

# 02

## COMBINED MANAGEMENT REPORT

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## 02.1 BACKGROUND TO THE GROUP

- Zalando is Europe's leading online platform for fashion
- ZALANDO SE and its 32 subsidiaries thus cover the entire supply chain of an online retailer
- Strategic investments to cement partnerships with customers and suppliers and in infrastructure
- Zalando expands fulfillment in Poland, France and Italy
- Sustainability is firmly anchored in the company's DNA

### 02.1.1 BUSINESS MODEL

Zalando is Europe's leading online fashion platform for women, men, and children. The Berlin-based company offers its customers a wide assortment of fashion articles including shoes, apparel, and accessories, with free delivery and returns.

Zalando cooperates with more than 1,500 international brands to offer an assortment ranging from popular global brands, fast-fashion, and local brands, and is completed by private label products. Zalando's offering has been extended and enhanced with Zalando Lounge, which offers registered members special offers at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt, and Cologne opened between 2012 and 2016 and serve as additional sales channels for excess inventory. The parent company, ZALANDO SE, was founded in 2008 and has its registered offices in Berlin. Zalando's online offering is tailored to local customer needs in 15 different European markets: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Poland, Spain, Sweden, Switzerland, and the United Kingdom. In each of these markets, our country-specific websites and mobile apps respond to the specific needs and preferences of our customers. A network of four fulfillment centers in Germany enables Zalando to serve its customers throughout Europe efficiently, completed by an additional fulfillment center currently being constructed in Poland, as well as two new satellite warehouses in Italy and France that will help to address the rising demand in online retail. Zalando increasingly benefits from economies of scale generated by its centralized management of sourcing, fulfillment, and technology divisions.

In order to provide the perfect shopping experience, Zalando offers its customers free delivery and returns with a return policy of up to 100 days, a free service hotline, exciting online content, and customized recommendations. The group believes that the combination of fashion, operating excellence, and online technology is a crucial factor in the success of the company and allows Zalando to present compelling propositions to customers and fashion-brand partners.



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Further information in the  
Zalando City Guide  
[zln.do/en-city-guide](https://zln.do/en-city-guide)

## 02.1.2 GROUP STRUCTURE

### GOVERNANCE AND CONTROL

The Zalando group is managed by its ultimate parent company, ZALANDO SE, based in Berlin, Germany, which bundles all management functions and generates nearly 100% of group revenues. In addition to the parent company, Zalando comprises 32 subsidiaries that operate in the areas of fulfillment, customer service, product presentation, advertising, marketing, and in-house developed private labels for ZALANDO SE. ZALANDO SE and its subsidiaries represent the entire value chain of an online retailer. ZALANDO SE has full control over all subsidiaries, either indirectly or directly.

G4-7  
G4-17

As a result, group reporting essentially corresponds to the reporting for ZALANDO SE. Supplementary information concerning the separate financial statements is presented in Section 02.6.

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



Further information  
Corporate Governance Report  
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### GROUP SEGMENTS

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

## 02.1.3 STRATEGY AND OBJECTIVES OF THE GROUP

Zalando is Europe's leading online platform for fashion. Around 12,000 employees are committed to fulfilling and exceeding customer expectations. The company provides a fashion platform for almost 20 million active customers in 15 countries and is a key retail channel for over 1,500 brand partners.



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Zalando's successful development in recent years evidences the strength of its business model, which has consistently delivered against its performance objectives. The group aims to generate profitable revenue growth in a range of 20% – 25% in 2017, by further expanding its market share in the European online fashion industry.



Further information  
Outlook  
p. 113

The company establishes itself as a meeting place bringing customers and fashion together. On this platform, Zalando creates value for all participants by further developing its operational and technological infrastructure. Zalando's vision is to expand its platform to be the key operating system of the fashion world by introducing multiple ways of integrating a diverse group of fashion contributors and stakeholders, catering to their specific needs. It offers digital and infrastructure services such as analytics, advertising, and fulfillment. Participants include customers, brands/merchants, and intermediaries (e.g. fashion stylists, content creators, logistics, and service providers). Its platform approach will help Zalando deliver attributes that are highly valued by consumers, at scale and with the right cost structure, such as incremental selection and inspirational content, incremental delivery methods, incremental services, and access to fashion expertise. The company expects these attributes to trigger reinforcing growth dynamics and further unlock Zalando's growth and development potential. Improved merchandise selection and availability for example, feeds growth of Zalando's consumer reach and vice versa. For brand partners, access to this unprecedented consumer reach presents a huge benefit and commercial opportunity as they leverage our platform infrastructure.

