.4%
<b>Total</b>	<b>4,479.6</b>	<b>100.0%</b>	<b>3,650.7</b>	<b>100.0%</b>	<b>828.9</b>	<b>22.7%</b>

\*) As in fiscal 2016, DACH countries include Germany, Austria and Switzerland.

\*\*\*) As in fiscal 2016, the Rest of Europe comprises the Netherlands, France, Italy, the United Kingdom, Poland, Belgium, Sweden, Finland, Denmark, Spain, Norway and Luxembourg.

Other operating income mainly results from income from foreign currency translation.

The cost of materials rose by EUR 490.6m to EUR 2,533.9m, in line with the expansion of business. The increase of 0.7 percentage points in the ratio of the cost of materials to revenue to 56.6% can be primarily attributed to a higher discount level in fiscal year 2017. Overall, the company generated a gross profit of EUR 2,031.1m in fiscal year 2017 (prior year: EUR 1,703.3m).

Personnel expenses rose by EUR 51.4m to EUR 278.8m, in line with the rise in the number of employees. As of December 31, 2017, the headcount increased by 365 on the prior year from 3,929 to 4,294 employees.

Other operating expenses primarily include marketing expenses as well as shipping and fulfillment costs. The cost ratio as a percentage of revenue (34.5%) is slightly below the previous year. The increase in the fulfillment cost ratio, which is mainly driven by the extension of the logistics network, was not fully compensated for by lower marketing costs resulting from efficiency gains in particular within performance marketing.

The EBIT for the year of EUR 169.4m decreased by 1.8 percentage points mainly due to a lower gross profit margin and a higher fulfillment cost ratio.

The financial result comprises income from profit transfers of EUR 6.6m (prior year: EUR 4.4m) mainly from the profits generated by the outlets in Berlin, Frankfurt and Cologne during the reporting period.

Income taxes include the deferred taxes and current income taxes paid or payable. They comprise trade tax, corporate income tax and the solidarity surcharge. As in the prior year, the statutory corporate income tax rate, including the solidarity surcharge, for the assessment period 2017 was 15.8%. The applicable trade tax rate was 14.8% as in the prior year.

Current and deferred taxes are presented in the following table.

Income Taxes		→ 35	
IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	
Deferred taxes	-21.1	-41.8	
Current taxes in Germany	-43.3	-23.9	
<b>Total</b>	<b>-64.4</b>	<b>-65.7</b>	

In fiscal year 2017, deferred tax liabilities of EUR 16.5m were recognized mainly due to the capitalization of intangible assets.

### Net Assets and Financial Position

The net assets of ZALANDO SE are shown in the following condensed statement of financial position.

Assets		→ 36			
IN EUR M	Dec 31, 2017		Dec 31, 2016		Change
Non-current assets	620.3	21.2%	461.8	17.9%	158.5
Current assets	2,292.8	78.3%	2,091.8	81.3%	201.0
Prepaid expenses	14.3	0.5%	15.4	0.6%	-1.1
Deferred tax assets	0.0	0.0%	4.5	0.2%	-4.5
<b>Total assets</b>	<b>2,927.4</b>	<b>100.0%</b>	<b>2,573.5</b>	<b>100.0%</b>	<b>353.9</b>

## Equity and Liabilities

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IN EUR M	Dec 31, 2017		Dec 31, 2016		Change
Equity	1,569.0	53.6%	1,444.0	56.1%	125.0
Special items for government grants	0.2	0.0%	0.1	0.0%	0.1
Provisions	250.9	8.6%	237.2	9.2%	13.7
Liabilities	1,087.1	37.1%	890.5	34.6%	196.6
Deferred income	3.7	0.1%	1.7	0.1%	2.0
Deferred tax liabilities	16.5	0.6%	0.0	0.0%	16.5
<b>Total equity and liabilities</b>	<b>2,927.4</b>	<b>100.0%</b>	<b>2,573.5</b>	<b>100.0%</b>	<b>353.9</b>

The total assets of ZALANDO SE rose by around 13.8% as a result of the further increase in business volume. The assets of the company primarily consist of current assets, specifically inventories and cash and cash equivalents. Equity and liabilities exclusively comprise equity and current liabilities and provisions.

In fiscal year 2017, investments focused on intangible assets (EUR 46.4m) and financial assets (EUR 135.2m). Investing activities were financed exclusively from the group's own funds.

In fiscal year 2017, inventories solely comprised merchandise used in the core operational business of ZALANDO SE.

As of December 31, 2017, ZALANDO SE's trade receivables were up EUR 84.0m to EUR 387.2m.

With regard to the liquidity and the financial development of ZALANDO SE, we refer to the financial development of the Zalando group. The financial development of Zalando group essentially reflects the financial development of ZALANDO SE. Furthermore, ZALANDO SE is responsible for the cash management of the Zalando group.

In the past fiscal year, Zalando generated positive cash flow from operating activities of EUR 200.3m (prior year: EUR 252.9m). The cash flow was influenced by lower cash inflow from working capital, cash outflows for VAT liabilities and receivables and lower cash inflows from recognizing reimbursement obligations towards customers.

