3.5 Notes to the Consolidated Financial Statements

3.5.1 Company Information

Company Name, Registered Office

ZALANDO SE (the "company") is the parent of the Zalando group ("Zalando" or the "group"). The company was registered in the commercial register at the Berlin-Charlottenburg district court on May 28, 2014, (HRB 158855 B). ZALANDO SE's registered offices are located at Tamara-Danz-Str. 1 in 10243 Berlin.

Nature of Operating Activities

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 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 offering has been extended and enhanced with the Zalando Lounge, which offers registered members special articles at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt am Main and Cologne serve as additional sales channels for remaining stock. Zalando was founded in 2008 and has its registered offices in Berlin.

3.5.2 General Principles

Application of IFRS

The consolidated financial statements of ZALANDO SE for the fiscal year from January 1 to December 31, 2017, were compiled in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU as of the reporting date. In addition, the provisions of Section 315a (1) HGB have been taken into account. The consolidated financial statements give a true and fair view of the group's financial performance and position.

General Information

The consolidated financial statements have been prepared by accounting for assets and liabilities at amortized cost. Excluded from this are certain financial instruments that are measured at fair value. The statement of profit or loss within the statement of comprehensive income was prepared using the function of expense method. Assets and liabilities are classified based on their maturities.

The fiscal year is the calendar year. The consolidated financial statements are presented in euros. Due to rounding, it is possible that figures may not add up exactly to the total stated, and the percentages presented may not precisely reflect the figures they correspond to.

3.5.3 New Accounting Standards

Effects of New or Amended IFRS Relevant for Fiscal Year 2017

The consolidated financial statements take into account all IFRS endorsed as of the reporting date and whose adoption is mandatory in the European Union.

The changes in IFRS relate to IAS 7, IAS 12 and IFRS 12. Application has been mandatory since January 1, 2017. For Zalando, the amendments to IAS 7 require an extension of the disclosures with regard to changes in respect of liabilities arising from financing activities (see section 3.5.7. (25.)).

All other standards subject to first-time application in fiscal year 2017 have not had any material impact on Zalando's financial performance, position or disclosure.

New or Amended IFRS Not yet Applied

The following accounting standards had already been issued by the IASB as of the time the financial statements were authorized for issue, but their adoption is not yet mandatory and they have not yet been adopted by Zalando.

Standard / interpretation		Impending change
Improvements to International Financial Reporting Standards 2016 (Annual Improvements 2014 – 2016)		Minor amendments to a large number of IFRS (IFRS 1, IFRS 12, IAS 28).
Amendments to IFRS 2	Share-based payments	The clarifications relate to the effect of vesting conditions on the measurement of a cash-settled share-based payment, changes in the classification of a transaction from cash-settled to equity-settled and the classification of share-based payment transactions with net settlement features.
IFRS 9	Financial instruments	IFRS 9 introduces a uniform approach for classifying and measuring financial assets. IFRS 9 relates to the characteristics of the contractual cash flows and the business model by which these cash flows are managed. The standard also provides a new risk provision model that now also accounts for anticipated losses for the calculation of the risk provision. Moreover, IFRS 9 contains new regulations on hedge accounting in order to better present the risk management activities of an entity, in particular with regard to the management of non-financial risks.
Amendments to IFRS 9	Prepayment features with negative compensation	The amendment clarifies that the previous designation of a financial asset or liability can be revoked if there is a change in specific conditions regarding an accounting mismatch.

	IASB effective date	**Endorsed by the EU**	**Anticipated effects**
	January 1, 2018, (January 1, 2017 for amendments to IFRS 12 see below), early adoption on a case-by-case basis permitted	Yes	Application has no significant impact on the consolidated financial statements.
	January 1, 2018, early adoption permitted	No	Application has a minor impact on the consolidated financial statements.
	January 1, 2018, early adoption permitted	Yes	Zalando will apply the new classification and measurement requirements of IFRS 9 from January 1, 2018. The new classification model results in minor changes that will not have any material effect on the consolidated financial statements. The changes mainly relate to equity instruments held by the entity that are no longer allocated to available-for-sale financial assets but are now measured at fair value through profit and loss. Zalando will not voluntarily designate instruments to fair value through other comprehensive income. Likewise, it will not voluntarily designate financial assets to fair value through profit or loss. This is in accordance with the accounting treatment practiced by Zalando to date. The measurement of impairment losses on trade receivables considers the risk of default for customers in line with industry practices from the point of recognizing the revenue. Such an approach already corresponds with the lifetime ECL (expected credit losses) approach of IFRS 9. The measurement of cash and cash equivalents and term deposits will lead to the recognition of an insignificant loss allowance due to the 12-month ECL. The impairment loss will not exceed EUR 3.0m and will be considered directly under equity in accumulated profit as an effect of initial application. The amendments relating to hedge accounting will lead to reporting relief in the assessment of the effectiveness of hedging relationships and the designation of the underlying and the hedging instruments. Zalando will apply the new requirements on hedge accounting prospectively from January 1, 2018. Existing hedging relationships will be maintained beyond the date of initial application as they also qualify for hedge accounting under IFRS 9. A need for a rebalancing is not expected.
	January 1, 2019, early adoption permitted	No	Application has no significant effect on the consolidated financial statements.

Standard / interpretation		Impending change
IFRS 15	Revenue from contracts with customers	The core principle of IFRS 15 is that an entity recognizes revenue to reflect the transfer of goods or services to customers at an amount that represents the consideration the entity expects to receive. Revenue is recognized when the customer obtains control over the goods or services. IFRS 15 also contains guidance on the presentation of contract assets or contract liabilities. The standard also requires additional disclosures, including a disaggregation of total revenue, on performance obligations, on reconciliations of opening and closing balances of net contract assets and contract liabilities as well as on significant judgments and estimates.
Amendments to IFRS 15	Clarifications	The clarifications relate to identifying performance obligations, principal versus agent considerations, and licensing of intellectual property as well as the exceptions to the application of sales-based and usage-based royalties and the transitional relief to IFRS 15.
IFRS 16	Leases	IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. For the lessee, IFRS 16 introduces a single accounting model in contrast to IAS 17. The new model requires the lessee to recognize assets and liabilities from all leases in the statement of financial position except for leases with a lease term of 12 months or less or leases of low-value assets (option). There will also be changes within the statement of profit or loss. First, there is an interest expense on the outstanding lease liability. Secondly, depreciation of the right-of-use asset has to be shown instead of lease expenses. Thirdly, the cost burden at the beginning of a lease will be higher than at the end due to the frontloading effect. Furthermore, the majority of lease payments will no longer be shown in cash flow from operating activities, but in cash flow from financing activities. For lessors, IFRS 16 continues to distinguish between finance leases and operating leases for accounting purposes. Zalando acts exclusively as a lessee and not as a lessor. It is currently not intended to change this in the future.

	IASB effective date	Endorsed by the EU	Anticipated effects
	January 1, 2018, early adoption permitted	Yes	The application of IFRS 15 will not have any significant effects on the consolidated financial statements of Zalando. Due to Zalando's fraud prevention measures, only those contracts are entered into where it is probable that Zalando will receive consideration. The structure of the ordering process and the obligation to acknowledge the general terms and conditions makes it apparent to both contracting parties that they are entering into a contract from which various rights and obligations arise. The same applies for the terms of payment, which vary depending on the mode of payment chosen by the customer. Consequently, there is always a contract with a customer. The goods or services promised by Zalando (goods, free delivery and returns with a return policy of up to 100 days, free customer care) create a bundle that is distinct, i.e. the identified performance obligation. The services cannot be separated from the goods promised. Merely the "express delivery" option represents an independent service commitment. This is billed separately. With regard to revenue recognition, Zalando already makes a distinction between two types of promises. In our wholesale business, the performance obligation of Zalando consists of transferring control over its own goods to the customer. Zalando, as the principal, therefore recognizes the revenue in full. By contrast, in the Partner Program, Zalando's performance obligation consists of arrange for a third party (partner) to provide those goods to the customer. In this case, Zalando acts as an agent and merely recognizes revenue at the amount of the commission that is expected to be received from the business partner. The right of return extended by Zalando to all goods, which can be exercised for each individual item, constitutes variable consideration. The transaction price is therefore determined after considering the expected returns. This is estimated on the basis of past experience and is adjusted continuously. Moreover, the ratio of returns is determined on a country-specific and payment option basis. As in the past, revenue is therefore recognized only at the amount for which no returns are expected. A refund obligation is recognized under liabilities for the returns expected on customer payments already received. At the same time, a right to repossess goods is recognized under assets and deducted from the cost of sales at the amount of the expected returns. The right to repossess goods is reduced by the expected costs of returns. This accounting treatment already complies with IFRS 15.B21 et seq. Due to the fact that the transaction price comprises the sum of the individual prices of the goods in a shipment – and the prices listed in the shop constitute the stand-alone selling prices of the transaction in the sense of IFRS 15.77 – the revenue to be recognized for each item corresponds to the respective stand-alone price. Any rebates granted on the total order are allocated proportionately to the respective goods making up the order. Rebates that are granted on specific articles are allocated only to these articles. The performance obligations that Zalando must fulfill within the framework of the Fashion Store business do not meet the criteria for recognizing revenue over time because the customer does not simultaneously receive the benefits over time, nor is there any transfer of control to the goods over time. In addition, there is an alternative use to the entity for each of the goods since they could be equally assigned to any other customer. Consequently, revenue is recognized by Zalando at a point in time. The point in time for revenue recognition corresponds to the time at which the customer obtains control over the goods, i.e. the goods are handed over to the customer. Zalando already considers that partial deliveries may arrive at the customer at different times. Consequently, the revenue of an order can be recognized at different times. There are no significant financing components or contractual costs for Zalando. The new standard will be adopted by Zalando from January 1, 2018. Zalando will apply the modified retrospective method by which the prior-year figures will not be adjusted and any required adjustment is posted to equity. However, no such adjustment is expected at Zalando.
	January 1, 2018, early adoption permitted	Yes	Application has no significant impact on the consolidated financial statements.
	January 1, 2019, early adoption permitted	Yes	The new standard will have a material effect on the consolidated financial statements. The recognition of a right-of-use asset and a lease liability for leases previously recognized as operating leases under IAS 17 will increase the sum of total assets and the sum of total equity and liabilities. The increase is expected to be lower than EUR 400.0m at the transition date (January 1, 2019). This will have a non-recurring impact on certain financial indicators upon transition, particularly the equity ratio is expected to fall to around 50.0%. Moreover, the recognition of interest expenses will burden the financial result (effect expected to be less than EUR 15.0m for the financial year beginning on January 1, 2019). EBITDA will increase significantly (effect expected by up to EUR 85.0m) due to the depreciation of the right-of-use asset instead of the recognition of lease expenses. By contrast, EBIT will improve due to a lower depreciation expense for the right-of-use asset in comparison to the previous lease expenses. The increase in EBIT will be less than EUR 10.0m. Bottomline, net income of the period will only be minimally negatively affected (front loading effect to be lower than EUR 5.0m). In addition, lease payments will no longer be reported in cash flow from operating activities but in cash flow from financing activities, and the disclosures required in the notes will be extended. The effect of the reclassification within the consolidated statement of cash flows will be less than EUR 85.0m. Zalando plans to apply the standard retrospectively with no restatement of comparative information. We will measure the right-of-use asset with an amount equal to the lease liability at the date of initial application. Zalando elects to use the exemptions where permitted. These primarily relate to the separation of non-lease components, low-value and short-term leases as well as the licensing of software. Early adoption is not planned.

Standard / interpretation		Impending change
IFRS 17	Insurance contracts	IFRS 17 contains a consistent model to account for insurance contracts. The standard establishes principles for the recognition, measurement, presentation and disclosures of insurance contracts and eliminates differences in accounting practices. IFRS 17 supersedes the interim standard IFRS 4.
Amendments to IAS 28	Long-term interests in associates and joint ventures	Clarification to the application of IFRS 9 for specific long-term interests outside the scope of IAS 28.
Improvements to International Financial Reporting Standards 2017 (Annual Improvements 2015 – 2017)		Minor amendments to a large number of IFRS (IFRS 3, IFRS 11, IAS 12, IAS 23).

The IASB has issued other amendments of accounting standards that are not listed above (IFRS 4, IAS 19, IAS 40) and are not applied and do not have any material impact on Zalando's financial performance and position.

Additionally, the IASB issued the IFRIC Interpretations 22 (Foreign Currency Transactions and Advance Consideration) and 23 (Uncertainty over Income Tax Treatments). The Interpretations shall be applied on or after January 1, 2018 and 2019, respectively. Both were not endorsed by the EU by the reporting date and do not have any material impact on Zalando's financial performance and position.

3.5.4 Principles of Consolidation

Basis of Consolidation

The number of subsidiaries included in the basis of consolidation increased from 32 (prior year) to 40 on account of entities founded and acquired in fiscal year 2017.

Reporting Date of the Consolidated Financial Statements

The consolidated financial statements cover fiscal year 2017 on the basis of the reporting period from January 1 to December 31, 2017. Apart from abbreviated reporting periods due to the establishment or acquisition of entities, the fiscal year of the consolidated entities also corresponds to the calendar year.

Accounting Policies

A business combination is a transaction in which an acquirer obtains control of one or more businesses. Within the scope of the first-time consolidation of such a business, all acquired assets and liabilities are recognized in the statement of financial position at fair value at the acquisition date. A debit difference between the acquisition cost and proportionate fair value of identifiable assets, liabilities and contingent liabilities is shown as goodwill. A credit difference is recorded in the income statement.

The consolidated financial statement comprise ZALANDO SE and its subsidiaries over which the company has control within the meaning of IFRS 10.

	IASB effective date	Endorsed by the EU	Anticipated effects
	January 1, 2021, early adoption permitted	No	Zalando has no transactions within the scope of the new standard. Therefore, Zalando does not need to apply IFRS 17.
	January 1, 2019, early adoption permitted	No	Zalando does not have interests in an associate or joint venture to which the equity method is not applied. Hence, there will be no effect.
	January 1, 2019, early adoption permitted	No	Application has no significant impact on the consolidated financial statements.

The separate financial statements of the entities included in the consolidated financial statements have been prepared on the basis of the parent company's uniform accounting policies.

Intercompany receivables and liabilities are offset against each other. Offsetting differences are recognized through profit or loss if they arose in the reporting period. The company eliminates intercompany profits or losses from intercompany supplies and services and recognizes deferred tax relief and tax expenses from consolidation entries through profit or loss. The consolidation of intercompany profits involves offsetting intercompany revenue and other intercompany income against the corresponding expenses.

Shares in associates, i.e. entities over which the owner can exercise significant influence within the meaning of IAS 28, are accounted for using the equity method. The investment is initially recorded at cost and subsequently updated to include any changes in the share of the investee's net assets attributable to the investor after the acquisition date.

The consolidation methods were applied unchanged compared to the prior year.

Currency Translation

The consolidated financial statements are presented in euros, which is ZALANDO SE's functional currency and the presentation currency of the group. Transactions conducted in a currency other than the euro are translated into the functional currency using the historical rate on the date of the transaction.

Financial statements denominated in the foreign currency of foreign group entities are translated on the basis of the functional currency concept pursuant to IAS 21.

The assets and liabilities of subsidiaries whose functional currency is not the euro are translated to euros at the mean exchange rate prevailing as of the reporting date. Income and expenses in the statements of comprehensive income are translated into euro at the annual average exchange rate pursuant to IAS 21.40. Exchange rate differences arising in the statement of financial position or statement of comprehensive income are accounted for as exchange differences on translation of foreign financial statements in other comprehensive income.

Monetary assets and liabilities of subsidiaries denominated in foreign currencies are translated at the functional currency spot rates of exchange as of the reporting date. Exchange differences are recognized through profit or loss.

Non-monetary items in a foreign currency are translated using historical rates.

