

2.2 Report on Economic Position

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

2.2.1 Macroeconomic and Sector-Specific Environment

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

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

Consistent with the European landscape, the German overall retail market grew at 2.0% with online sales increasing by 10.7% in 2017¹⁹. Fashion trading volumes increased by a mere 0.6%²⁰ as a result of a decline in consumer footfall in brick-and-mortar stores to a volume of EUR 76bn²¹. It is reported that footfall dropped by 2.0% in 2017 from 2016²². Nevertheless, online fashion retail sales grew by almost 15.0% in 2017, to a market value of around EUR 14bn²³.

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

- Technological advancements are the key drivers behind the second wave of e-commerce. Advancements especially in machine learning will lead to a further increase in the online fashion business. Market penetration of internet fashion is expected to continue to increase at the expense of traditional brick-and-mortar retailers.
- Moreover, the increased usage of mobile devices and their extended range of applications have influenced the strong growth in online retail trade, including online fashion. Smartphones and tablets provide retail access anytime and nearly anywhere. Due to this convenience, consumers increasingly use them to shop for fashion. Forecasts for mobile commerce demonstrate that this trend is likely to continue. The annual growth rate for mobile retailing in Europe is expected to be 18.4% in the coming year and about 15.2% for the coming five years²⁴.
- Europe remains a very attractive fashion market with a high concentration of affluent customers. In Europe, purchasing power increased by 1.9%²⁵ in 2017 compared to 2016. Moreover, in our key market Western Europe the per capita spending on fashion amounted to EUR 764 in 2017²⁶, which is significantly higher than in most places in the world.
- Lastly, average gross margins for online fashion retailers range between 40% and 60%²⁷, considerably more attractive than average margins in other online product categories, such as electronics.



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

2.2.2 Business Development

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

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

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

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

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

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

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



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zln.do/en-investment-and-growth



zln.do/en-plus



zln.do/en-zfs

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

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

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

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

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

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

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

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



zln.do/en-logistics-network



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

2.2.3 Economic Situation

Financial Performance of the Group

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

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

Consolidated Income Statement

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



Further Information
Consolidated Statement of
Comprehensive Income p. 135

Other Consolidated Financial Information

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

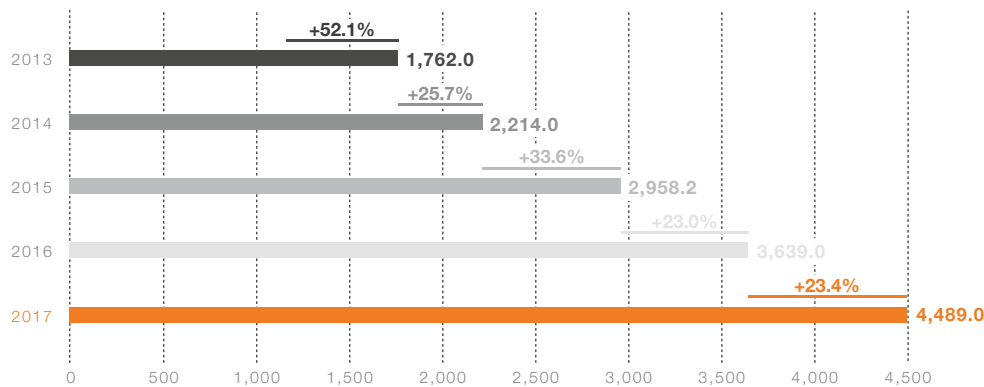
*) EBITDA is the EBIT before depreciation and amortization of property, plant and equipment and intangible assets. Depreciation and amortization of property, plant and equipment and intangible assets amounts to EUR 58.7m in 2017 (prior year: EUR 48.2m).

Development of Revenue

Annual Revenue Growth (2013 – 2017)