The cash flow from investing activities in fiscal year 2017 was mainly driven by capital increases in subsidiaries that were used to invest in the fulfillment infrastructure as well as to further expand the respective business segments of the subsidiaries. Cash and cash equivalents consist of cash on hand and bank balances as well as fixed-term deposits due within three months at credit institutions and in disposable money market funds.

The equity ratio stood at 53.6% (prior year: 56.1%).

Provisions and liabilities increased by EUR 210.3m to EUR 1,338.0m, in line with the expansion of the business. As of December 31, 2017, this figure mainly pertains to provisions for expected returns, outstanding invoices for fulfillment and marketing expenses and trade payables.

Reverse factoring agreements are in place with various suppliers and with several financial institutions. Under these agreements, the factor purchases the respective supplier receivables due from Zalando. Supplier claims against Zalando based on these agreements totaling EUR 328.9m had been transferred to the factor as of December 31, 2017 (prior year: EUR 282.3m). This amount is recognized in the balance sheet under trade payables.

### 2.6.3 Risks and Opportunities

The business development of ZALANDO SE is subject to largely the same risks and opportunities as the group. ZALANDO SE fully participates in the risks of its subsidiaries. Statements made by the Management Board on the overall assessment of the group's risk situation thus also summarize the risk situation of ZALANDO SE. The description of ZALANDO SE's accounting-related internal control system and risk management system stipulated in Section 289 (5) HGB ["Handelsgesetzbuch": German Commercial Code] is provided in the Risk and Opportunity Report of the group.

### 2.6.4 Outlook

The statements made on market trends and the development of revenue and the results for the group also apply here by virtue of the close ties between ZALANDO SE and the group companies and its weight within the group. The statements also reflect the expectations for the parent company.

Berlin, February 26, 2018

Robert Gentz      David Schneider      Rubin Ritter

## 2.7 Report on Equality and Equal Pay for ZALANDO SE<sup>44</sup>

In accordance with Section 21 German Act on Transparency of Pay (Entgelttransparenzgesetz).

### 2.7.1 Gender Equality

#### Measures to Promote Equality Between Women and Men

Promoting equality across genders is an important part of our diversity and inclusion efforts. In the first half of 2018, we are revisiting our goals and ambitions regarding inclusion and diversity in an effort to accelerate the agenda. But we already have much to build on having taken a number of measures focused on gender equality in 2017.

#### We Have Revised Our Promotion Process

Our revised promotion process articulates clearly what the expectations for each role are and defers promotion decisions to a committee instead of the direct leader. These committees of senior leaders are tasked with making consistent decisions across the organization based on facts and well-defined performance and promotion criteria. Additionally, members are trained to be aware of conscious and unconscious biases (in particular around gender) in order to mitigate them. We also track the outcomes of those decisions across genders.

#### We Have Raised Awareness and Understanding about Equality Across Genders

We have increased our embedded communications to bring the topic of gender equality forward in our internal social media channels.

We have also increased the number of analyses and reports to understand the status quo, e.g., to

- analyze the gender distribution of employees across work fields, roles and seniority levels
- assess potential differences in average pay across genders for comparable roles and grades
- understand whether gender (of an employee or that of their leader) is correlated with the likelihood of promotion or performance rating
- understand cultural health (satisfaction, engagement, sense of purpose, community, inclusion, etc.) across genders
- track the number and reasons for employee attrition out of the company for each gender.

This increased level of insights into the facts allows us to define more relevant and targeted measures to further promote gender equality.

44) The report on equality and equal pay for ZALANDO SE is not part of the audited combined management report.

### We Have Taken Ad Hoc Measures as Necessary

While we intend to be proactive on gender equality, we also want to capture opportunities to advance the topic as they arise. To name but two examples: triggered by internal employee initiatives, we have recognized those employees who do not identify either as a woman or man; and in the wake of the #metoo campaign, we have revised and broadcasted our guidelines and routines to prevent and deal with sexual harassment, discrimination and reprisals, reinforcing our zero tolerance principle and our Ask and Tell policy and process.

### Measures to Promote Equal Pay

At Zalando, we are committed to pay salaries based on objective criteria and regardless of gender.

The implementation of centralized processes based on defined criteria is aimed to assure fairness for individual pay decisions and to reduce the impact of factors that would lead to any potential bias. The target pay range for each employee is built on a role-based approach and has been consistently applied across Zalando. A new salary band structure was defined in 2017, which has been applied company wide.

In the past year, we also implemented a centralized annual pay review, which is steered by a central team to assure consistency and internal fairness. To increase transparency, our employees are informed in annual feedback and development talks about how their individual salary compares to the internal salary bands.

In addition, we have raised awareness with our leadership teams about the importance of objective pay decisions and a fair salary for both male and female employees.

#### 2.7.2 Employee Statistics for ZALANDO SE

##### Average Headcount 2017

Male	2,136
Female	2,149

##### Average Headcount 2017 (Part-Time / Full-Time)

	Full-time	Part-time
Male	2,020	116
Female	1,913	236