Foreign Exchange Rates → 47

		Closing rate		Annual average rate	
	ISO Code	Dec 31, 2017	Dec 31, 2016	2017	2016
British pound	GBP	0.8872	0.8562	0.8767	0.8195
Danish krone	DKK	7.4449	7.4344	7.4386	7.4452
Norwegian krone	NOK	9.8403	9.0863	9.3270	9.2906
Polish zloty	PLN	4.1770	4.4103	4.2570	4.3632
Swedish krona	SEK	9.8438	9.5525	9.6351	9.4689
Swiss franc	CHF	1.1702	1.0739	1.1117	1.0902
US dollar	USD	1.1993	1.0541	1.1297	1.1069

3.5.5 Accounting Policies

Intangible Assets

Intangible assets are measured at amortized cost. All intangible assets, except for brands and domain rights, have a finite useful life. These are amortized over their useful life of three to eight years on a straight-line basis. The carrying amounts of brands and domain rights are immaterial from the group's perspective. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the residual values or the respective useful lives are taken into consideration prospectively when measuring amortization. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. In 2017 no indication that an asset may be impaired exists.

Internally generated intangible assets are recognized at development cost if they satisfy the prerequisites of IAS 38 Intangible Assets, i.e., a newly developed or significant enhanced product/software can be unambiguously identified, is intended to be completed and Zalando has the necessary resources to do so, is technically feasible, and is intended for own use. Other recognition requirements are the generation of probable future economic benefits and the ability to measure reliably the expenditure attributable to the intangible asset.

Capitalized development costs are amortized over an anticipated useful life of an average of about three years. Amortization of the asset begins when development is complete and the asset is available for use. Research costs are expensed in the period in which they arise. An impairment test is performed once a year as long as the asset is under development regardless of any indications of impairment. The same applies to goodwill acquired and intangible assets with indefinite useful lives.

The amortization expense on intangible assets with finite lives is recognized in the statement of profit or loss in the expense category consistent with the function of the intangible asset.

Gains or losses arising from the disposal of intangible assets are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the statement of profit or loss when the asset is derecognized.

When testing for impairment pursuant to IAS 36, the carrying amount of an asset is compared to its recoverable amount. The asset is deemed to be impaired when the recoverable amount falls below its carrying amount. The asset is then written down to its recoverable amount through profit or loss. Otherwise, its carrying amount is retained. The recoverable amount is the higher of an asset's fair value (according to IFRS 13) less costs of disposal and its value in use.

For the assets subject to impairment testing, the value in use exceeds their carrying amount. Consequently, in these cases there is no need to determine their fair value less costs of disposal (IAS 36.19). The fair value less costs of disposal is preferred only for transactions close to the reporting date. At Zalando, value in use is calculated on the basis of reconciled planning statements and the budget forecasts they contain. A constant annual growth factor is assumed and the costs of capital before tax used as the discount rate are measured on instruments with a comparable risk profile. The duration of the detailed planning phase is based on the (remaining) useful life of the assets being tested and is capped at five years. In the case of goodwill and intangible assets with indefinite useful lives, the terminal value is added to the planning phase. For startup businesses and similar subjects that need to be tested, an additional period between planning phase and terminal value is added to reflect the transition to a steady state situation.

From the perspective of the group, intangible assets under development and goodwill acquired in business combinations are material. They are tested for impairment on the cash-generating unit level once a year. All other assets being tested are immaterial and concern units outside of the core business of Zalando. The total amount of the impairment losses arising from impairment testing is immaterial from a group perspective.

Property, Plant and Equipment

Property, plant and equipment are recognized at cost and depreciated in accordance with their expected useful life using the straight-line method. Depreciation is charged over the following useful lives.

Useful Lives → 48

	Years
Leasehold improvements	11–17
Plant and machinery	5–15
Furniture, fixtures and office equipment	2–15

An item of property, plant and equipment is derecognized upon disposal or when no further economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated income statement when the asset is derecognized.

The residual values, useful lives, and methods of depreciation of property, plant and equipment are reviewed at the end of each fiscal year and adjusted prospectively, if appropriate.

Impairment of Non-Financial Assets

The group assesses at each reporting date whether there is any indication that a non-financial asset reported in the statement of financial position may be impaired. If any indication exists, or when annual impairment testing is required, the group carries out an impairment test.

Current Versus Non-Current Classification

The group classifies its assets and liabilities in the statement of financial position as current and non-current assets or liabilities.

An asset is classified as current when:

- it is expected to be realized, or intended to be sold or consumed, within the normal operating cycle
- it is expected to be realized within 12 months after the reporting period or
- it is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for a period of at least 12 months.

All other assets are classified as non-current.

A liability is classified as current if:

- it is expected to be settled within the normal operating cycle
- it is expected to be realized within 12 months of the end of the reporting period or
- the company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting period.

All other liabilities are classified as non-current. Deferred tax assets and liabilities are always classified as non-current assets or liabilities.

Assets Held for Sale

Non-current assets are classified as held for sale and therefore presented separately within the balance sheet if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This is the case if:

- the asset is available for sale and
- the sale is highly probable.

Non-current assets classified as held for sale are measured at the lower of their carrying amount or their fair value less costs to sell. Such assets are not depreciated or amortized.

Leases – The Group as Lessee

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception date. It requires an assessment of whether fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

A lease is classified as a finance lease if all risks and rewards incidental to ownership of the leased asset are transferred to the lessee. All other leases are classified as operating leases. Finance leases are recognized as assets and liabilities at the lower of fair value of the leased asset or the present value of minimum lease payments at the inception of the lease. Minimum lease payments are to be apportioned between the finance charge and the reduction of the outstanding liability so as to achieve a constant rate of interest on the remaining balance of the liability. The asset is depreciated over the shorter of the lease term and the estimated useful life of the asset. There are no material finance leases within the group.

Assets leased under operating leases are not recognized. Instead, the lease payments are expensed on a straight-line basis over the term of the lease. Significant operating leases pertain to leases of office space and logistic premises in the group.

Income Taxes

The income tax expense of the period comprises current and deferred taxes. Taxes are recognized in the profit or loss for the period, unless they relate to items recognized directly in equity or in other comprehensive income, in which case, the corresponding taxes are also recognized in equity or in other comprehensive income.

The current tax expense is calculated using the tax laws of the countries in which the entities operate and generate taxable income effective as of the reporting date.

Management regularly prepares tax returns, paying close attention to matters open to interpretation, and recognizes provisions based on the amounts that are expected to be payable to the tax authorities.

Deferred taxes are calculated using the liability method on the basis of IAS 12. Deferred taxes are recognized on the basis of temporary differences between the carrying amounts recognized in the consolidated financial statements and the tax accounts if these differences lead to future tax relief or tax expenses. Measurement of deferred taxes is performed taking into account the tax rates and tax laws expected to apply at the time when the differences are reversed.

Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits and unused tax losses to the extent that it is sufficiently probable that taxable profit will be available against which the deductible temporary differences and the carryforward of unused tax credits and unused tax losses can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

The group offsets deferred tax assets and deferred tax liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authority.

Inventories

Merchandise accounted for as inventories is recognized at cost pursuant to IAS 2. Cost is calculated on the basis of an item-by-item measurement, either based on goods market prices or moving average prices. Supplier payments that are to be classified as a reduction of cost reduce the carrying amount of inventories.

Merchandise as of the reporting date is measured at the lower of cost or net realizable value. The net realizable value is the expected selling price less the costs necessary to make the sale. Adequate write-downs to net realizable value were made to allow for all risks from slow-moving goods and/or reduced salability. When the circumstances that previously caused merchandise to be written down below cost no longer exist, the write-down is reversed.

Financial Instruments

General Information

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are disclosed in the consolidated statement of financial position when Zalando becomes a contractual party to a financial instrument. All regular way contracts are recognized irrespective of their classification as of the settlement date. The settlement date is the date on which an asset is delivered to or by the entity. The trade date is the date that the company commits to purchase or sell an asset. Derivative financial instruments are recognized on the trade date.

Financial assets and financial liabilities classified as financial instruments are generally not netted; they are netted only if the group intends to settle the amounts on a net basis. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire or the financial asset is transferred. Financial liabilities are derecognized when the contractual commitments have been discharged, cancelled, or have expired.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. If there are listed prices on an active market (e.g. share prices), these are used as a measurement base. If there is no active market, reference is made to the market most favorable for the entity for measurement purposes.

The amortized cost of a financial asset or a financial liability is the amount:

— at which the financial asset or financial liability is measured at initial recognition
— less any repayments and
— any write-downs for impairment or uncollectibility (in the case of financial assets) and
— plus or minus the cumulative amortization using the effective interest method over the term of the financial asset or financial liability of any difference between that initial amount and the maturity amount (e.g. premium or transaction costs).

The amortized cost of current receivables and liabilities generally corresponds to the nominal value or settlement amount.

Financial Assets

Financial assets are assigned to the following categories for the purposes of subsequent measurement:

- loans and receivables,
- held-to-maturity investments (n/a during the reporting and comparative period),
- financial assets at fair value through profit or loss, or
- available-for-sale financial assets.

When financial assets are recognized initially, they are measured at fair value. For all categories except financial assets at fair value through profit or loss, the transaction costs incurred are included in initial recognition.

The allocation to the aforementioned categories must be observed for the subsequent measurement of financial assets. There are differing measurement rules for each category.

If there are indications of impairment for financial assets that are not measured at fair value through profit or loss, corresponding impairment losses are recognized. If the reasons for impairment no longer apply for loans and receivables, the impairment losses are reversed to amortized cost. For all financial assets, the impairment losses through profit or loss are recognized in separate accounts.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. They are measured at amortized cost. This measurement category is used for trade receivables, other financial assets, and cash and short-term deposits.

All financial assets held for trading are allocated to the category of financial assets at fair value through profit or loss. Financial instruments held for trading are those acquired for the purpose of selling or repurchasing in the near term. Derivative financial instruments that are not effective hedging instruments are also allocated to this category. Changes in fair value for financial assets are recognized through profit or loss.

The category of available-for-sale financial assets relates to those non-derivative financial assets that were not allocated to any of the aforementioned categories. Changes in the fair value of available-for-sale financial assets are recognized directly in other comprehensive income. The fluctuations in value recognized in other comprehensive income are transferred to profit or loss for the period only at the time the assets are disposed of or in the event of their impairment. Equity instruments that do not have a listed market price in an active market and whose fair value cannot be reliably measured are measured at cost. In the case of impairment, a write-down to the present value of future cash flows is performed.

Impairment of Financial Assets

As of every reporting date, the group tests financial assets or groups of financial assets to determine whether there is any indication that they may be impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of negative changes in the future cash flows of the financial asset or the group of financial assets. Impairments recognized in the form of allowances are recorded through profit or loss. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account.

Zalando accounts for impairments of trade receivables using portfolio-based specific allowances that are calculated with the help of sales-channel and country-specific allowance rates based on expected risks of default and how long they are past due.

Receivables, together with the allowance recognized, are written off when there is no realistic prospect of future recovery and all collateral has been realized or the right to receive cash flows has been settled.

Financial Liabilities

Financial liabilities are recognized initially at fair value, plus directly attributable transaction costs in the case of loans and borrowings. Zalando allocates financial liabilities to one of the categories upon initial recognition.
Financial liabilities fall into one of the following two categories:

- financial liabilities at fair value through profit or loss, or
- financial liabilities measured at amortized cost.

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. In particular, these include derivative financial instruments that are not designated as hedging instruments. Gains and losses from the subsequent measurement are recognized through profit or loss.

After initial recognition, trade payables, liabilities to banks, and other financial liabilities not held for trading are measured at amortized cost using the effective interest method and thus allocated to the category of financial liabilities measured at amortized cost.

Derivative Financial Instruments and Hedge Accounting

Zalando uses derivative financial instruments such as forward exchange contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative financial instruments are initially recognized at fair value both on the date on which a derivative contract is entered into and on subsequent reporting dates. Derivative financial instruments are reported as financial assets if their fair value is positive. They are presented as financial liabilities in the statement of financial position if their fair value is negative.

Whether or not profits and losses from changes in the fair value of derivative financial instruments are recognized depends on whether the requirements of IAS 39 are met with regard to hedge accounting. Zalando uses derivative financial instruments exclusively to hedge against risks.

Gains and losses from changes in the fair value of derivative financial instruments other than hedging instruments are recognized immediately through profit or loss.

Hedge accounting involves classifying derivative financial instruments either as an instrument to hedge the fair value of a hedged item (fair value hedge), an instrument to hedge forecast transactions (cash flow hedge) or an instrument to hedge a net investment in a foreign operation.

As part of its risk management, Zalando has formally set out and documented objectives and strategies for mitigating risk.

A portion of the forward exchange contracts are used to hedge goods purchased in US dollars and pounds sterling and the resulting trade payables. Another portion of the forward exchange contracts is used to hedge goods sold in foreign currency and the resulting trade receivables. These forward exchange contracts are concluded in Swiss francs, Norwegian krone, Polish zloty and Swedish krona.

The interest rate hedges were entered into to mitigate the interest risk from floating-rate bank loans.

Fair Value Hedges

A fair value hedge is a hedge of the exposure to changes in fair value of recognized assets or liabilities. Changes in the fair value of derivatives and changes in the hedged item's market value on which the hedged risk is based are recognized in the profit or loss for the period.

Zalando uses forward exchange contracts to mitigate the risk of fluctuations in the fair value of trade payables denominated in US dollars and pound sterling, as well as trade receivables denominated in Swiss francs, Norwegian krone, Polish zloty and Swedish krona arising from market value changes.

Cash Flow Hedges

A cash flow hedge hedges the fluctuations of future cash flows attributable to a recognized asset or liability (in the case of interest risks), to planned or highly probable forecast transactions and to fixed contractual obligations not shown on the face of the statement of financial position.

If a cash flow hedge is effective, the changes in the fair value of the hedge are recorded directly in equity under other comprehensive income. Changes in the fair value of the ineffective portion of the hedging instrument are posted directly as profit or loss for the period. The gains and losses resulting from hedges initially remain in equity and are later recognized through profit or loss for the period in which the hedged transaction influences the net income for the period.

Zalando uses forward exchange contracts as hedging instruments to hedge foreign currency risks resulting from contractual merchandise sourcing transactions that have yet to be fulfilled. In addition, Zalando uses forward exchange contracts to hedge planned revenue in foreign currency against exchange rate fluctuations. These are recognized as cash flow hedges if the conditions of hedge accounting are fulfilled. These amounts recognized as other comprehensive income are reclassified through profit or loss once the hedged items are realized. In the case of contractual merchandise sourcing transactions, other comprehensive income is derecognized via the cost of materials. The share of other comprehensive income that is attributable to hedging revenue is posted via revenue through profit or loss.

The interest rate swaps that Zalando has concluded to hedge interest rate risks from floating-rate bank loans drawn are also recorded as cash flow hedges. Amounts recognized in equity are depleted through interest expense.

Fair Value Measurement

The group applies measurement techniques that are appropriate under the respective circumstances and for which sufficient data is available for fair value measurement. In the process, observable market inputs are to be preferred to non-observable inputs.

Assets and liabilities measured or presented at fair value in the financial statements are classified on the basis of the following fair value hierarchy. The classification uses the input parameters of the lowest category that is material to the fair value measurement.

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs have a significant effect on measurement are observable, either directly or indirectly
- Level 3: unobservable inputs for the assets and liabilities

For forward exchange contracts, the fair value is determined on the basis of the official exchange rates as of the reporting date issued by the European Central Bank taking account of forward premiums and discounts for the respective remainder of the contract, compared with the contractually agreed exchange rate. Interest rate hedges are measured on the basis of discounted future expected cash flows using market discount rates for the remaining term of the contracts.

Provisions

General Information

Provisions are recognized in accordance with of IAS 37 when the group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

A best estimate is made of the amount of the provisions taking into consideration all the discernible risks arising from the obligation. This refers to the amount that is most likely needed to settle the liability. Provisions with a residual term of more than one year are discounted on the reporting date.