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IN EUR M

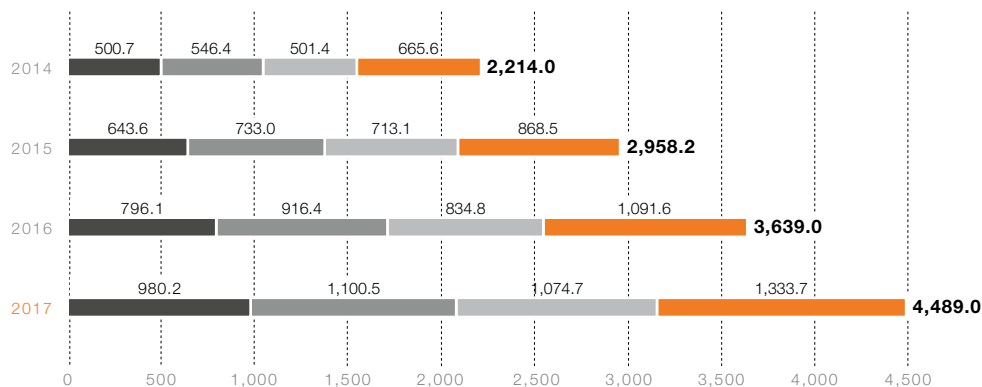


In 2017, Zalando increased its revenue by 23.4% or EUR 850.0m from EUR 3,639.0m to EUR 4,489.0m.

Revenue by Quarter (2014 – 2017)

→ 16

IN EUR M



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

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

Key Performance Indicators

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

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

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

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

2.2 REPORT ON ECONOMIC POSITION

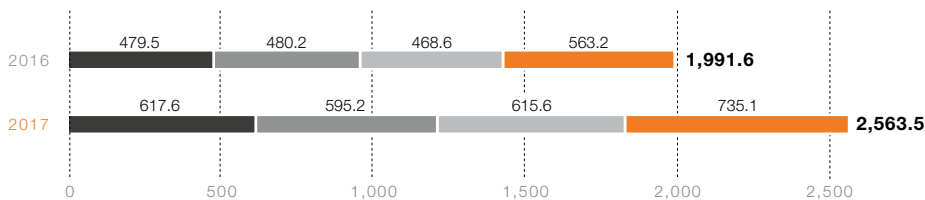
through our continued focus on investing in the consumer and brand proposition as well as in our technology and operations infrastructure.

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

Site Visits by Quarter (2016–2017)

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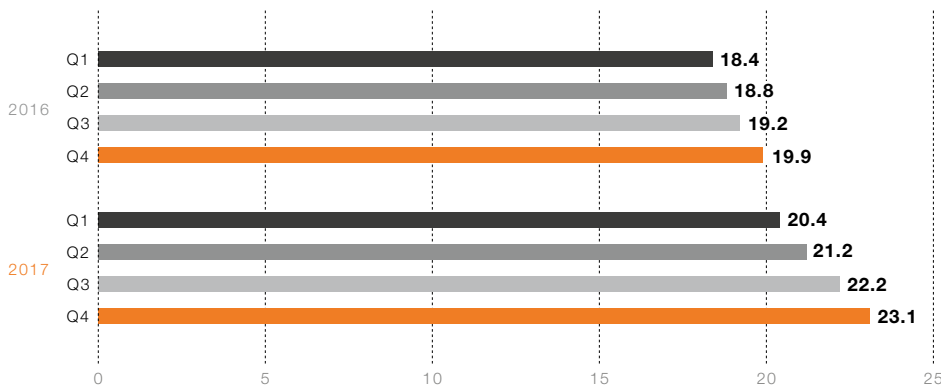
IN M



Number of Active Customers by Quarter (2016–2017)

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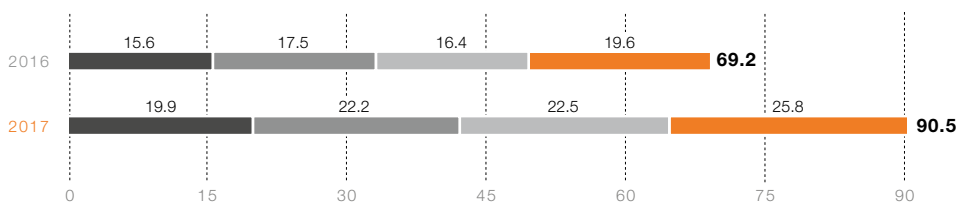
IN M



Number of Orders by Quarter (2016–2017)

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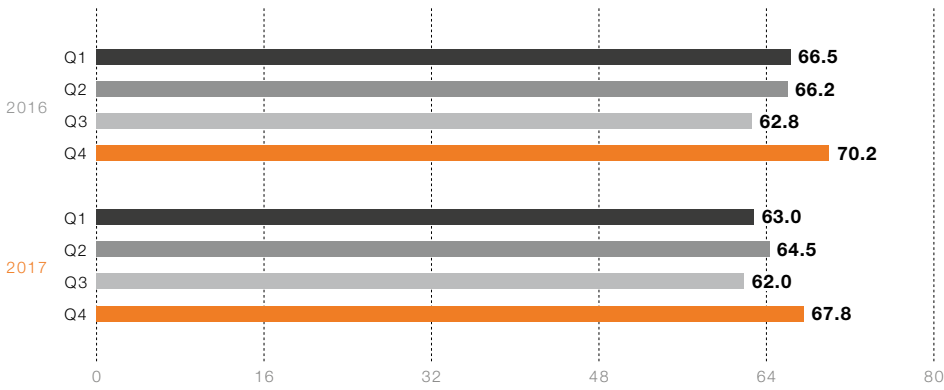
IN M