Zalando's focus on technology forms the foundation for the fashion platform. It handles the increasing diversity and complexity of the platform as more partners and products join. Zalando actively addresses any challenges facing its fashion partners and provides solutions. The Zalando shop and its mobile applications provide an ever-increasing customer reach while simultaneously providing a wealth of information on user behavior and customer buying patterns. These analyses allow our partners to better address their target markets with relevant product offerings and advertising. Zalando aims to win partners, who are as diverse as possible to enrich its platform and combine them in an intelligent manner with the help of its technological expertise to create the most appealing customer offering in the market place.

Zalando's management defined three strategic investment areas for 2017.

#### INVESTMENT IN CONSUMER PROPOSITION

Zalando will continue investing in four key consumer propositions to strengthen its positioning as the most fashion competent destination – assortment, convenience, brand, and mobile.



Corporate strategy

#### INVESTMENT IN SUPPLIER PROPOSITION

To maintain the position as fashion suppliers' preferred e-commerce partner, Zalando will continue investing in the areas of wholesale solutions, partner program, digital services, and fulfillment services.

#### INVESTMENT IN INFRASTRUCTURE

Zalando's supporting investment in technology and operations infrastructure provide the strong foundation on which the group offers compelling consumer and supplier propositions.

Zalando will continue to focus on growing its market share and thereby leveraging the continued growth dynamics of linking consumer reach and providing an industry-leading infrastructure. For consumers, Zalando will continue to be, more than ever, the top-of-mind destination to seek fashion inspiration, advice, and discover fashion products.

Detailed information regarding our strategy are provided in the separate Section 01.3 Corporate Strategy.

#### 02.1.4 CORPORATE RESPONSIBILITY

In the face of global challenges like resource scarcity, climate change, and increasing inequality, we see a pressing urgency to reimagine fashion in a way that benefits all stakeholders involved in the fashion ecosystem. We believe that we can use our expertise in fashion, technology, and operations to make a substantial contribution to a more transparent and sustainable fashion industry.

To approach this goal in a targeted way, we developed and implemented our corporate responsibility (CR) strategy called the do.STRATEGY. The name of the strategy reflects the same philosophy we have implemented in all parts of our business. We have a bias for action. The do. is part of our DNA. Consequently, this is how we approach sustainability, too. The foundation of the do.STRATEGY focuses on five areas defined by the materiality analysis we conducted in 2014 and 2015 by consulting 5,000 customers and 1,200 employees on topics where we potentially have the biggest positive and negative impact. Furthermore, we organized internal workshops across all hierarchies and functions that aimed at finding those topics that are or will be crucial for our business model. The input received from these key stakeholder groups resulted in a list of 16 material topics in five different focus areas. We see it as a promise to our customers and partners, but also as a commitment to all other stakeholders we are connected with. In striving towards our company purpose, we want to leverage the commitment of our employees by empowering them to do their bit for a better fashion industry and a better society in general.

Additional information regarding our sustainability strategy, management and engagement are provided in the separate Section 01.4 Corporate Responsibility.<sup>16</sup>

#### 02.1.5 MANAGEMENT SYSTEM

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



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Further information  
Report on Economic Position  
p. 80

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

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

- **Ratio of mobile site visits to total site visits:** Users are making greater use of mobile devices to access the internet. In our effort to offer customers the opportunity to enjoy high quality shopping on their mobile devices, Zalando continues to develop and refine its websites and apps. As a result, the ratio of website visits from mobile devices to the total number of website visits increased by around 8.5 percentage points in 2016, rising from 57.1 in 2015 to 65.6.
- **Number of active customers:** The Zalando group measures its success by the number of active customers. Each customer that has placed at least one order within the last year (based on the reporting date) is considered active. Compared to the prior year, the number of active customers increased by 2 million, rising from 17.9 million to 19.9 million in 2016.
- **Number of orders:** In addition to revenue, the number of orders placed is a key performance indicator for the management of the group. This indicator is monitored independently from the value of merchandise and is a key driver of growth. In 2016, the number of orders placed increased from 55.3 million in 2015 to 69.2 million.
- **Average number of orders per active customer:** The average number of orders placed by active customers during the last twelve months totaled 3.5 as of December 31, 2016 (prior year: 3.1).
- **Average basket size:** Similar to the number of orders placed, the average basket size has a direct effect on the revenue of the group. It is also an important indicator of the trust customers place in the company. The average basket size slightly decreased in fiscal year 2016 from EUR 67.8 to EUR 66.6.