Restoration Obligations

The group recognizes provisions for restoration expenses for leasehold improvements in the leased fulfillment centers and office buildings. The provision is recognized at an amount equivalent to the present value of the estimated future restoration obligations. The restoration obligations are recognized as part of the cost of the leasehold improvements for the corresponding amount. The estimated cash flows are discounted using a discount rate that is commensurate with the maturity and risk profile. Unwinding of the discount is expensed as incurred and recognized as an interest expense in the statement of comprehensive income.

Share-Based Payments

The share-based payment programs in the group are accounted for as equity-settled share-based payments.

Zalando recognizes the equity-settled share-based payments as expenses at the fair value of the granted options. Expense recognition and the addition to the capital reserves are performed over the contractually agreed vesting period. The vesting period is the period in which the performance and service conditions must be fulfilled. The fair value of the options granted is measured at the grant date and not adjusted subsequently.

The cost of equity-settled transactions is recognized together with a corresponding increase in the capital reserves in equity over the vesting period. The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the best estimate of the number of equity instruments that will ultimately vest. The income or expense recognized in the profit or loss for the period corresponds to the change in cumulative expenses recognized in the reporting period.

No expense is recognized for awards that do not ultimately vest due to a service or performance condition not being fulfilled. Equity-settled payment models with market-related performance conditions and other non-vesting conditions affect the fair value of the payment on the grant date only.

When the terms of an equity-settled transaction are modified, the minimum expense recognized is the expense that would have been incurred if the original terms of the arrangement had been fulfilled. Zalando also recognizes increases in the fair value of the equity instruments granted due to modifications.

When an equity-settled award is canceled, it is treated as if it vested on the date of cancellation. Any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the canceled award and designated as a replacement award on the grant date, the new awards are treated as if they were a modification of the original award.

Revenue Recognition

Revenue is recognized in accordance with the provisions of IAS 18 when the goods or services are delivered, provided that it is likely that economic benefits will flow to the group and the amount can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. Revenue is recorded net of sales deductions.

The following specific recognition criteria must also be met before revenue is recognized:

- When selling merchandise to customers, Zalando typically renders its service when the significant risks and rewards of ownership of the goods and the control of the asset have been transferred to the customer. This is generally the case when the goods are delivered.
- If rights of return are agreed when products are sold, revenue is not recognized unless sufficient values on the probability of the exercise of these rights based on past experience are available. The expected volume of returns is estimated and recognized as reducing revenue.

Expected Returns

Zalando presents the expected returns of goods on a gross basis in the statement of profit or loss and reduces revenue by the full amount of sales that it estimates will be returned. The dispatch of goods that is recorded in full upon dispatch of the goods is then corrected by the estimated amount of returns.

Zalando also presents expected returns on a gross basis in the statement of financial position. In this context, a right to recover possession of goods from expected returns is recognized in other non-financial assets. The amount of the asset corresponds to the cost of the goods delivered for which a return is expected, taking into account the costs incurred for processing the return and the losses resulting from disposing of these goods.

Trade receivables that have underlying transactions that are not expected to be concluded due to the goods being returned are derecognized.

For customer receivables already paid and for which returns are expected in the future, Zalando recognizes a refund obligation vis-à-vis the customer within other current financial liabilities.

Government Grants

Government grants are recognized when there is reasonable assurance that the grant will be received because Zalando complies with all attached conditions. Investment subsidies are deducted from the cost of the subsidized assets in the statement of financial position.

When the government grant relates to an expense item, it is recognized as income on a systematic basis over the periods that the costs that it is intended to compensate are incurred. Grants received to compensate costs that have already been incurred are recognized through profit or loss and offset against the corresponding expense in the period when the entitlement arises.

3.5.6 Use of Estimates and Assumptions

The preparation of financial statements in accordance with IFRS requires management to make assumptions and estimates that have effects on the amounts recognized in the financial statements and the related disclosures. Although these estimates, to the best of management's knowledge, are based on the current events and circumstances, there may be deviations between estimated and actual results. Significant estimates and assumptions have been used for the following matters in particular:

- identification and determination of write-downs of merchandise and receivables; see comments under notes 3.5.7 (15.) and 3.5.7 (16.),
- setting the expected rate of returns, see comments under note 3.5.7 (23.),
- the determination of the fair value of obligations from financial liabilities and share-based payments; see comments under 3.5.7 (20.) as well as note 3.5.8 (1.),
- the determination of the recoverability of deferred tax assets on unused tax losses; see comments under notes 3.5.7 (8.) and 3.5.7 (26.),
- impairment test for goodwill and intangible assets under development, see comments under note 3.5.7 (11.),
- identification and determination of anticipated effects from the application of new or amended IFRS not yet applied, see comments under note 3.5.3.

All estimates and assumptions are based on circumstances and judgments at the reporting date and the expected future development of the group's business taking into consideration the anticipated development of its business environment. If these general conditions develop differently, the assumptions and the carrying amounts of the assets and liabilities recognized are adjusted accordingly.

3.5.7 Notes to the Consolidated Statement of Comprehensive Income and Statement of Financial Position

Further Information Consolidated Statement of Comprehensive Income p. 135

(1.) Revenue

Revenue

→ 49

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Revenue from the sale of merchandise	4,358.9	3,553.1
Revenue from other services	130.1	85.9
Total	**4,489.0**	**3,639.0**

Zalando was able to significantly increase its revenue in all market segments. Revenue rose by 23.4%.

The rise in revenue is mainly attributable to a larger customer base and an increase in 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 customer rising by 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 higher traffic also relates to a significant increase in the share of visitors who access our shops 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.

The considerable rise in these revenue drivers was enabled through our continued focus on investing in the consumer and brand proposition as well as in our technology and operations infrastructure.

(2.) Cost of Sales

Cost of Sales

→ 50

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Non-personnel costs	2,444.8	1,964.3
Personnel costs	84.8	65.2
Total	**2,529.6**	**2,029.6**

Cost of sales mainly consists of cost of materials, personnel costs, write-downs on inventories, third-party services and infrastructure costs.

Cost of sales rose by 24.6% year on year from EUR 2,029.6m to EUR 2,529.6m, roughly in line with the expansion of business. For 2017, the gross margin decreased slightly by 0.6 percentage points from 44.2% to 43.6% due to a slightly higher group discount rate. Furthermore, the growing share of the Rest of Europe segment in Zalando's business contributes to this effect as the Rest of Europe segment shows higher discounting. In 2017, we continued our conscious management of the trade-off between sales promoting measures and margin and invested in customer acquisition around cyber days and during the end-of-season sale. Furthermore, Zalando attracts a growing number of younger customers who prefer to shop for fast fashion articles at lower prices, which also impacts gross margin. Economies of scale from continued negotiation successes with brand partners partially offset the aforementioned effects.

The cost of materials in the group totals EUR 2,250.9m (prior year: EUR 1,823.4m).

Zalando generated a gross profit of EUR 1,959.4m in fiscal year 2017 (prior year: EUR 1,609.4m).

(3.) Selling and Distribution Costs

Selling and Distribution Costs → 51

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Non-personnel costs	1,212.4	1,005.2
Personnel costs	318.4	218.4
Total	**1,530.8**	**1,223.7**

In 2017, selling and distribution costs rose by EUR 307.1m to EUR 1,530.8m and pertain to fulfillment costs of EUR 1,168.2m (prior year: EUR 847.8m) and marketing costs of EUR 362.5m (prior year: EUR 375.9m). 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 logistic costs as Zalando is building up a diverse logistic 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.

(4.) Administrative Expenses

Administrative Expenses → 52

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Non-personnel costs	80.1	71.8
Personnel costs	162.8	119.5
Total	**242.9**	**191.3**

The non-personnel costs primarily contain office expenses, depreciation and legal and advisory expenses. The increase in personnel costs mainly results from the higher headcount in administration to strengthen the Zalando platform and from the integration of newly acquired companies in 2017.

(5.) Other Operating Income

Zalando recognized changes in the fair value of a derivative resulting from the interest in the proceeds from the sale of developed land owned by third parties (see section 3.5.7 (13.)). Income recognized in that context amounted to EUR 1.0m (prior year: EUR 10.6m). Therefore, decrease totaling EUR –4.9m in other operating income to EUR 11.8m (prior year: EUR 16.7m) mainly stems from the prior year.

(6.) Other Operating Expenses

Other operating expenses of EUR 9.9m (prior year: EUR 4.1m) mainly stem from expenses relating to other periods as well as Supervisory Board remuneration.

(7.) Financial Result

Financial Result → 53

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Interest and similar income	3.9	2.1
thereof from hedging derivatives	4.3	3.2
thereof from trade and other receivables	0.2	0.3
thereof from other financial instruments	–2.2	–1.4
thereof from unwinding the discount on non-current assets	1.6	0.0
Interest and similar expenses	–14.5	–11.8
thereof from financial liabilities at amortized cost	–7.5	–6.5
thereof from hedging derivatives	–4.1	–2.6
thereof other interest and similar expenses	–2.6	–2.5
thereof from unwinding the discount on non-current provisions	–0.2	–0.1
Result of investments accounted for using the equity method	0.3	–3.6
Other financial result	–2.2	–0.7
thereof from hedging transactions	1.7	–0.6
thereof from ineffective hedging transactions	–1.6	0.0
thereof from currency effects	–2.2	–0.2
Financial result	**–12.4**	**–14.1**

The increase in interest and similar income is mainly attributable to the higher hedging volume in the current reporting year.

As a result of the higher reverse factoring volume, interest expenses from financial liabilities at amortized cost increased. Further, interest expense from derivatives rose in the reporting year due to the higher hedging volume.

(8.) Income Taxes

Income taxes include deferred taxes and current income taxes paid or payable in the respective countries. They comprise trade tax, corporate income tax, solidarity surcharge and the equivalent foreign tax charges. As in the prior year, the statutory corporate income tax rate, including solidarity surcharge, for the 2017 assessment period in Germany was 15.8%. The applicable trade tax rate was also unchanged in comparison to the prior year at 14.7%. This results in an effective tax rate for the group of 30.5% (prior year: 30.5%).

Current and deferred taxes are presented in the following table.

Income Taxes

→ 54

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Deferred taxes	–27.0	–47.9
Current taxes	–46.6	–24.5
Total	**–73.6**	**–72.5**

As of the reporting date, the Zalando group maintains unused corporate income tax losses of EUR 60.8m (prior year: EUR 98.0m) and unused trade tax losses of EUR 25.0m (prior year: EUR 75.5m). Currently, loss carry forwards are mainly attributable to foreign companies (prior year to ZALANDO SE). The amount of these unused tax losses depends on the final assessment by the applicable tax office.

The utilization of unused tax losses for which no deferred tax assets have been recognized in the past did not affect the tax result in the reporting year (prior year: EUR 0.3m).

The reasons for the difference between expected and disclosed tax expense in the group are as follows:

Tax Rate Reconciliation

→ 55

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Earnings before taxes	175.2	192.9
Income tax rate for the group	30.5%	30.5%
Expected tax expense (–) / tax income (+)	–53.4	–58.8
Share of taxes for:		
Non-deductible expenses	–8.8	–6.8
Recognition of previously unrecognized unused tax losses	–0.2	0.0
Unrecognized unused tax losses	–7.8	–3.8
Entities included using the equity method	0.1	–1.1
Tax expenses (–) / tax income (+) relating to other periods	–0.2	–0.2
Tax rate differences	–3.2	–1.5
thereof share of subsidiaries with higher tax rates	0.1	0.0
thereof share of subsidiaries with lower tax rates	–3.3	–1.5
Other	0.0	–0.2
Income tax expense according to the consolidated statement of comprehensive income	**–73.6**	**–72.5**
Effective tax rate	*42.0%*	*37.6%*

(9.) Earnings per Share

The basic earnings per share are determined by dividing the net income for the period attributable to the shareholders of ZALANDO SE by the basic weighted average number of shares.

The basic earnings per share decreased in comparison to the prior year due to lower net income for the period.

Basic Earnings per Share (EPS) → 56

	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Net income for the period attributable to the shareholders of ZALANDO SE (in EUR m)	103.1	120.5
Basic weighted average number of shares (in millions)	247.3	247.2
Total (in EUR)	**0.42**	**0.49**

The diluted earnings per share are determined by dividing the net income for the period attributable to the shareholders by the diluted weighted average number of shares.

Diluted Earnings per Share (EPS) → 57

	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Net income for the period attributable to the shareholders of ZALANDO SE (in EUR m)	103.1	120.5
Weighted average number of diluted shares (in millions)	259.5	256.3
Total (in EUR)	**0.40**	**0.47**

Employee options and contracts, which can be equity-settled, were also taken into account in the calculation of the diluted earnings per share in fiscal year 2017, except for those equity-settled share-based payments, which include performance conditions that had not yet been met as of the reporting date. As a result, the options granted within the scope of VSOP 2017 and EIP in fiscal year 2017 were not taken into account in the calculation of diluted earnings.

(10.) Personnel Expenses

Personnel Expenses → 58

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Wages and salaries	523.4	390.5
Social security, pensions and other benefit costs	91.2	67.2
thereof pension costs	0.2	0.3
Total	**614.6**	**457.7**

The average number of salaried employees in the group was 13,940 in fiscal year 2017 (prior year: 11,036). Contributions to the statutory pension insurance scheme rose by EUR 11.0m to EUR 41.2m (prior year: EUR 30.2m).

(11.) Intangible Assets

Intangible assets developed as follows:

Statement of Movements of Intangible Assets 2017

→ 59

IN EUR M	Capitalized development costs	Industrial rights, similar rights and assets as well as licenses	Goodwill	Prepayments and assets under development	Total
Historical costs					
As of Jan 1, 2017	**79.1**	**42.1**	**13.9**	**38.4**	**173.5**
Additions	14.4	20.9	36.6	36.8	108.7
thereof from business combinations	0.0	17.3	36.6	0.0	53.9
Disposals	0.0	0.1	0.1	0.0	0.2
Reclassifications	17.1	–0.9	0.0	–16.4	–0.2
As of Dec 31, 2017	**110.6**	**62.0**	**50.4**	**58.8**	**281.8**
Amortization					
As of Jan 1, 2017	**48.0**	**24.6**	**0.0**	**0.0**	**72.6**
Additions	20.0	6.9	0.0	0.0	26.9
As of Dec 31, 2017	**68.0**	**31.5**	**0.0**	**0.0**	**99.5**
Carrying amounts					
As of Dec 31, 2016	**31.1**	**17.5**	**13.9**	**38.4**	**100.9**
As of Dec 31, 2017	**42.6**	**30.5**	**50.4**	**58.8**	**182.3**

Statement of Movements of Intangible Assets 2016

→ 60

IN EUR M	Capitalized development costs	Industrial rights, similar rights and assets as well as license	Goodwill	Prepayments and assets under development	Total
Historical cost					
As of Jan 1, 2016	**50.0**	**33.8**	**0.0**	**9.8**	**93.6**
Additions	21.3	8.7	13.6	36.4	80.0
thereof from business combinations	0.0	6.8	13.6	0.0	20.4
Disposals	0.0	0.1	0.0	0.0	0.1
Reclassifications	7.8	–0.3	0.3	–7.8	0.0
As of Dec 31, 2016	**79.1**	**42.1**	**13.9**	**38.4**	**173.5**
Amortization					
As of Jan 1, 2016	**26.9**	**17.9**	**0.0**	**0.0**	**44.8**
Additions	21.1	6.7	0.0	0.0	27.8
As of Dec 31, 2016	**48.0**	**24.6**	**0.0**	**0.0**	**72.6**
Carrying amounts					
As of Dec 31, 2015	**23.1**	**15.9**	**0.0**	**9.8**	**48.8**
As of Dec 31, 2016	**31.1**	**17.5**	**13.9**	**38.4**	**100.9**

Additions mainly relate 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). These mainly concern production costs for internally developed software.