Average Basket Size by Quarter (2016–2017)

→ 20

IN EUR



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

Revenue by segment breaks down as follows:

Revenue by Segment

→ 21

IN %

8.2 [2016: 7.0]

Other



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

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

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

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

Development of EBIT

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

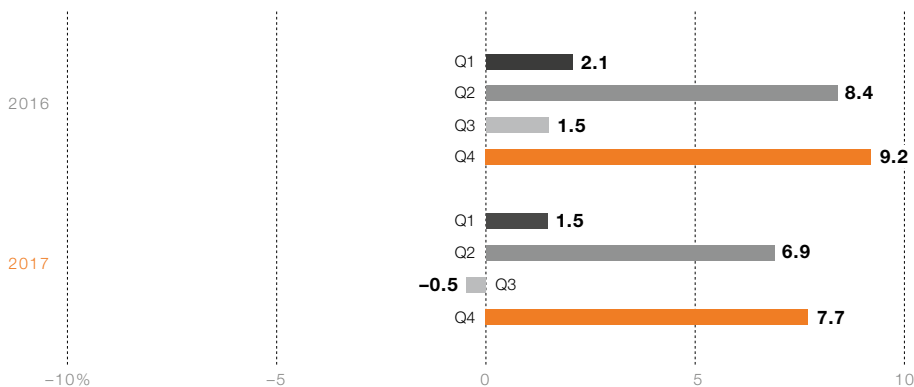


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EBIT Margin by Quarter (2016–2017)

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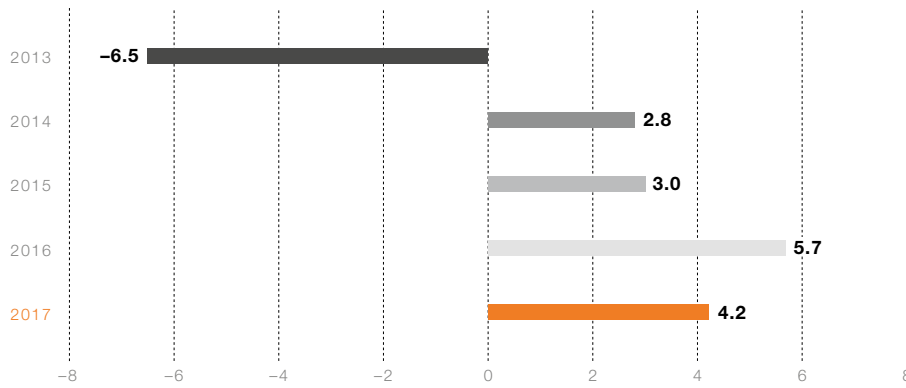
IN %



Yearly EBIT Margin (2013–2017)

→ 23

IN %

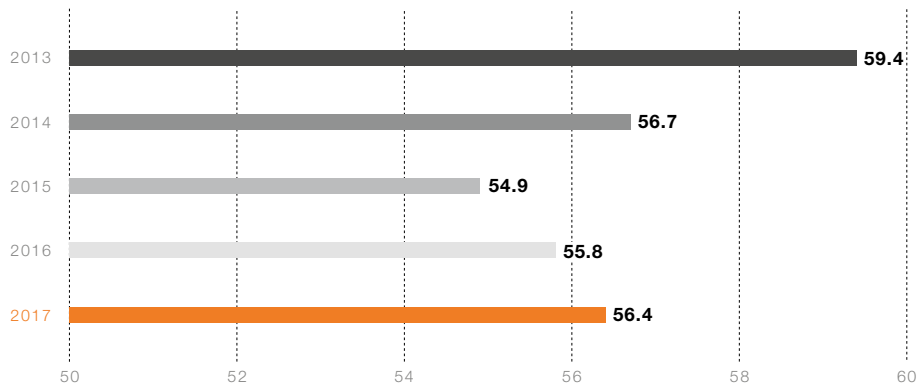


Five-Year Summary of Cost Items (Non-Adjusted)

Cost of Sales (2013–2017)