### 02.1.6 RESEARCH AND DEVELOPMENT

Zalando develops key components of its software internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes in particular are supported using internally developed software. Important technical developments in 2016 included fashion store technical enhancements, Checkout Rebuild, Order Management Service, Merchant Inventory, A/B Testing & Personalization Service, Same Day Delivery, Fulfillment by Zalando, Ramp-up fulfillment centers Lahr and Stradella, Zalon Apps, and many more.

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

Development work at Zalando is performed by teams of developers which are organized by the respective function/line: e.g. fashion store, Smart Logistics, Payments, Brand Solutions, etc.

In 2016, the group recognized development costs of EUR 57.7m (prior year: EUR 23.1m), of which EUR 36.4m relate to prepayments (prior year: EUR 9.2m). The increase in development costs is attributable to the enhancement of the above-mentioned software and new technical projects.

Research costs were immaterial.

## 02.2 REPORT ON ECONOMIC POSITION

- European internet retailing and online fashion sales once again grow considerably more strongly than the economy as a whole
- For Zalando, the fiscal year 2016 was highly successful and nearly all key indicators have improved
- All segments contribute to the 23.0% growth in revenue to EUR 3,639m
- EBIT rose from EUR 89.6 m to EUR 207.0 m, the EBIT margin improved from 3.0% to 5.7%
- Cash flow from operating activities more than doubled to EUR 275.8m

### 02.2.1 MACROECONOMIC AND SECTOR-SPECIFIC ENVIRONMENT

The mega-trend towards online shopping continued in 2016: The European online retail sector<sup>17</sup> rose by 13.6% in 2016, outperforming the general retail industry which grew by only 2.6%. The European fashion retail sector<sup>18</sup> closed the year with a trading volume of around EUR 425bn, up by 0.9% nominally, while the online fashion market rose by 9.1% to EUR 51bn, compared to the prior year.

The German market posted figures consistent with the European landscape, with the overall retail industry<sup>19</sup> growing at 2.5% while online retail sales rose by 11.6% in 2016. Trading volumes declined by 0.2% in 2016 after a number of years of stagnant growth, reflecting adverse weather conditions: A mild January and a cold March, moving into a rainy summer and warm fall was only partly alleviated by increasing sales in the fourth quarter<sup>20</sup>. Nevertheless, online fashion retailer increased sales by 7.4% in 2016, to a market value of around EUR 12.3bn<sup>21</sup>.

We believe our business model will continue to benefit from the positive outlook for European fashion and online retail.

- Technological advancements are the key drivers behind the second wave of e-commerce that will spur further growth of the online fashion business. The market share of internet fashion retail is expected to continue to grow at the expense of traditional brick-and-mortar retailers.
- Europe remains a very attractive fashion market with a high concentration of affluent customers. In our major markets in Western Europe<sup>22</sup>, per capita spending on fashion amounted to EUR 780 in 2016, more than anywhere else in the world. Coupled with high population density, Western Europe leads with the highest spending per square kilometer on fashion, estimated at EUR 88.1k, compared to EUR 15.5k worldwide. Spending per square kilometer is an important indicator for online retailers, as it allows for faster delivery, at lower cost.
- Average gross margins for online fashion retailers range between 40% and 60%<sup>23</sup>, considerably more attractive than average margins in other online product categories, such as electronics.



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

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

- The increased penetration of mobile devices and their extended range of applications have been a key driver for the strong growth in online retail trade, including online fashion. Smartphones and tablets provide access anytime and nearly anywhere, and consumers increasingly use these devices to shop for fashion. Forecasts for mobile commerce<sup>24</sup> illustrate that this trend is likely to continue, expecting an average annual growth rate of roughly 15.3% for the next five years.

### 02.2.2 BUSINESS DEVELOPMENT

ZALANDO SE, Europe's leading online platform for fashion, looks back on a successful business performance in fiscal year 2016. Compared to 2015, the group reported 23.0% revenue growth in the period to EUR 3,639m (prior year: EUR 2,958m). All segments contributed to revenue growth: Revenues in the DACH region increased by 14.8%, in Rest of Europe by 29.6% and the Other segment by 53.2%. Zalando continued to gain market share in all its markets. Zalando's performance goes from strength to strength, building a solid and consistent track record since its IPO in 2014.



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Apparel remained Zalando's single biggest product category, followed by shoes and accessories. The customer base continued to grow strongly, reaching 19.9 million active customers at the end of 2016 (17.9 million on December 31, 2015).