Research costs were recognized directly in profit and loss.

Apart from goodwill (see below), brand names and domain rights of EUR 4.7m (prior year: EUR 1.3m) were assigned an unlimited useful life since there are no legal, regulatory, contractual, competition-related, economic or other factors that would limit the useful life.

Amortization of EUR 26.9m was recorded in the reporting period (prior year: EUR 27.8m). Of this amount, EUR 4.4m (prior year: EUR 4.2m) is recognized in cost of sales, EUR 18.5m (prior year: EUR 19.5m) in selling and distribution costs, and EUR 4.1m (prior year: EUR 4.1m) in administrative expenses.

Impairment Test for Goodwill

Zalando recognized goodwill totaling EUR 50.4m as of December 31, 2017. This amount is not deemed to be material for the group, so we refrain from providing information beyond the following.

The goodwill is allocated to four units (substantially to DACH and RoE), being either individual cash-generating units or a group of cash-generating units (see 3.5.8 (5.)).

The annual impairment testing was carried out in the fourth quarter of the reporting year at the level of such cash-generating units. Recoverable amounts were calculated using value-in-use concept. At Zalando, the value in use is calculated based on reconciled planned financial statements, which have been approved by the Management Board. Thereafter, an additional period is added to reflect the strong growth of the Zalando businesses combined with the transition to a steady state situation. Beyond that, a terminal value is added as a perpetual annuity. The underlying planned financial statements reflect current performance and management's best possible estimates on the future development of individual parameters, such as market prices and profit margins. Market assumptions, such as economic development and market growth, are included based on external macroeconomic sources as well as sources specific to the business.

Zalando calculated the discount rate before taxes using the capital asset pricing model. Consequently, a risk-free rate, a market risk premium and a spread for credit risk based on the respective business-specific peer group were determined. In addition, the calculations include capital structure and the beta factor of the respective peer group as well as the average tax rate of each cash-generating unit. The resulting discount rates before taxes lie in the range of 11.8% to 12.8%.

The annual impairment testing did not uncover any goodwill impairment losses. Beyond this, it has been tested whether reasonably possible changes in the key assumptions could lead to the carrying amount of the units exceeding their respective recoverable amounts. Such situation did not exist as of December 31, 2017.

(12.) Property, Plant and Equipment

Property, plant and equipment were as follows:

Statement of Movements of Property, Plant and Equipment 2017 → 61

IN EUR M	Plant and machinery	Other equipment, furniture and fixtures	Land and buildings and buildings on third-party land	Prepayments and assets under construction	Total
Historical cost					
As of Jan 1, 2017	**137.4**	**75.8**	**4.5**	**84.3**	**302.0**
Additions	35.6	31.9	35.9	86.3	189.7
thereof from business combinations	0.0	1.2	0.0	0.0	1.3
Disposals	–0.1	–3.8	0.0	–0.5	–4.4
Reclassifications	40.6	1.9	0.2	–42.5	0.2
Reclassified to held for sale	0.0	0.0	–39.5	–12.5	–52.0
Currency translation differences	0.0	0.0	0.2	1.0	1.2
As of Dec 31, 2017	**213.5**	**105.8**	**1.3**	**116.1**	**436.7**
Depreciation					
As of Jan 1, 2017	**25.2**	**33.5**	**0.3**	**0.0**	**59.0**
Additions	13.9	17.3	0.6	0.0	31.8
Disposals	–0.1	–4.0	0.0	0.0	–4.1
Reclassifications	0.0	0.0	0.0	0.0	0.0
Reclassified to held for sale	0.0	0.0	–0.5	0.0	–0.5
As of Dec 31, 2017	**39.0**	**46.8**	**0.4**	**0.0**	**86.2**
Carrying amounts					
As of Dec 31, 2016	**112.2**	**42.3**	**4.2**	**84.3**	**243.0**
As of Dec 31, 2017	**174.5**	**59.0**	**0.9**	**116.1**	**350.5**

Statement of Movements of Property, Plant and Equipment 2016

→ 62

IN EUR M	Plant and machinery	Other equipment, furniture and fixtures	Buildings on third-party land	Prepayments and assets under construction	Total
Historical cost					
As of Jan 1, 2016	**100.5**	**53.0**	**0.7**	**12.7**	**166.9**
Additions	26.8	23.0	3.8	82.1	135.7
thereof from business combinations	0.0	0.2	0.0	0.0	0.2
Disposals	0.0	–0.4	0.0	0.0	–0.4
Reclassifications	10.1	0.2	0.0	–10.3	0.0
Currency translation differences	0.0	0.0	0.0	–0.2	–0.2
As of Dec 31, 2016	**137.4**	**75.8**	**4.5**	**84.3**	**302.0**
Depreciation					
As of Jan 1, 2016	**15.7**	**22.8**	**0.2**	**0.0**	**38.7**
Additions	8.8	11.5	0.1	0.0	20.4
Disposals	0.0	–0.1	0.0	0.0	–0.1
Reclassifications	0.7	–0.7	0.0	0.0	0.0
Reclassified to held for sale	0.0	0.0	0.0	0.0	0.0
As of Dec 31, 2016	**25.2**	**33.5**	**0.3**	**0.0**	**59.0**
Carrying amounts					
As of Dec 31, 2015	**84.8**	**30.2**	**0.5**	**12.7**	**128.2**
As of Dec 31, 2016	**112.2**	**42.3**	**4.2**	**84.3**	**243.0**

The additions mainly pertain to investments in expanding the fulfillment centers in Lahr, Mönchengladbach and Szczecin.

The assets held for sale contain the warehouse set up in Szczecin, Poland, consisting of the land and building. The warehouse set up is available for immediate sale as of December 31, 2017. According to an agreement signed in November 2017, the property is to be sold in the first quarter of 2018. The transaction will be expected as an asset deal. Subsequently, the fulfillment center will be leased back by Zalando. The rental arrangement will qualify as an operating lease in accordance with the criteria set forth in IAS 17.

Depreciation of property, plant and equipment was EUR 31.8m (prior year: EUR 20.4m). Of this total, an amount of EUR 4.1m (prior year: EUR 2.6m) is recognized in cost of sales, EUR 21.2m (prior year: EUR 14.2m) in selling and distribution costs and EUR 6.4m (prior year: EUR 3.6m) in administrative expenses.

(13.) Non-Current Financial and Non-Financial Assets

As of the reporting date, non-current financial assets and non-current non-financial assets comprise the following components.

Non-Current Financial and Non-Financial Assets → 63

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
Other non-current financial assets	**25.9**	**29.2**	**–3.3**
thereof derivative financial instruments	17.2	11.2	6.0
thereof restricted cash	2.5	12.9	–10.4
thereof other	6.2	5.1	1.1
Other non-current non-financial assets	**3.5**	**3.0**	**0.5**
thereof deferred items	3.5	3.0	0.5

Derivative financial instruments include the long term fair value of a derivative resulting from the interest in the proceeds from the sale of developed land owned by third parties (EUR 15.4m; prior year: EUR 10.9m).

(14.) Investments Accounted for Using the Equity Method

As of the reporting date, investments accounted for using the equity method comprise the following entities:

Investments Accounted for Using the Equity Method → 64

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
FashionTrade.com B.V.	4.1	0.0	4.1
Le New Black SAS	1.8	0.0	1.8
Anatwine Ltd.	0.0	14.8	–14.8
Total	**5.9**	**14.8**	**–8.9**

During 2017, Zalando acquired additional shares of Anatwine and obtained control. Consequently, Anatwine is now fully consolidated and no longer presented in the investments accounted for using the equity method (see section 3.5.8 (5.)).

(15.) Inventories and Prepayments

Inventories of merchandise, mainly consisting of shoes and textiles, are recognized in an amount of EUR 778.9m (prior year: EUR 576.9m). The EUR 201.9m increase in inventories resulted from the increased business volume and from holding larger amounts of inventory in stock in order to increase availability and thus customer satisfaction.

Allowances of EUR 98.9m were recognized on inventories and the right to repossess goods associated with expected returns (prior year: EUR 82.9m). Expenses for allowances recorded on inventories was EUR 127.6m in the reporting year (prior year: EUR 95.3m).

(16.) Trade and Other Receivables

Trade receivables are mainly due from customers of ZALANDO SE. The entire portfolio of receivables was reduced by bad debt allowances, as in the prior year.

On aggregate, the bad debt allowances developed as follows:

Development of Bad Debt Allowances

→ 65

IN EUR M	Dec 31, 2017	Dec 31, 2016
Accumulated bad debt allowances as of Jan 1	**71.7**	**132.9**
Additions to portfolio-based specific bad debt allowance	38.0	28.1
Utilizations	–34.4	–82.1
Reversals	–9.0	–7.0
Exchange rate effects and other changes	–1.0	–0.2
Accumulated bad debt allowances as of Dec 31	**65.4**	**71.7**

Additions to bad debt allowances totaled EUR 38.0m in the reporting year (prior year: EUR 28.1m). Of the bad debt allowances recognized as of December 31 of the prior year, EUR 34.4m was utilized (prior year: EUR 82.1m) and EUR 9.0m reversed (prior year: EUR 7.0m). Bad debt losses for uncollectible receivables amounted to EUR 43.9m in the fiscal year (prior year: EUR 89.4m).

Bad debt allowances are in line with prior year's allowances. Zalando continues to optimize and improves its steering of payment options and works with a solvency score provider for better monitoring of fraudulent activities, resulting in a low level of bad debt allowances.

Additions to bad debt allowances are reported under selling and distribution costs. Receivables do not bear interest and are therefore not subject to interest rate risk.

(17.) Other Current Financial Assets and Other Non-Financial Assets

As of the reporting date, current financial assets and current non-financial assets comprise the following components:

Other Current Financial Assets and Other Non-Financial Assets

→ 66

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
Other current financial assets	**80.7**	**245.8**	**–165.1**
thereof term deposits	40.0	220.0	–180.0
thereof derivative financial instruments	20.7	8.9	11.7
thereof receivables from suppliers	14.5	5.0	9.5
thereof other financial instruments	5.6	11.9	–6.3
Other current non-financial assets	**152.7**	**133.1**	**19.6**
thereof VAT receivables	67.4	59.6	7.8
thereof right to repossess goods	62.5	46.7	15.8
thereof deferred items	13.0	13.5	–0.4
thereof other	9.7	13.3	–3.6

Zalando did not continue the investments in term deposits because the interest conditions for term deposits are currently not favorable.

(18.) Cash and Cash Equivalents

Zalando's cash and cash equivalents comprise the categories as presented in the following table. The short-term deposits presented have original terms to maturity of up to three months.

Cash and Cash Equivalents

→ 67

IN EUR M	Dec 31, 2017	Dec 31, 2016
Money market funds	475.5	477.9
Cash in bank	529.8	439.6
Short-term bank deposits	60.0	55.0
Cash on hand	0.2	0.1
Total	**1,065.5**	**972.6**

(19.) Equity

The parent company issued 247,384,898 ordinary bearer no-par value shares (Stückaktien auf den Inhaber) as of the reporting date (prior year: 247,255,868). Each share represents an imputed share of issued capital of EUR 1.00 and entitles the bearer to one vote at the company's annual general meeting.

During fiscal year 2017, the issued capital of the parent company was increased by a total of EUR 0.1m to EUR 247.4m by making partial use of the authorized capital 2013. The capital contribution for the newly issued shares has been paid in in full.

As of the reporting date, authorized and conditional capital comprise the following components.

Authorized and Conditional Capital

→ 68

	Amount in EUR m	Number of no-par value shares	Purpose
Authorized capital 2013	2.7	2,736,745	Servicing of subscription rights from COPs and SOP 2011 until October 28, 2018
Authorized capital 2015	94.7	94,694,847	Cash or non-cash capital increases until June 1, 2020
Conditional capital 2013	9.8	9,817,500	Servicing of subscription rights from SOP 2013
Conditional capital 2014	6.7	6,732,000	Servicing of subscription rights from SOP 2014
Conditional capital 2015	73.9	73,889,248	Issue of convertible bonds and / or bonds with warrants until June 1, 2020
Conditional capital 2016	5.1	5,098,440	Servicing of subscription rights from EIP

The use of authorized capital 2013 and the authorized capital 2015 requires the approval of the Supervisory Board. Authorized capital 2015 was not used in fiscal year 2017. No subscription rights from conditional capital 2013, conditional capital 2014 or conditional capital 2016 were exercised in the fiscal year.

The capital reserve amounts to EUR 1,182.4m (prior year: EUR 1,161.0m). In the reporting year, contributions were made under the share-based payment plans in accordance with IFRS 2 of EUR 27.5m (prior year: EUR 19.9m).

Other reserves include effects from cash flow hedging of EUR 10.9m (prior year: EUR −2.3m) and deferred taxes on the resulting measurement differences of EUR −3.3m (prior year: EUR 1.0m). Due to cash flow hedging in the reporting year, income of EUR 15.3m (prior year: EUR 3.6m) was recycled from other reserves to revenue, and expense of EUR 4.2m (prior year: EUR 0.1m) to cost of sales. Moreover, expenses of EUR 0.1m (prior year: EUR 0.2m) from interest rate hedging were recycled to the financial result in the reporting year.

In July 2017, ZALANDO SE repurchased 17,000 treasury shares at an average price of EUR 43.53, which corresponds to a notional share in share capital of EUR 17,000 and thus 0.01% of share capital. In November 2017, ZALANDO SE repurchased 143,773 treasury shares at an average price of EUR 41.73, which corresponds to a notional share in share capital of EUR 143,773 and thus 0.06% of share capital. Total repurchased shares per December 31, 2017, amount to a notional share in share capital of EUR 230,773 (prior year: 70,000) and thus to 0.09% (prior year: 0.03%) of share capital.

The accumulated profit results from the profit and loss carry forwards of past reporting periods and the profit of the current reporting period.

In 2017, ZALANDO SE purchased additional shares in Anatwine Ltd. after first-time full consolidation (see section 3.5.8 Other Notes (5.)). The difference between acquisition cost and proportional equity acquired was recognized in accumulated profit (EUR 4.9m).

Non-controlling interest arose from the acquisition and first-time full consolidation of Anatwine Ltd. in 2017. Minority shareholders hold 2.5% of the Anatwine shares per December 31, 2017; the non-controlling interest amounted to EUR –0.1m (prior year: EUR 0.0m).

The development of equity is shown in the statement of changes in equity.

(20.) Share-Based Payments

The share-based payment awards granted by Zalando are primarily designed as equity-settled plans.

Equity-Settled Plans

Overview

Various share-based equity-settled payment awards were in place as of the reporting date. For reporting purposes, plans with similarities are grouped together. Zalando makes a distinction between six kinds of payment awards: First, the Call Option Programs (“COPs”); second, the Stock Option Program 2011 (“SOP 2011”); third, the Stock Option Program 2013 (“SOP 2013”); fourth, the Stock Option Program 2014 (“SOP 2014”); fifth, the Equity Incentive Program (“EIP”) and sixth, the Virtual Stock Option Program 2017 (“VSOP 2017”). The following section includes the explanation of significant programs.

The goal of share-based payments is to reward the recipients’ contribution to the value of the business and foster the long-term success of the company. These variable compensation packages, with their long-term incentive and risk-based character, are a useful way of tying together the interests of the shareholders and recipients.

In addition, Zalando has entitled all employees to subscribe to the “Share Invest” program and, unless they participate in the EIP, also the “Share Bonus” program. The Share Invest Program is designed as a self-financed acquisition of shares by the participants (investment shares) with a subsequent issue by the company of matching shares. Following a one-year acquisition period and a two-year waiting period, the company grants each program participant matching shares equivalent to 50% of the investment shares acquired during the acquisition period, provided the participant is still employed at Zalando and still holds the relevant investment shares at the time of matching.