→ 24

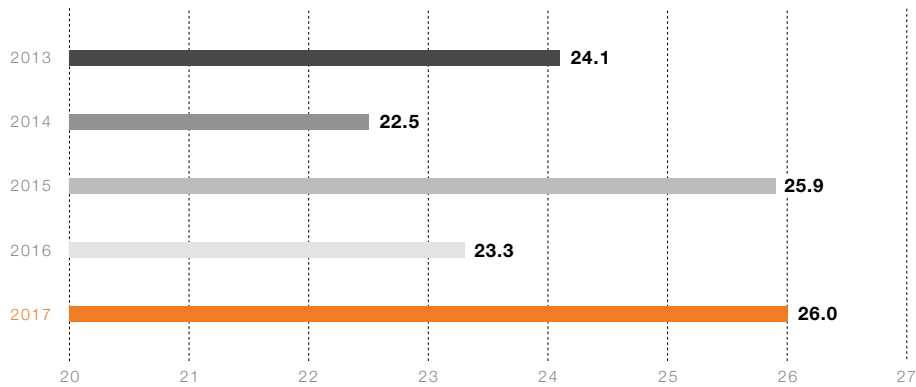
AS % OF REVENUE



Fulfillment Costs (2013–2017)

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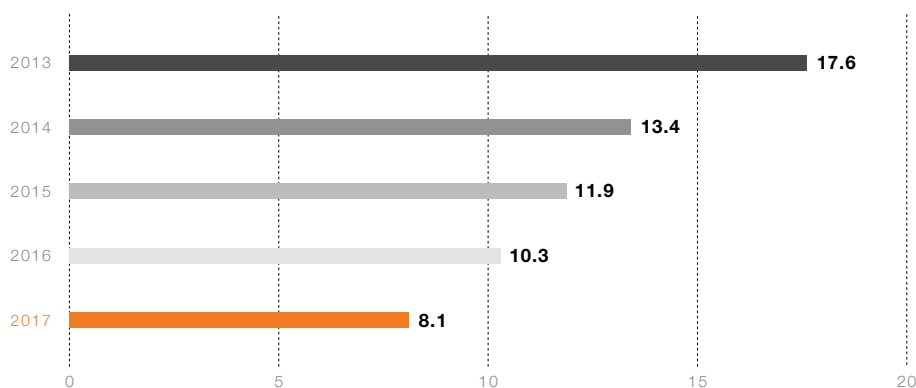
AS % OF REVENUE



Marketing Costs (2013–2017)

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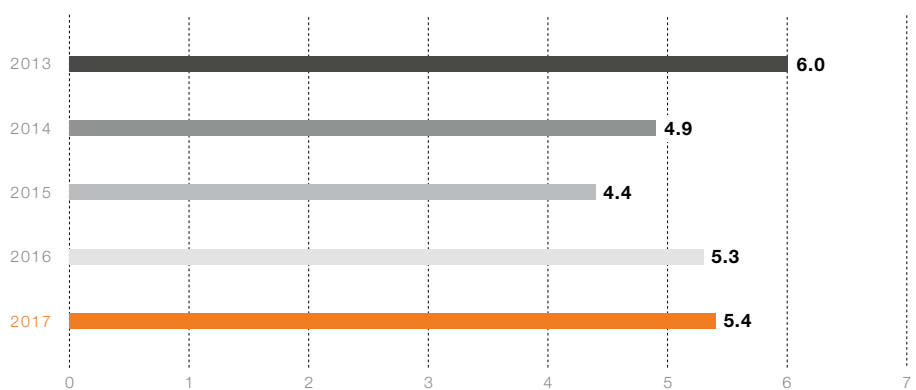
AS % OF REVENUE



Administrative Expenses (2013–2017)

→ 27

AS % OF REVENUE



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

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

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



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



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

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

Adjusted EBIT

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

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

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

Share-Based Compensation Expenses per Functional Area

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

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

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

Results by Segment

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

Consolidated Segment Results

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

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

Share-Based Compensation Expenses per Segment

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

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

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

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

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

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

Adjusted EBIT by Segment

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

Cash Flows

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

Condensed Statement of Cash Flows

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



Further Information
Consolidated Statement
of Cash Flows p. 140

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

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

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

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

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

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

Credit Facility

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

Financial Position

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

Assets

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

Equity and Liabilities

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

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

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

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



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

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

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

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



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

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

Overall Assessment

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

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

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

2.2.4 Employees

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

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



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²⁸⁾ The sustainability report is not part of the audited combined management report.