As in previous years, Zalando put customer satisfaction as its main objective and invested significantly in its customer proposition, including mobile, brand, assortment, and convenience. Investment in infrastructure underpins Zalando's strength in technology and operations and enables the expansion of its platform strategy. Zalando's operational structure provides the best fulfillment experience for online fashion in Europe. In 2016, the company successfully launched a satellite warehouse in Italy. It already fulfills nearly 70% of orders for our Italian customers and significantly improved our customer proposition. Its success encouraged management to build another satellite warehouse close to Paris, France, which will start operations in the first quarter of 2017. In addition, there are plans for a third one, in Sweden, to be built in 2017 and further improve the Zalando experience for our customers in the Scandinavian markets. These facilities are operated by a third-party service provider. Construction of a large-scale (130,000m<sup>2</sup>) fulfillment center close to Szczecin, Poland, announced earlier in 2016, is expected to be completed in fall 2017.

Well over 1,000 individual 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 over 1,600 dedicated technology engineers who develop and drive all critical processes in-house. Amongst other achievements, this allowed Zalando to significantly improve its mobile offering and to win the renowned Editor's Choice Award from Google Play for its Android App. An impressive 65.6% of visits to the Zalando online shop were conducted from a mobile device and the app was downloaded more than 28 million times in 2016.

Zalando's vision to connect people with fashion and give consumers better access to the fashion world was brought to life by turning Berlin's famous Bread&Butter fashion trade show into a consumer facing trend event that was open to the public, digitalized, and focused on new trends

24) Euromonitor, Western Europe

and ideas in September 2016. Staged in September 2016, it created an innovative platform where brands shared their stories and collection, offering fashion for all, with most items instantly available to buy. The Bread&Butter fashion event was sold out, attracted more than 20,000 visitors and showcased the Zalando brand in the best possible way, with more than 800 million impressions across all media and social media channels. Highlights included the presentation by Gigi Hadid of her co-created Tommy Hilfiger's Tommy X Gigi collection, and the introduction of Marni's exclusive shoe collection for Zalando.



Further information in the  
Zalando City Guide  
[zln.do/en-b-and-b](http://zln.do/en-b-and-b)

Throughout the year, other notable additions to Zalando's brand portfolio included Fenty by Rihanna, Club Monaco, Ivyrevel, and Kate Spade. The Zalando brand raised its visibility and reach, supported for example by joint campaigns such as Ivy Park. The number of available items increased to approximately 200,000, further enriching the breadth and depth of Zalando's well-curated offering.

In 2016, Zalando started a pilot with international brand partner adidas to connect adidas' Berlin-based performance store to its platform so that the shop's merchandise is available to order from Zalando's website. This strategic partnership opens the door for Zalando's vision of an integrated platform that responds even faster and better to consumer expectations and their preference for a single point of contact that provides access to all fashion items, irrespective of their physical location.



Further information in the  
Zalando City Guide  
[zln.do/en-partner-services](http://zln.do/en-partner-services)

Employee numbers increased by about 20%, strongly driven by the headcount increase in Technology to more than 1,600 engineers, based not only in Berlin, but across Europe in six further locations.

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

The Zalando share is listed in numerous important domestic and foreign indices. These include the German MDAX, the broader European STOXX Europe 600 Index, and the German Entrepreneurial Index GEX. The Zalando share was also listed in relevant industry indices such as the STOXX Europe 600 Retail Index, and the Deutsche Börse Prime Retail Performance Index. The Zalando share closed 2016 at EUR 36.13.



Further information  
The Zalando Share –  
2016 In Review  
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### 02.2.3 ECONOMIC SITUATION

#### FINANCIAL PERFORMANCE OF THE GROUP

The consolidated income statement for 2016 shows ongoing strong revenue growth and substantial improvement of profitability. This was driven by our focus on growing our business and market share by offering the best possible customer experience, while we continued to invest in our business and its platform initiatives.

## 02.2 REPORT ON ECONOMIC POSITION

## CONSOLIDATED INCOME STATEMENT

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Further information  
Consolidated Statement of  
Comprehensive Income  
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IN EUR M	JAN 1 – DEC 31, 2016	As % of revenue	JAN 1 – DEC 31, 2015	As % of revenue	Change
Revenue	3,639.0	100.0%	2,958.2	100.0%	0.0pp
Cost of sales	-2,029.6	-55.8%	-1,624.0	-54.9%	-0.9pp
<b>Gross profit</b>	<b>1,609.4</b>	<b>44.2%</b>	<b>1,334.1</b>	<b>45.1%</b>	<b>-0.9pp</b>
Selling and distribution costs	-1,223.7	-33.6%	-1,118.9	-37.8%	4.2pp
Administrative expenses	-191.3	-5.3%	-129.0	-4.4%	-0.9pp
Other operating income	16.7	0.5%	10.2	0.3%	0.1pp
Other operating expenses	-4.1	-0.1%	-7.0	-0.2%	0.1pp
<b>Earnings before interest and taxes (EBIT)</b>	<b>207.0</b>	<b>5.7%</b>	<b>89.6</b>	<b>3.0%</b>	<b>2.7pp</b>