The Share Bonus program gives all participants the opportunity of receiving Zalando shares for free for the fiscal year. The bonus shares are issued voluntarily. There is a lock-up period of one year for bonus shares commencing on the respective date on which they are settled.

The company can decide at its own discretion whether and to what extent it will entitle the employees to subscribe to the “Share Invest” program and the “Share Bonus” program in subsequent years.

Furthermore, Zalando has decided to implement a Top Performance Options Plan (“TPOP”) for employees of the company and its subsidiaries. The TPOP only applies to the granting of a bonus for the performance period from July 1, 2017, to June 30, 2018. The purpose of the plan is to reward employees for excellent performance and to give them an opportunity to participate in the future development of the company.

The grant for the performance year amounts to no more than 1/12 of the comprehensive annual target compensation of the respective participant. One top performance option entitles the participant to receive one share and has a term of two years from the valuation date. Any grant under this plan is voluntary. Therefore, the status or possible status of an employee as a participant or the fact that a participant was granted a bonus under this plan cannot be interpreted as an obligation of the company. In particular, no operational practice is constituted by the granting of Top Performance Options.

SOP 2011

The SOP 2011 was granted to the Management Board in fiscal year 2011. The SOP 2011 consists of options that entitle the recipients to acquire 3,085,500 new shares in the company after a certain period of service. The exercise price is EUR 5.65 per option. Each option entitles the beneficiary to acquire one share. The issue of options within the scope of the SOP 2011 is closed.

The options granted to the recipients vest in tranches. They vest if the recipient is employed at Zalando for the entire vesting period of the respective sub-tranche. The last sub-tranche of SOP 2011 can be exercised in October 2018. The options are forfeited if the recipient leaves the group before the end of the vesting period. The recipients have no claim to cash payment.

The number of outstanding options developed as follows in the reporting period.

Development of Options (SOP 2011)

→ 69

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**2,730,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	187,000	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**2,543,200**	**5.65**
Options vested as of Dec 31, 2016	**1,870,000**	**5.65**
Outstanding options as of Jan 1, 2017	**2,543,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	691,900	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**1,851,300**	**5.65**
Options vested as of Dec 31, 2017	**1,486,650**	**5.65**

The options granted by the company can be exercised as of the vesting date. The recipients can exercise vested options for an unlimited period. The weighted average share value on the date of exercise of an option exercised in the reporting period amounts to EUR 41.39 (prior year: EUR 30.93).

SOP 2013

The SOP 2013 includes call options granted to the members of the Management Board in fiscal year 2013. The options entitle the holders to acquire 9,817,500 shares in the company, provided that the recipients have worked for the company for the period specified within a tranche, the performance conditions contained in SOP 2013 have been fulfilled, and the waiting period has elapsed. The exercise price is EUR 15.63 per option. Each option entitles the recipient to acquire one share. The issue of options within the scope of SOP 2013 is closed. No new options are granted.

The options granted to the recipients vest in 60 tranches over a period of five years. The condition of a tranche relating to the period of service is met if the recipient is employed at Zalando over the vesting period of the respective sub-tranche. The performance condition stipulates that Zalando must achieve a certain level of contractually agreed revenue growth over a period of four years, starting on the grant date. If the contractual revenue target is not achieved, the options are forfeited without replacement. The waiting period commences on the date on which the option is granted. It also lasts for a period of four years. The recipients can exercise vested options after the waiting period within a certain time frame over a period of five years. Within the five-year exercise period, options can be exercised within three weeks of the publication of each of the quarterly, half-year and annual financial statements. The recipients have no claim to cash payment.

The number of outstanding options developed as follows in the reporting period:

Development of Options (SOP 2013)

→ 70

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**9,817,500**	**15.63**
Options vested as of Dec 31, 2016	**5,856,840**	**15.63**
Outstanding options as of Jan 1, 2017	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**9,817,500**	**15.63**
Options vested as of Dec 31, 2017	**7,809,120**	**15.63**

The options can be exercised in return for payment of the exercise price. The recipients can alternatively request a reduction of the exercise price from EUR 15.63 to EUR 1.00 for options already vested but not yet exercised. In this case, the number of options already vested but not yet exercised is reduced, leaving the recipient neither better nor worse off economically.

The weighted average of the remaining contractual term of the outstanding or exercisable options (meaning the period until the options' expiry date) is four years and 354 days as of the reporting date (prior year: five years and 354 days).

SOP 2014

The SOP 2014 authorizes senior members of the management team to subscribe to a total of 6,732,000 shares in ZALANDO SE. The options vest provided that the recipients have worked for the company for the period specified within a tranche, the performance conditions contained in the SOP 2014 have been fulfilled, and the waiting period has elapsed. The exercise price is EUR 17.72, EUR 22.79, EUR 25.03, EUR 29.92, EUR 30.48 and EUR 31.60 per option based on the respective grant date of the options. Each option entitles the recipient to acquire one share.

The options granted to the recipients vest in 16 tranches over a period of four years. The condition of a tranche relating to the period of service is met if the recipient is employed at Zalando over the vesting period of the respective sub-tranche. The performance condition stipulates that Zalando must achieve a certain level of contractually agreed revenue growth over a period of four years, starting on the grant date. If the contractual revenue target is not achieved, the options are forfeited without replacement. The waiting period commences on the date on which the option is granted. It continues for a period of four years. The recipients can exercise vested options after the waiting period within a certain time frame over a period of five years. Within the five-year exercise period, options can be exercised within three weeks of the publication of each of the quarterly, half-year and annual financial statements. The recipients have no claim to cash payment.

The number of outstanding options developed as follows in the reporting period:

Development of Options (SOP 2014)

→ 71

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**6,468,554**	**19.13**
Options granted during the reporting period	342,450	31.60
Options forfeited during the reporting period	215,485	22.91
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**6,595,520**	**19.65**
Options vested as of Dec 31, 2016	**3,450,009**	**18.90**
Outstanding options as of Jan 1, 2017	**6,595,520**	**19.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	298,608	**21.22**
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**6,296,912**	**19.58**
Options vested as of Dec 31, 2017	**4,826,377**	**19.13**

The weighted average of the remaining contractual term of the outstanding options (meaning the period until the options' expiry date) is five years and eight months as of the reporting date (prior year: six years and seven months).

The weighted average fair value of a new option last granted in fiscal year 2016 within the scope of the SOP 2014 was EUR 7.10. The fair value of the options comprises the intrinsic value and the fair value multiplied by the probability that the performance target will be reached. The fair value of the options was calculated using the Black-Scholes option price model. In fiscal year 2017, no new options were granted under SOP 2014. The input parameters included in the calculation of the last granted options in 2016 are summarized in the following table:

Parameters SOP 2014 → 72

IN EUR M	Jan 1 – Dec 31, 2016
Weighted average share price (EUR)	29.2
Weighted average exercise price (EUR)	31.6
Expected volatility (%)	36.2
Expected life of option (years)	4.0
Expected dividends (%)	0.0
Risk-free interest rate for equivalent maturities (%)	0.0
Probability of reaching the performance target (%)	95.2

The parameters used in the valuation were determined as follows: The share price was set with reference to the trading price of the Zalando shares. The estimated volatility used in the model is primarily based on the historical share price of the Zalando share. An estimate was made for the expected life of the option in line with the factors regarding early exercise contained in IFRS 2.B18. The risk-free interest rate for equivalent maturities was calculated using the Svensson method. The probability that the performance target will be reached was determined based on market assumptions as far as possible.

VSOP 2017

The VSOP 2017 entitles selected senior members of the management team to subscribe to virtual stock options in order to be remunerated for any sustained increase in the value of ZALANDO SE. The virtual stock options were issued at an exercise price of EUR 25.00 (Type A options) or at EUR 50.00 (Type B options). In fiscal year 2017, a total of 270,000 A options and 600,000 B options were issued. For each option that is exercised, the holder receives a cash settlement of an amount equal to the closing price of the share of the company listed on the Frankfurt Stock Exchange on the date on which notification is received that the option is being exercised less the exercise price of EUR 25.00 for Type A options and EUR 50.00 for Type B options. The company has the right to fulfill the cash settlement obligations towards the holder of the option by delivering shares instead.

The options vest provided that (i) the recipients have worked for the company for the period specified within a tranche, (ii) the performance target defined in the VSOP 2017 has been fulfilled, and (iii) the waiting period has elapsed.

The options granted to the recipients vest in 12 tranches over a period of three years. Generally, over the three years starting with the grant date, 1/12th of the options granted are deemed to have vested in each three-month period in which the option holder is employed at ZALANDO SE (or a group company).

The performance target stipulates that Zalando must achieve a certain level of contractually agreed revenue growth over a period of three years, starting on the grant date. If the contractual revenue target is not achieved, the options are forfeited without replacement.

The waiting period of three years commences on the date on which the options are granted. At the end of the waiting period, the holders of exercisable options can exercise them at any time over the following two years, except during black-out-periods.

The number of outstanding options developed as follows in the reporting period:

Development of Options (VSOP 2017)

→ 73

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2017	**0**	**–**
Options granted during the reporting period	870,000	42.24
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**870,000**	**42.24**
Options vested as of Dec 31, 2017	**72,498**	**42.24**

The weighted average of the remaining contractual term of the outstanding options (meaning the period until the options' expiry date) as of the reporting date is four years and six months.

The weighted average fair value of a new option granted within the scope of the VSOP 2017 was EUR 17.76 for Type A options and EUR 8.79 for Type B options in the reporting period. The fair value of the options comprises the intrinsic value and the market value multiplied by the probability that the performance target will be reached. The fair value of the options was calculated using a binomial model. The input parameters included in the calculation of the newly granted options are summarized in the following table:

Parameters VSOP 2017

→ 74

	Jan 1 – Dec 31, 2017
Weighted average share price (EUR)	40.0
Weighted average exercise price Type A (EUR)	25.0
Weighted average exercise price Type B (EUR)	50.0
Expected volatility (%)	36.0
Expected dividends (%)	0.0
Risk-free interest rate for equivalent maturities (%)	–0.2
Probability of reaching the performance target (%)	93.1

The parameters used in the valuation were determined as follows: The share price was set with reference to the trading price of the Zalando share. The estimated volatility used in the model is primarily based on the historical share price of the Zalando share. The risk-free interest rate for equivalent maturities was calculated using the Svensson method. Where possible, the probability that the performance target will be reached was determined based on market assumptions.

EIP

The first EIP tranche was granted in fiscal year 2016 to the members of the Management Boards of affiliated companies and managerial staff members as well as selected key employees of the company and affiliated companies. In fiscal year 2017, the second tranche was granted.

The Management Board is authorized to issue until May 30, 2021, a total of up to 5,098,440 subscription rights for up to 5,098,440 non-par value shares of the company with a pro-rata share in the share capital of EUR 1.00 each by granting of subscription rights for shares (performance shares) and stock appreciation rights with subscription rights for shares (performance options). The options issued under the EIP entitle the participants to receive an annual mix (portfolio) of performance shares and performance options depending on the total amount in euros granted to each participant (the annual grant). The participant can decide how to split the annual grant between performance shares and performance options and regarding the performance options, whether they will be granted as ATM (at the money) performance options or OTM (out of the money) performance options.

The performance options provide a payout only in case of an increase of the value of ZALANDO SE. The management of Zalando aims to settle performance shares and performance options by issuing shares.

The value of the performance shares and performance options and the resulting swap ratio for performance shares and performance options granted is at the discretion of Zalando. It is set on the basis of a fair value measurement using the Black-Scholes model. The only distinction between performance shares, ATM performance options and OTM performance options is the exercise price. Performance shares have a set exercise price of EUR 1.00, for ATM performance options the exercise price is set equal to the volume-weighted price on the market over the last 60 days of trading prior to the grant date (base price), and the OTM performance options have a price set at 120% of the base price. The recipients only have to pay the exercise price for performance shares. The exercise prices are the starting point to measure the actual increase in business value.

The ability to exercise the portfolio is tied to a number of conditions. First, the recipient has to be employed by the company during the vesting period. Second, the terms and conditions of the EIP must be met, and third, the waiting period must have expired.

The performance options and performance shares granted to the recipients vest in four tranches over a period of twelve months and under the condition that the recipient is employed at Zalando over the vesting period of the tranche. The performance condition stipulates that Zalando must achieve a certain level of a contractually agreed revenue growth over a period of four years, starting on the grant date. If the contractual revenue target is not achieved, the portfolio is forfeited without replacement. The waiting period of four years commences on the date on which the portfolio of performance options and performance shares is granted. It continues for a period of four years. The recipients can exercise vested performance options and performance shares after the waiting period within certain time frames over a period of four years.

When the performance options and performance shares are exercised, the difference between the price of the Zalando share on the exercise date and the respective exercise price is calculated. This difference will be paid out in Zalando shares. The price of the Zalando share on the exercise date is decisive for calculating the number of Zalando shares to be issued. If the necessary number of shares exceeds the number authorized by the annual general meeting, any overhang is paid out in cash.

The number of outstanding options developed as follows in the reporting period:

Development of Options (EIP 2016 and 2017)

→ 75

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**0**	**–**
Options granted during the reporting period	879,721	24.77
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**879,721**	**24.77**
Options vested as of Dec 31, 2016	**219,731**	**24.78**
Outstanding options as of Jan 1, 2017	**879,721**	**24.77**
Options granted during the reporting period	1,232,955	36.45
Options forfeited during the reporting period	188,899	31.17
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**1,923,777**	**31.65**
Options vested as of Dec 31, 2017	**1,155,365**	**28.15**

The weighted average fair value of performance shares within the scope of the EIP was EUR 35.76 in the reporting period. The weighted average fair value of ATM performance options was EUR 9.79, and of OTM performance options was EUR 7.20.

The fair value of the options comprises the intrinsic value and the time value multiplied by the probability that the performance target will be reached. The fair value was calculated using the Black-Scholes option price model. The input parameters included in the calculation of the newly granted options are summarized in the following table:

Parameters EIP 2016 and 2017

→ 76

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Weighted average share price (EUR)	39.3	24.6
Weighted average exercise price Performance Share (EUR)	1.0	1.0
Weighted average exercise price ATM Performance Option (EUR)	40.2	27.1
Weighted average exercise price OTM Performance Option (EUR)	48.2	32.5
Expected volatility (%)	36.0	36.0
Expected life of option (years)	4.0	4.0
Expected dividends (%)	0.0	0.0
Risk-free interest rate for equivalent maturities (%)	–0.4	–0.6
Probability of reaching the performance target (%)	93.5	95.1

The parameters used in the valuation were determined as follows: The share price was set with reference to the trading price of the Zalando share. The expected volatility used in the model is primarily based on the historical share price of the Zalando share. A best estimate was made for the expected life of the option in line with the factors regarding early exercise contained in IFRS 2. B18. The risk-free interest rate for equivalent maturities was calculated using the Svensson method. The probability that the performance target will be reached was determined based on market assumptions as far as possible.

Total Expenses Recognized for Share-Based Payment Awards

The following table shows the expenses recognized for share-based payments awards in fiscal years 2017 and 2016:

Expenses from Share-Based Payments

→ 77

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Equity-settled	27.5	19.9
Total expenses recognized	**27.5**	**19.9**

(21.) Provisions

Provisions developed as follows in the reporting year:

Development of Provisions

→ 78

IN EUR M	Jan 1, 2017	Usage	Addition	Interest expense	Dec 31, 2017
Restoration obligations	11.8	0.1	2.9	0.3	14.9
Other provisions	2.6	1.9	0.5	0.0	1.2
Total	**14.4**	**2.0**	**3.4**	**0.3**	**16.1**

The provisions for restoration obligations exclusively relate to leasehold improvements. Other provisions pertain to provisions for retention obligations and onerous contracts.

The following table shows the maturities of the provisions at the end of fiscal year 2017:

Maturity of Provisions

→ 79

	Due in			
IN EUR M	Less than 1 year	1–5 years	More than 5 years	Total
Restoration obligations	0.0	1.0	13.9	14.9
Other provisions	0.4	0.7	0.1	1.2
Total	**0.4**	**1.7**	**14,0**	**16.1**

(22.) Trade Payables and Similar Liabilities and Prepayments Received

Trade payables and similar liabilities rose by EUR 199.5m to EUR 1,120.0m. The increase is largely due to deliveries of merchandise in light of the higher business volume and longer payment terms.

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 are recognized in the statement of financial position under trade payables and similar liabilities.

Trade payables contain liabilities denominated in foreign currency equivalent to EUR 23.4m as of the reporting date (prior year: EUR 31.1m).

Prepayments received pertain to advance payments received from customers for orders.

(23.) Other Current Non-Financial Liabilities and Other Financial Liabilities

As of the reporting date, current financial liabilities and current non-financial liabilities comprise the following components:

Other Current Financial Liabilities and Other Current Non-Financial Liabilities

→ 80

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
Other current financial liabilities	**84.0**	**69.0**	**15.0**
thereof obligations to reimburse customers for returns	53.2	34.9	18.3
thereof debtors with credit balances	12.2	22.8	–10.6
thereof cash contribution for capital increase	3.3	0.0	3.3
thereof others	15.3	11.3	4.0
Other current non-financial liabilities	**123.9**	**86.7**	**37.2**
thereof VAT liabilities	66.1	43.3	22.8
thereof liabilities from gift vouchers	24.2	17.3	6.9
thereof liabilities from wage and salary	25.6	19.0	6.6
thereof others	8.0	7.1	0.9

The increases in VAT liabilities and liabilities from gift vouchers are largely due to the higher business volume. Liabilities from the sale of gift vouchers are recognized at the value of the anticipated utilization. The changes in liabilities from wage and salary are mainly impacted by the increase in the number of employees (see section 3.5.8 (6.))

(24.) Borrowings

Borrowings are due to banks and relate to the financing of fulfillment centers. For more information, please refer to section 3.5.8 Other Notes (1.).

(25.) Notes to the Statement of Cash Flows

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. 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 impacted the cash flow. Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities increased from a very low level of EUR –127.6m in the prior year to EUR –62.4m as of December 31, 2017.

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, amounted to EUR 243.9m (prior year: EUR 181.7m). In 2017, an amount of EUR 34.9m was invested in corporate acquisitions (prior year: EUR 30.4m). 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).

Changes in borrowings impacted the statement of cash flows and the statement of financial position as follows.

Reconciliation of Liabilities Arising from Financing Activities

→ 81

IN EUR M	Carrying amount as of Dec 31, 2016	Cash flows	Non-cash flow changes	Carrying amount as of Dec 31, 2017
Non-current borrowings	11.2	0.0	–2.8	8.4
Current borrowings	3.2	–3.2	2.8	2.8

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.

Free cash flow decreased by EUR 153.3m 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 higher capex.

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 – slightly declined in 2017 by EUR 87.1m to EUR 1,105.5m.

(26.) Deferred Taxes

Deferred tax assets and liabilities recognized as of the reporting dates of the reporting and comparative periods break down as follows:

Deferred Tax Assets and Liabilities

→ 82

IN EUR M	Deferred tax assets		Deferred tax liabilities		Net balance	
	Dec 31, 2017	Dec 31, 2016	Dec 31, 2017	Dec 31, 2016	Dec 31, 2017	Dec 31, 2016
Intangible assets	2.1	1.9	–27.9	–20.6	–25.8	–18.7
Property, plant and equipment	0.1	0.0	–3.5	–3.4	–3.4	–3.4
Inventories	0.6	0.0	–5.3	–2.5	–4.7	–2.5
Trade and other receivables	1.2	0.2	–11.9	–6.7	–10.7	–6.6
Provisions	3.8	3.2	0.0	0.0	3.8	3.2
Other financial and non-financial liabilities	6.6	5.0	0.0	–0.2	6.6	4.8
Unused tax losses	0.2	21.7	0.0	0.0	0.2	21.7
Total	**14.7**	**31.9**	**–48.7**	**–33.5**	**–34.0**	**–1.5**
Netting	**–13.2**	**–30.3**	**13.2**	**30.3**	**0.0**	**0.0**
Total recognized deferred tax assets and liabilities	**1.4**	**1.6**	**–35.4**	**–3.1**	**–34.0**	**–1.5**

The increase of net deferred tax liabilities is mainly impacted by the usage of loss carry forwards in 2017, which were mainly attributable to ZALANDO SE and zLabels (EUR –21.7m) and due to an increase in deferred tax liability on capitalized development costs totaling EUR –6.2m. Furthermore, market values of hedging derivatives and other derivatives also increased net deferred tax liabilities (EUR –7.7m; prior year: EUR –3.1m).

Changes in the fair values of hedging derivatives (cash flow hedges) in equity had an equity-decrease effect from deferred taxes of EUR –3.3m (prior year: EUR +0.9m), which are included in other comprehensive income.

Deferred tax assets on unused tax losses in the 2017 reporting year pertain primarily to foreign subsidiaries (EUR 0.2m; prior year mainly to ZALANDO SE: EUR 21.4m). The amounts recognized are based on the tax results expected in the planning period.

(27.) Financial Instruments

Carrying Amounts of Financial Assets / Liabilities and Their Fair Values 2017

→ 83

IN EUR M	Category pursuant to IAS 39*	Carrying amount as of Dec 31, 2017	Amount recognized in the balance sheet pursuant to IAS 39			Fair value as of Dec 31, 2017**
			Amortized cost	Fair value not through profit or loss	Fair value through profit or loss	
Assets						
Cash and cash equivalents	LaR	1,065.5	1,065.5	–	–	–
Trade receivables	LaR	278.7	278.7	–	–	–
Other financial assets	LaR	64.7	64.7	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	17.2	–	17.2		17.2
Other derivative financial instruments	FVtPL	20.6			20.6	20.6
Investments in equity instruments	Afs	4.1	4.1***			
Liabilities						
Trade payables and similar liabilities	FLAC	1,120.0	1,120.0	–	–	–
Financial liabilities	FLAC	11.2	11.2	–	–	11.9
Other financial liabilities	FLAC	78.3	78.3	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	5.7	–	5.7		5.7
Other derivative financial instruments	FVtPL	2.1			2.1	2.1

*) LaR – Loans and Receivables
FLAC – Financial Liabilities measured at Amortized Cost
FVtPL – at Fair Value through Profit or Loss
Afs – available for sale
n.a. – not assigned to a category

**) Based on the simplification allowed under IFRS 7.29, the company assumed that for current financial assets and liabilities accounted under amortized cost the book value fairly represents the fair value.

***) Zalando used the exception in accordance with IAS 39.46 (c).

Carrying Amounts of Financial Assets / Liabilities and Their Fair Values 2016

→ 84

IN EUR M	Category pursuant to IAS 39*	Carrying amount as of Dec 31, 2016	Amount recognized in the balance sheet pursuant to IAS 39 – Amortized cost	Fair value not through profit or loss	Fair value through profit or loss	Fair value as of Dec 31, 2016**
Assets						
Cash and cash equivalents	LaR	972.6	972.6	–	–	–
Trade receivables	LaR	216.0	216.0	–	–	–
Other financial assets	LaR	254.9	254.9	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	7.3	–	6.2	1.1	7.3
Other derivative financial instruments	FVtPL	12.8			12.8	12.8
Liabilities						
Trade payables	FLAC	920.5	920.5	–	–	–
Financial liabilities	FLAC	14.4	14.4	–	–	15.5
Other financial liabilities	FLAC	61.8	61.8	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	9.5	–	9.3	0.2	9.5

*) LaR – Loans and Receivables
FLAC – Financial Liabilities measured at Amortized Cost
FVtPL – at Fair Value through Profit or Loss
n.a. – not assigned to a category

**) Based on the simplification allowed under IFRS 7.29, the company assumed that for current financial assets and liabilities accounted under amortized cost the book value fairly represents the fair value.

As of the reporting date, Zalando had forward exchange contracts in pounds sterling, Norwegian kroner, Polish zloty, Swedish kronor, Swiss francs and US dollars as well as interest rate swaps in euros.

The nominal and market values of the derivative financial instruments are as follows as of the reporting date.

Nominal Amounts and Market Values of Derivative Financial Instruments

→ 85

		Market value				
	Nominal value	Assets	Liabilities	Total	Nominal value	Market value
IN EUR M	Dec 31, 2017	Dec 31, 2017	Dec 31, 2017	Dec 31, 2017	Dec 31, 2016	Dec 31, 2016
Forward exchange contracts	1,288.1	22.5	7.6	14.8	1,104.4	–1.9
Interest rate swaps	6.7	0.0	0.2	–0.2	8.8	–0.3
Total	**1,294.8**	**22.5**	**7.8**	**14.7**	**1,113.3**	**–2.2**

The nominal amounts correspond to the sum of all the non-netted purchases and sales amounts of the derivative financial transactions. The market values reported correspond to the fair value. The fair values of the derivative financial instruments were calculated without taking into account opposite developments in the value of the hedged items.

The market values of the interest swaps designated to a hedging relationship are reported in the statement of financial position under other non-current financial liabilities and assets.

The market values of forward exchange contracts designated to a hedging relationship as well as forward exchange contracts that are not designated to a hedging relationship are reported in the statement of financial position under other current or non-current financial assets and liabilities.

In the event that all contractual partners fail to meet their obligations from the forward exchange contracts, the credit risk for the group amounts to EUR 15.0m as of the reporting date (prior year: EUR 0.2m).

The forward exchange contracts in place as of the reporting date have a remaining term of up to 13 months.

In the reporting period, income from fair value measurement of financial instruments designated as a cash flow hedge of EUR 11.5m (prior year: EUR –3.1m) was recognized directly in equity.

Net Gains and Losses from Financial Assets and Financial Liabilities

The net gains / losses from financial assets and financial liabilities contain effects from the fair value measurement of derivatives that are not designated as a hedge and changes in the fair value of other financial instruments as well as interest payments. In addition, the net gains/losses contain effects from the impairment losses, reversals of impairment losses, derecognition and exchange rate fluctuations of loans and receivables as well as liabilities measured at amortized cost.

Net Gains and Losses from Financial Instruments 2017

→ 86

IN EUR M	From interest affecting profit or loss	From subsequent measurement affecting profit or loss			From disposal affecting profit or loss	Total 2017
		At fair value	Currency translation	Allowances		
Loans and receivables	–2.2	0.0	–3.8	–38.0	–3.8	–47.8
Fair value through profit or loss	1.6	1.0	0.0	0.0	0.0	2.6
Liabilities in the category measured at amortized cost	–7.5	0.0	0.5	0.0	0.0	–7.1
Total	**–8.2**	**1.0**	**–3.3**	**–38.0**	**–3.8**	**–52.3**

Net Gains and Losses from Financial Instruments 2016

→ 87

IN EUR M	From interest affecting profit or loss	From subsequent measurement affecting profit or loss			From disposal affecting profit or loss	Total 2016
		At fair value	Currency translation	Allowances		
Loans and receivables	–0.5	0.0	–0.9	–28.1	5.1	–24.4
Fair value through profit or loss	0.1	10.6	0.0	0.0	0.0	10.8
Liabilities in the category measured at amortized cost	–6.5	0.0	–0.1	0.0	0.0	–6.6
Total	**–6.9**	**10.6**	**–0.9**	**–28.1**	**5.1**	**–20.2**

Fair Value Hierarchy

As of the reporting date, the group held financial assets and financial liabilities measured at fair value. These financial instruments are classified within a three-level fair value hierarchy.

With regards to financial instruments that are regularly measured at fair value, the group determines whether items are to be reclassified between hierarchy levels. This is determined by reassessing the inputs of the lowest level that is of significance for fair value measurement as of the end of the reporting period.

As in the prior year, derivative financial instruments that are designated as a hedge are allocated to level 2. The forward exchange contracts are measured based on observable spot foreign exchange rates of the European Central Bank and the interest yield curves of the corresponding currencies. Hedging instruments used to hedge the interest exposure are measured by discounting the future cash flows using a discount rate for instruments of equivalent terms. Beyond these, there are no input factors that cannot be observed.

Other financial assets include an interest in the proceeds from the sale of developed land owned by third parties. This is measured at fair value through profit or loss using the income approach and level 3 inputs of the fair value hierarchy (observable sales price). As of December 31, 2017, it amounted to EUR 15.6m (prior year: EUR 12.8m).

Offsetting

Zalando concludes agreements for derivative financial instruments in accordance with the global netting agreements of the ISDA (International Swaps and Derivatives Association) and other comparable national framework agreements. The requirements according to IAS 32.42 on presenting a net amount of financial instruments recognized in the statement of financial position is typically not met as they only grant the right to offset for future events, for instance the default of one of the contractual parties.

Financial assets and liabilities that are subject to netting agreements or similar contracts are presented below.

Netting of Financial Instruments 2017

→ 88

IN EUR M	Gross amount	Amount netted in the statement of financial position	Net amount shown in the statement of the financial position	Associated amounts not netted in the statement of financial position	Net amount as of Dec 31, 2017
Financial assets					
Derivative financial assets	22.5	0.0	22.5	7.5	15.0
Financial liabilities					
Derivative financial liabilities	7.6	0.0	7.6	7.5	0.2

Netting of Financial Instruments 2016

→ 89

IN EUR M	Gross amount	Amount netted in the statement of financial position	Net amount shown in the statement of the financial position	Associated amounts not netted in the statement of financial position	Net amount as of Dec 31, 2016
Financial assets					
Derivative financial assets	7.3	0.0	7.3	7.1	0.2
Financial liabilities					
Derivative financial liabilities	9.5	0.0	9.5	7.1	2.3

3.5.8 Other Notes

(1.) Risks Relating to Financial Instruments and Financial Risk Management

In the course of its ordinary activities, Zalando is exposed to credit risks liquidity risks, and market risks (mainly 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. The derivative financial instruments are used in the group solely for the purpose of risk management. Zalando would be exposed to higher financial risks if it did not use these instruments. The group's management is responsible for the management of the risks.

Changes in exchange rates and interest rates can lead to considerable fluctuations in the market values of the derivatives used. These market value fluctuations should therefore not be considered in isolation from the hedged items as derivatives and hedged items from a unit in terms of their offsetting developments in value.

Market Risk

Market risk arises from changes in the fair value of future cash flows from financial instruments due to changes in market prices. Market risks include interest rates, currency and other price risks.

The currency risk can be broken down into two further types of risk: the transaction risk and the translation risk. The translation risk describes the risk of changes in the items in the statement of financial position and income statement of a subsidiary due to exchange rate changes when translating the foreign local financial statements into the group's currency. The changes caused by currency fluctuations from the translation of items in the statement of financial position are presented in equity. Zalando is exposed to translation coming from foreign subsidiaries in United Kingdom, Poland and China. Currently Zalando does not hedge the translation risk for these subsidiaries.

The transaction risk relates to the fact that exchange rate fluctuations can lead to changes in value of future foreign currency payments. Zalando operates in different markets and is therefore exposed to foreign currency risk generated from revenues and sourcing transactions in foreign currencies. Forward exchange contracts are used to hedge these activities. Basically, derivative financial instruments are concluded and processed in accordance with internal guidelines that set out binding rules for the scope of action and responsibilities as well as 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 actual 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

→ 90

	Impacts on profit or loss							
IN EUR M	CHF	DKK	GBP	NOK	PLN	SEK	USD	Total
FX rate as Dec 31, 2017	**1.1702**	**7.4449**	**0.8872**	**9.8403**	**4.1770**	**9.8438**	**1.1993**	
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

→ 91

	Impact on other comprehensive income							
IN EUR M	CHF	DKK	GBP	NOK	PLN	SEK	USD	Total
FX rate as Dec 31, 2017	**1.1702**	**7.4449**	**0.8872**	**9.8403**	**4.1770**	**9.8438**	**1.1993**	
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 swaps.

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

Credit Risk

Credit risk is the risk of a customer or contractual partner defaulting on payment, resulting in the assets, financial assets or receivables reported in the consolidated statement of financial position having to be written down. Credit risks primarily concern trade receivables. The credit risk is provided for by portfolio-based valuation allowances based on historical experience and the maturity profile. Uncollectible receivables are written off in full individually.

There is no significant concentration of credit risk.

In addition, for cash and cash equivalents, there is a credit risk that banks can no longer meet their obligations. The maximum exposure corresponds to the carrying amounts of these financial assets at the end of the respective reporting period. The company addresses this exposure by distributing its derivative financial instruments and cash held at banks over multiple financial institutions with good credit standing and money market funds with an AAA rating (according to Standard & Poor's).

Liquidity Risk

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

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

To reduce the liquidity risk further, Zalando uses reverse factoring as an additional financing source to extend the payment terms with different financial partners and suppliers in order to improve working capital. Under these agreements, the factor purchases the claims held by the respective supplier against Zalando. These are recognized in the consolidated statement of financial position under trade payables and similar liabilities.

The tables below show the contractually agreed (undiscounted) interest and principal payments for primary financial liabilities and for derivative financial instruments with their negative fair value. All instruments in the portfolio as of December 31, 2017, and December 31, 2016, and for which payments had already been contractually agreed were included. Planned figures for new future liabilities were not included. The floating-rate interest payments from the financial instruments were determined based on the interest rates most recently fixed before December 31, 2017, and December 31, 2016, respectively. All on-call financial liabilities are always allocated to the earliest possible date.

Payments for Financial Liabilities and Derivative Financial Instruments 2017

→ 92

	Carrying amount	Cash flows 2018		Cash flows 2019–2022	
IN EUR M	Dec 31, 2017	Interest	Repay-ments	Interest	Repay-ments
Borrowings	11.2	0.3	2.8	0.4	8.4
Trade payables and similar liabilities	1,120.0	1.6	1,120.0	0.0	0.0
Other financial liabilities	88.5	0.1	84.0	0.1	4.5
thereof from derivatives	7.8	0.1	7.6	0.1	0.0
Total	**1,219.6**	**2.0**	**1,206.8**	**0.6**	**12.8**

Payments for Financial Liabilities and Derivative Financial Instruments 2016

→ 93

	Carrying amount	Cash flows 2017		Cash flows 2018–2021	
IN EUR M	Dec 31, 2016	Interest	Repay-ments	Interest	Repay-ments
Borrowings	14.4	0.4	3.2	0.8	11.2
Trade payables and similar liabilities	920.5	1.4	920.5	0.0	0.0
Other financial liabilities	71.3	0.1	69.0	0.2	2.3
thereof from derivatives	9.5	0.1	0.0	0.2	0.0
Total	**1,006.2**	**1.9**	**992.8**	**1.0**	**13.5**

Capital Management

The objectives of capital management at the group are short-term solvency and an adequate capital base to finance projected growth while sustainably increasing the business value. This ensures that all group entities can operate on a going concern basis.

Capital management and its objectives and definition are based on key performance indicators derived from the consolidated financial statements in accordance with IFRS. Zalando defines the equity ratio key performance indicator as the ratio of equity to total assets and the net working capital key performance indicator as the sum of inventories and trade receivables less trade payables and similar liabilities. The equity ratio stood at 51.6% as of the reporting date (prior year: 55.5%) and net working capital came to EUR –62.4m as of the reporting date (prior year: EUR –127.6m). The company achieved the key performance indicator targets set by management during both the 2017 year and in the prior year.

Collateral

Zalando pledged financial assets of EUR 2.5m as collateral in the reporting period (prior year: EUR 12.9m). They mainly relate to collateral in connection with lease. The collateral provided may be drawn upon by the beneficiaries should the group not be able to fulfill its payment obligations.

(2.) Information about Related Parties

Zalando identified the related parties of ZALANDO SE in accordance with IAS 24. Zalando had transactions with related parties in the reporting period in the ordinary course of business. The transactions were carried out in accordance with the arm's length principle.

Goods and services from related parties give rise to liabilities of EUR 67.3m as of the reporting date (prior year: EUR 59.2m). Of this amount, EUR 65.4m (prior year: EUR 59.2m) is due to a reverse factoring provider on account of reverse factoring agreements between Zalando and related parties. As a result, there were trade payables or similar liabilities due directly to related parties totaling EUR 1.9m (prior year: EUR 0.0m). Furthermore, trade receivables from related parties amount to EUR 0.3m (prior year: EUR 0.4m).

Merchandise of EUR 161.2m was ordered from related parties in the reporting period. The order volume totaled EUR 122.7m in the comparative period of the prior year. In addition, goods totaling EUR 2.7m were sold to related parties. The cost of services received from related parties came to EUR 3.5m in the reporting period (prior year: EUR 0.3m).

Furthermore, there are no loan receivables due from a related party (prior year: EUR 3.5m).

Related parties controlled by ZALANDO SE are presented in the list of shareholdings.

The members of the Management Board and Supervisory Board were identified as related parties of ZALANDO SE in accordance with the principles contained in IAS 24. The Management Board of ZALANDO SE is made up as follows:

Members of the Management Board

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Management Board	Profession
Robert Gentz	Management Board member with focus on technology, human resources and strategy
David Schneider	Management Board member with focus on brand marketing, sourcing and private labels
Rubin Ritter	Management Board member with focus on operations, finance and corporate governance

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Members of the Supervisory Board

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Supervisory Board	Profession held	Member of the Supervisory Board since
Alexander Samwer	Independent internet entrepreneur, Munich, Germany	Dec 12, 2013
Anders Holch Povlsen (Vice chairperson)	CEO Bestseller A / S, Brande, Denmark	Dec 12, 2013
Beate Siert	Talent Acquisition Specialist ZALANDO SE, Berlin, Germany	Jun 2, 2015
Dominik Asam	CFO Infineon Technologies AG, Munich, Germany	May 31, 2017
Dylan Ross	Category Management / Men Textile Fashion ZALANDO SE, Berlin, Germany	Jun 2, 2015
Jørgen Madsen Lindemann	CEO & President Modern Times Group MTG AB, Klampenborg, Denmark	May 31, 2016
Konrad Schäfers	Digital Experience ZALANDO SE, Berlin, Germany	Jun 2, 2015
Lothar Lanz (Chairperson of the Supervisory Board)	Member of Supervisory Boards, including Axel Springer SE and TAG Immobilien AG as well as of the Board of Directors of Kinnevik AB	Feb 10, 2014
Shanna Prevé	Managing Director Business Development for Google Consumer Hardware Group, San Francisco, USA (California)	May 31, 2017

Further Information
Report of the Supervisory Board p. 42

The term of office of Kai-Uwe Ricke and Lorenzo Grabau expired on May 31, 2017. Furthermore, Dylan Ross stepped down from the Supervisory Board in January 2018.

The members of the Management Board and Supervisory Board only receive remuneration relating to their function as persons in key positions. In fiscal year 2017, expenses of EUR 4.3m were recorded for the members of management who hold key positions in the group (prior year: EUR 5.9m). Of this amount, EUR 3.7m is attributable to share-based payment awards in fiscal year 2017 (prior year: EUR 5.3m). The expenses for share-based payment awards are calculated using graded vesting, which means that the periodical expense gradually decreases over the course of the vesting period. All other remuneration is classified as short-term benefits.

The share-based payments were granted in fiscal years 2011 and 2013. They can vest over a certain period of time and will be included in the total remuneration over this time period based on the service rendered in the respective fiscal year. The share-based payment awards granted to key management personnel are included in the plans explained in section 3.5.7 (20.) of the notes to the consolidated financial statements.

(3.) Remuneration of the Management Board and Supervisory Board of ZALANDO SE

Total remuneration of the Management Board totaled EUR 0.6m in fiscal year 2017 (prior year: EUR 0.6m). No new option rights were granted to the Management Board in fiscal year 2017 (prior year: 0 options). Further information regarding Section 314 (1) No. 6a HGB can be found in the remuneration report, which is presented in the corporate governance report and is part of the combined management report.

The members of the Supervisory Board received remuneration of EUR 0.8m in fiscal year 2017 (prior year: EUR 0.6m). The Management Board and Supervisory Board propose to the annual general meeting the granting of remuneration in accordance with the provision contained in Art. 15 of ZALANDO SE's Articles of Association.

(4.) Corporate Governance Declaration

The declaration by the Management Board and the Supervisory Board regarding the Corporate Governance Code pursuant to Section 161 AktG of December 2017 is published on the company's website.

(5.) Business Combinations

During 2017, Zalando invested in corporate acquisitions totaling EUR 26.7m. These acquisitions closed in June 2017 include KICKZ Never Not Ballin' GmbH, Munich, Germany ("KICKZ"), and Anatwine Ltd, Cheltenham, United Kingdom ("Anatwine"). Resulting from this, Zalando acquired 100% and 78.4% of the voting equity interests in KICKZ and Anatwine respectively.

zln.do/en-kickz

KICKZ is a leading multi-channel basketball retailer. With the addition of KICKZ, Zalando will further strengthen its sports and lifestyle segment, especially in basketball.

Furthermore, Zalando acquired additional shares of Anatwine in order to effectively obtain control of the company. Anatwine provides marketplace supply-side integration solutions for retailers and brands, especially in the fashion and lifestyle sectors. With this acquisition, Zalando will strengthen its ability to digitalize partner stock and connect it to retail channels. Consequently, the majority of the purchased goodwill was allocated to DACH and RoE.

Both acquisitions impacted additions to intangible assets totaling EUR 53.9m, including goodwill of EUR 36.6m and additions to property, plant and equipment totaling EUR 1.3m. Furthermore, Zalando acquired inventories totaling EUR 12.5m. In addition, Zalando remeasured its previously held equity interest in Anatwine at its acquisition-date fair value and recognized the resulting gain in the financial result totaling EUR 3.2m.

(6.) Average Number of Employees

The average number of employees by individual business unit as of the reporting date is presented below:

Average Number of Employees → 96

	2017	2016
Commercial	1,939	1,347
Operations	8,445	6,620
Technology	1,852	1,439
Other	1,704	1,630
Total	**13,940**	**11,036**

(7.) Operating Leases

The group has obligations from operating leases for real estate, furniture and fixtures and for motor vehicles. The contracts have remaining terms of between one and ten years. Some contain renewal and purchase options and escalation clauses, which do not, however, affect the classification of the leases as operating leases.

The expenses recognized from operating leases came to EUR 45.3m in the reporting period (prior year: EUR 34.5m). Future minimum lease payments under non-cancelable operating leases are shown in the following table:

Future Minimum Lease Payments

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IN EUR M	Less than 1 year	1–5 years	More than 5 years	Total
Dec 31, 2017	**64.5**	**190.7**	**55.4**	**310.6**
Dec 31, 2016	42.8	97.0	49.2	189.0

There are no future minimum receipts from non-cancelable operating sub-leases.

(8.) Information Regarding the Auditor

The consolidated financial statements and the annual financial statements of ZALANDO SE for the fiscal year from January 1 to December 31, 2017, were audited by Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart. The lead auditors were Dr. Ingo Röders (since 2013) and Mr. Sebastian Haas (since 2016). Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, may audit the financial statements of the company until 2023, after which the audit has to be put out for tender.

The fees recognized as expenses for the auditor, Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, amount to:

- EUR 0.7m for the audit (separate and consolidated financial statements) (prior year: EUR 0.5m) and
- EUR 0.1m for other assurance services (prior year: EUR 0.3m).

(9.) Shareholdings

ZALANDO SE's direct and indirect shareholdings in its subsidiaries as of December 31, 2017, can be summarized as follows:

List of Shareholdings

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No.	Company	Company domicile	Currency	Share of equity held by*	Share in capital in % 2017
Subsidiaries					
1	zLabels GmbH	Berlin	EUR	Directly	100.0
2	Zalando Operations GmbH	Berlin	EUR	Directly	100.0
3	Zalando Logistics SE & Co. KG	Brieselang	EUR	Directly 2	99.0 1.0
4	Zalando Logistics Mönchengladbach SE & Co. KG	Mönchen-gladbach	EUR	Directly 2	99.0 1.0
5	Zalando Logistics Süd SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
6	Zalando S.A.S.	Paris, France	EUR	Directly	100.0
7	Zalando Customer Care DACH SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
8	Zalando Customer Care International SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
9	Zalando Content Creation SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
10	Zalando Fashion Entrepreneurs GmbH	Berlin	EUR	Directly	100.0
11	Zalando Lounge Service GmbH	Berlin	EUR	Directly	100.0
12	Zalando Outlets GmbH	Berlin	EUR	Directly	100.0
13	Zalando Ireland Ltd.	Dublin, Ireland	EUR	Directly	100.0
14	Zalando Finland Oy	Helsinki, Finland	EUR	Directly	100.0
15	Bread & Butter GmbH & Co. KG	Berlin	EUR	Directly	100.0
16	Portokali Property Development III SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
17	Fashion Connectivity Technologies GmbH	Berlin	EUR	Directly	100.0
18	Mobile Fashion Discovery GmbH	Berlin	EUR	Directly	100.0
19	Zalando Media Solutions GmbH	Berlin	EUR	Directly	100.0
20	Bread & Butter Tradeshow Verwaltungs GmbH	Berlin	EUR	15	100.0

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No.	Company	Company domicile	Currency	Share of equity held by*	Share in capital in % 2017
21	zLabels Trading Ltd.	Hong Kong, Hong Kong	HKD	1	100.0
22	zLabels China Trading Co. Ltd.	Dongguan, China	CNY	21	100.0
23	ifansho Holding GmbH	Berlin	EUR	Directly	100.0
24	nugg.ad GmbH	Berlin	EUR	19	100.0
25	Zalando Logistics Operations Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
26	Tradebyte Software GmbH	Ansbach	EUR	Directly	100.0
27	Zalando Logistics Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
28	Zalando Lounge Logistics SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
29	zLabels Trading Southern Europe S.L.U	Elche, Spain	EUR	1	100.0
30	zLabels LP GmbH	Berlin	EUR	1	100.0
31	Zalando Payments GmbH	Berlin	EUR	Directly	100.0
32	Ifansho Portugal, Unipessoal Lda	Lisbon, Portugal	EUR	Directly	100.0
33	KICKZ Never Not Ballin' GmbH	Munich	EUR	Directly	100.0
34	Lindentor 308. V V GmbH	Berlin	EUR	Directly	100.0
35	Terrehill Investments sp. z o.o.	Warsaw, Poland	PLN	Directly	100.0
36	Anatwine Ltd.	Cheltenham, United Kingdom	GBP	Directly	97.5
37	Anatwine, Inc.	New Castle, Delaware, USA	USD	36	100.0
38	Zalando OpCo Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
39	zLabels Creation & Sales GmbH & Co. KG	Berlin	EUR	1 30	99.0 1.0
40	zLabels Platform Services GmbH & Co. KG	Berlin	EUR	1 30	99.0 1.0
Associated companies					
41	Le New Black S.A.S.	Paris, France	EUR	23	33.9
42	FashionTrade.com B.V.	Amsterdam, Netherlands	EUR	23	50.0

*) The number refers to the number of the company.

(10.) Disclosure Exemptions

In accordance with Section 264b HGB, the partnerships[45] listed as shareholdings are exempt from the requirement to disclose their financial statements and to prepare notes to the financial statements and a management report. In accordance with the provisions of Section 264 (3) HGB, Zalando Lounge Service GmbH, Zalando Outlets GmbH, Zalando Fashion Entrepreneurs GmbH, Tradebyte Software GmbH and Zalando Media Solutions GmbH are exempt from the requirement to disclose their financial statements and to prepare notes to the financial statements and a management report.

(11.) Segment Reporting

Reporting on the business segments is in line with the internal reporting. The reporting to the top body of management of ZALANDO SE for purposes of internal control fundamentally corresponds to the principles of financial reporting described in section 3.5.3 in accordance with IFRS.

ZALANDO SE's internal reporting structure was initially based on a sales channel-related perspective. In a second step, the Management Board also monitors the development of the business for the main sales channel Zalando Shop according to a geographical breakdown into the regions DACH (Germany, Austria and Switzerland), Rest of Europe (Belgium, Denmark, Finland, France, Italy, Luxembourg, Netherlands, Norway, Poland, Spain, Sweden and United Kingdom) and Other. The main sales channel, Zalando Shop, comprises the revenue for all countries from the sale of shoes, clothin and accessories via the respective country-specific Zalando portal. All other sales channels are grouped in the Other segment. The largest share of revenue stems from the sales channel Zalando Lounge and the new platform initiatives. The revenue from the Zalando Lounge stems from additional sales campaigns for selected products at reduced prices for registered users. The products sold by Zalando are all allocable to the Fashion & Lifestyle product group.

The Management Board measures the performance of the segments on the basis of the EBIT calculated in accordance with IFRS. EBIT for segment reporting purposes is defined as earnings before interest and taxes. There are no intersegment transactions in the internal reporting structure. No information on segment assets or liabilities is available or relevant for decision-making.

45) Partnerships, which are exempt from the requirement to disclose their financial statements are presented with the following numbers in the shareholding table above: 3, 4, 5, 7, 8, 9, 16, 28, 39, 40.

Segment Reporting 2017

→ 100

IN EUR M	DACH	Rest of Europe	Other	Total 2017
Revenue	2,145.6	1,973.6	369.9	4,489.0
Cost of sales	–1,131.4	–1,200.0	–198.2	–2,529.6
Gross profit	**1,014.2**	**773.6**	**171.7**	**1,959.4**
Selling and distribution costs	–736.2	–666.2	–128.4	–1,530.8
Administrative expenses	–104.9	–98.0	–40.0	–242.9
Other operating income	7.2	3.8	0.7	11.8
Other operating expenses	–4.7	–3.6	–1.6	–9.9
Earnings before interest and taxes (EBIT)	**175.6**	**9.6**	**2.5**	**187.6**

Segment Reporting 2016

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IN EUR M	DACH	Rest of Europe	Other	Total 2016
Revenue	1,813.8	1,570.2	255.1	3,639.0
Cost of sales	–933.3	–948.9	–147.4	–2,029.6
Gross profit	**880.4**	**621.3**	**107.7**	**1,609.4**
Selling and distribution costs	–576.1	–554.1	–93.5	–1,223.7
Administrative expenses	–89.8	–78.5	–23.0	–191.3
Other operating income	8.9	6.9	0.9	16.7
Other operating expenses	–2.1	–1.8	–0.2	–4.1
Earnings before interest and taxes (EBIT)	**221.4**	**–6.2**	**–8.1**	**207.0**

Of the total revenue generated in the DACH region, Germany accounts for 60.2% (prior year: 61.9%). In the Other reporting segment, Germany accounts for 33.8% of total revenue (prior year: 39.2%). The non-current assets of the group are mainly located in Germany. Cost of sales include valuation allowances of inventories for the DACH segment of EUR 51.8m (prior year: EUR 41.5m), for the Rest of Europe segment of EUR 63.9m (prior year: EUR 42.2m)
and for the Other segment of EUR 12.0m (prior year: EUR 11.6m).

The selling and distribution costs contain valuation allowances of trade receivables and write-downs due to uncollectible receivables for the DACH segment of EUR 25.8m (prior year: EUR 14.1m), for the Rest of Europe segment of EUR 14.6m (prior year: EUR 7.6m) and for the Other segment of EUR 1.4m (prior year: EUR 1.1m).

Total expenses include depreciation and amortization of property, plant and equipment and intangible assets for the DACH segment of EUR 28.5m (prior year: EUR 21.5m), for the Rest of Europe segment of EUR 23.8m (prior year: EUR 17.3m and for the Other segment of EUR 6.4m (prior year: EUR 9.5m).

Other operating income in the prior year 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.

The group's financial result is not allocated to the segments.

(12.) Subsequent Events

No significant events occurred after the reporting date which could materially affect the presentation of the financial performance and position of the group.

(13.) Authorization of the Financial Statements for Issue

The consolidated financial statements and group management report of ZALANDO SE are published in the Bundesanzeiger [German Federal Gazette]. The consolidated financial statements and the group management report were authorized for issue by the Management Board on February 26, 2018.

Berlin, February 26, 2018

The Management Board

Robert Gentz   David Schneider   Rubin Ritter

3.6 Responsibility Statement by the Management Board

We assure to the best of our knowledge and in accordance with the applicable reporting principles that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the group, and that the group management report, which is combined with the management report of ZALANDO SE, includes a fair review of the development and performance of the business and the position of the group, together with a description of the material opportunities and risks associated with the expected development of the group.

Berlin, February 26, 2018

The Management Board

Robert Gentz David Schneider Rubin Ritter

3.7 Independent Auditor's Report

To ZALANDO SE

Report on the Audit of the Consolidated Financial Statements and of the Combined Management Report

Opinions

We have audited the consolidated financial statements of ZALANDO SE, Berlin, its subsidiaries (the group), which comprise the consolidated statement of comprehensive income for the fiscal year from January 1 to December 31, 2017, the consolidated statement of financial position as at December 31, 2017, the consolidated statement of changes in equity and the consolidated statement of cash flows for the fiscal year from January 1 to December 31, 2017, and the notes to the consolidated financial statements, including a summary of significant accounting policies. We have also audited the combined management report of ZALANDO SE, which is combined with the management report of the company, for the fiscal year from January 1 to December 31, 2017. In accordance with the German legal requirements, we have not audited the information included in the statement on corporate governance contained in the corporate governance report in the combined management report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with IFRS as adopted by the EU and the supplementary provisions of German law pursuant to Section 315e (1) HGB ["Handelsgesetzbuch": German Commercial Code] and give a true and fair view of the assets and liabilities and financial position of the group as at December 31, 2017 and its financial performance for the fiscal year from January 1 to December 31, 2017 in accordance with these requirements, and
- the accompanying combined management report as a whole provides an appropriate view of the group's position. In all material respects, this combined management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the combined management report does not cover the content of the statement on corporate governance contained in the corporate governance report.

Pursuant to Section 322 (3) Sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the combined management report.

Basis for the Opinions

We conducted our audit of the consolidated financial statements and of the combined management report in accordance with Section 317 HGB and the EU Audit Regulation (No 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Combined Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the consolidated financial statements and on the combined management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the fiscal year from January 1, 2017 to December 31, 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon; we do not provide a separate opinion on these matters.

Below, we describe what we consider to be the key audit matters:

1) Occurrence and Measurement of Revenue from the Delivery of Merchandise Taking into Account Expected Returns

Reasons Why the Matter Was Determined to Be a Key Audit Matter

As part of selling merchandise to customers, Zalando typically satifies its performance obligation when the merchandise is delivered, i.e., the date on which the significant risks and rewards of ownership and control of the merchandise are transferred to the customer. Zalando customers have the option to return merchandise within the revocation period stipulated by law and, in addition to that period, the return periods granted by Zalando. Zalando's executive directors calculate expected returns, for which no revenue is recognized. Their assumptions and judgments are based primarily on country-specific and month-specific rates of returns, taking seasonal influences into account. Revenue has a significant influence on the net income of the group and is one of the most important performance indicators for the Zalando group.

We consider the existence and measurement of revenue from the delivery of merchandise to be a key audit matter due to the large volume of transactions from the sale of merchandise as well as the risk of fictitious revenue and the degree of uncertainty associated with expected returns.

Auditor's Response

In the course of our audit, we traced the process of revenue recognition from the order through to payment receipt on the basis of the documentation provided to us. Furthermore, we tested the effectiveness of the internal controls in place. This approach includes in particular the operating effectiveness of IT-supported controls. In order to identify anomalies regarding revenue and the development of revenue, we developed a forecast of country-specific revenue from the sale of merchandise based on historical daily, weekly and monthly revenue and compared it with the revenue recognized in the current fiscal year. In addition, we examined the posting ledger for any revenue entries that were entered manually and analyzed the respective contra accounts.

Moreover, as part of the substantive audit procedures, we obtained documentation (delivery slips, invoices, payment receipts) for a test of sales based on mathematical-statistical assumptions regarding the existence of revenue in order to determine whether the revenue recognized was based on a corresponding delivery of merchandise. We also verified the clerical accuracy of the expected returns as determined by Zalando. We obtained documentation of past annual and monthly returns and documentation of seasonal factors, among other things, for the assumed country-specific rate of returns. In order to evaluate the assumed country-specific rate of returns, we also compared this to the merchandise actually returned by the time we concluded our audit.

Our procedures did not lead to any reservations relating to the occurrence of revenue or the measurement of revenue from the sale of merchandise inventory.

Reference to Related Disclosures

With regard to the accounting policies applied for the recognition of merchandise revenue, we refer to the company's disclosures in Notes 3.5.5 (Accounting and Valuation Methods) and 3.5.7 (1.) (Revenue) in the Notes to the Consolidated Financial Statements.

2) Measurement of Trade Receivables from Distance Retail

Reasons Why the Matter Was Determined to Be a Key Audit Matter

Trade receivables from distance retail are characterized by a high number of individual receivables typical to distance retail. Within trade receivables, impairment risks are accounted for by portfolio-based specific allowances. These are determined according to payment type and country based on their age and taking into account expected risks of default, how long they are past due as well as historical bad debts. Zalando's executive directors are responsible for selecting the valuation model as well as the underlying assumptions used in calculating impairment from the valuation model, which is subject to judgment.

We consider the measurement of trade receivables from distance retail to be a key audit matter due to the large number of individual receivables, the complexity of the valuation models as well as the use of judgment in the assumptions of the executive directors.

Auditor's Response

We analyzed the trade receivables measurement process and tested the effectiveness of the internal controls in place including the relevant IT-supported controls.

Furthermore, we considered bad debts recorded in the past as well as payments on open receivables received between the reporting date and the end of our audit according to payment type and country in order to evaluate the incoming payments accepted in the model. In addition, we verified the assumptions regarding expected future incoming payments on open receivables. In this context, we substantiated this using estimates obtained by Zalando's executive directors from the external service providers responsible for the collection of open receivables. We also analyzed whether the valuation model applied provides a suitable basis to measure the recoverability of trade receivables.

Our procedures did not lead to any reservations relating to the measurement of trade receivables from distance retail.

Reference to Related Disclosures

With regard to the accounting policies applied for trade receivables, we refer to the company's disclosures in Notes 3.5.5. (Accounting and Valuation Methods) and 3.5.7 (16.) (Trade and Other Receivables) in the Notes to the Consolidated Financial Statements.

3) Subsequent Measurement of Merchandise Inventory

Reasons Why the Matter Was Determined to Be a Key Audit Matter

Zalando's merchandise inventory is continuously subject to risks associated with existing and potential future excess stocks, which are sold with high discounts through distance retail or are disposed of outside of distance retail. Write-downs on estimated future excess stocks as well as existing excess stocks are calculated at the end of the reporting period and recognized in the consolidated financial statements.

Zalando's executive directors calculate excess stocks based on the expected future sell-through for various sales channels and seasons. Future sell-through and the resulting estimated net realizable value are based on planning assumptions subject to judgment, which are determined using figures observed in the past.

We consider the subsequent measurement of merchandise inventory to be a key audit matter due to the high volume and heterogeneity of merchandise as well as the judgment used in calculating excess stocks and estimating the future net realizable value.

Auditor's Response

We evaluated the compliance of the accounting policies Zalando applied in calculating the merchandise inventory and the timely recognition of write-downs with the IFRS Framework and the relevant IFRSs.

We also analyzed the process used by Zalando's executive directors regarding the subsequent measurement of merchandise and gained an understanding of the process steps and the internal controls in place.

Within the scope of the valuation process, the executive directors consider the expected sell-through of merchandise for various sales channels and seasons. We analyzed the timing of the sell-through using past data compared with actual sales and examined any significant deviations or irregularities in detail. In addition, we considered the allocation to seasons and valuation groups as well as the classification of articles always available in the valuation model.

The valuation model also incorporates the expected proceeds from excess stocks. We examined the assumptions associated with expected proceeds considering proceeds actually generated in the past from merchandise sold with high discounts as well as merchandise for disposal outside of distance retail. In this context, we considered lower-quality features (BCD merchandise) separately. We developed expectations regarding potential future excess stocks based on this and compared them with valuation model assumptions and the write-downs recorded. Furthermore, we verified the clerical accuracy of the valuation model.

Our procedures did not lead to any reservations relating to the subsequent measurement of merchandise inventory.

Reference to Related Disclosures
With regard to the accounting policies applied for the subsequent measurement of merchandise inventory, we refer to the company's disclosures in Notes 3.5.5 (Accounting and Valuation Methods) and 3.5.7 (15.) (Inventories and Prepayments) in the Notes to the Consolidated Financial Statements.

Other Information

The Supervisory Board is responsible for the Report of the Supervisory Board. In all other respects, the executive directors are responsible for the other information. Other information comprises the information included in the statement on corporate governance contained in the corporate governance report in the combined management report as well as the remaining components of the annual report, with the exception of the audited consolidated financial statements and combined management report as well as our independent auditor's report, in particular:

- the responsibility statement contained in the responsibility statement by the Management Board pursuant to Section 297 (2) Sentence 4 HGB and Section 315 (1) Sentence 5 HGB
- the combined non-financial report contained in the "Corporate Responsibility" section pursuant to Section 315b HGB
- the "Report of the Supervisory Board" section and
- the "Report on Equality and Equal Pay for ZALANDO SE" section.

We received a version of this other information prior to issuing this independent auditor's report.

Our opinions on the consolidated financial statements and the combined management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, the combined management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Executive Directors and the Supervisory Board for the Consolidated Financial Statements and the Combined Management Report

Management is responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted in the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB and for the preparation of the consolidated financial statements that, in compliance with these requirements, give a true and fair view of the assets and liabilities, financial position and financial performance of the group. In addition, the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the combined management report that, as a whole, provides an appropriate view of the group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a combined management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the combined management report.

The Supervisory Board is responsible for overseeing the group's financial reporting process for the preparation of the consolidated financial statements and of the combined management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Combined Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the combined management report as a whole provides an appropriate view of the group's position and is, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the consolidated financial statements and on the combined management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this combined management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the combined management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the combined management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the combined management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the group to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express opinions on the consolidated financial statements and on the combined management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.
- Evaluate the consistency of the combined management report with the consolidated financial statements, its conformity with [German] law, and the view of the group's position it provides.
- Perform audit procedures on the prospective information presented by the executive directors in the combined management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information Pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on May 31, 2017. We were engaged by the audit committee and the Supervisory Board on August 8, 2017. We have been the group auditor of ZALANDO SE without interruption since fiscal year 2010. ZALANDO SE has been a corporation geared to the capital market pursuant to Section 264d HGB since 2014.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

In addition to the financial statement audit, we have provided to the company or entities controlled by it the following services that are not disclosed in the consolidated financial statements or in the combined management report:

- services associated with the voluntary audit of financial statements for subsidiaries
- review of the company's voluntarily prepared half-year financial statements as of June 30, 2017
- audit of the system to comply with the requirements pursuant to Section 20 (1) WpHG ["Wertpapierhandelsgesetz": German Securities Trading Act]
- performance of agreed-upon procedures
- audit of financial statements or their individual elements in accordance with IDW AuS 490
- audit to obtain limited assurance of the non-financial statement pursuant to Section 289b et seq. and Section 315b et seq. HGB
- translation services

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Dr. Ingo Röders.

Berlin, February 26, 2018

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Dr. Röders	Haas
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]