## OTHER CONSOLIDATED FINANCIAL INFORMATION

→ 26

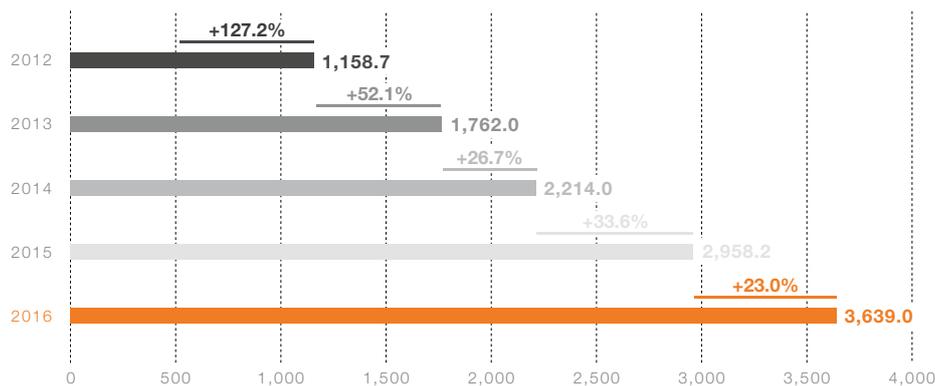
IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
EBIT margin (as % of revenue)	5.7%	3.0%	2.7pp
Adjusted EBIT (excl. equity-settled share-based payments and non-operating one-time effects)	216.3	107.5	108.8
Adjusted EBIT margin (as % of revenue)	5.9%	3.6%	2.3pp
EBITDA	255.3	123.8	131.5
Adjusted EBITDA (excl. equity-settled share-based payments and non-operating one-time effects)	264.5	141.7	122.8

## DEVELOPMENT OF REVENUE

## ANNUAL REVENUE GROWTH (2012–2016)

→ 12

IN EUR M

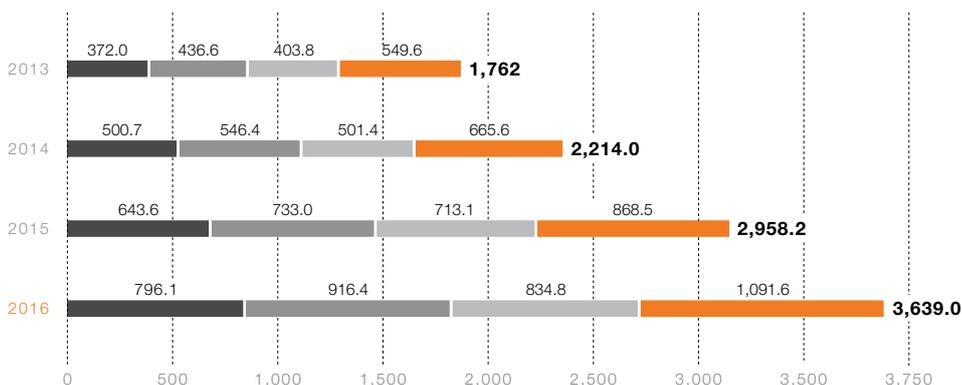


In 2016, Zalando increased its revenue by EUR 680.8m or 23% from EUR 2,958.2m to EUR 3,639.0m.

## REVENUE BY QUARTER (2013–2016)

→ 13

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 in 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 1,091.6m, group revenue in the fourth quarter was up 25.7% on the comparable period of the prior year (Q4 2015: EUR 868.5m). It was the first time that Zalando broke the one billion-euro barrier in a single quarter, a clear result of our customer focus.

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



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## KEY PERFORMANCE INDICATORS

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KEY PERFORMANCE INDICATORS*	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
Site visits (in millions)	1,991.6	1,656.4	20.2%
Mobile visit share (as % of site visits)	65.6	57.1	8.5pp
Active customers (in millions)	19.9	17.9	10.9%
Number of orders (in millions)	69.2	55.3	25.2%
Average orders per active customer	3.5	3.1	12.9%
Average basket size (in EUR)	66.6	67.8	-1.8%
Revenue (in EUR m)	3,639.0	2,958.2	23.0%
Adjusted fulfillment cost ratio (as % of revenue)	23.2	25.8	-2.6pp
Adjusted marketing cost ratio (as % of revenue)	10.3	11.7	-1.4pp
Fulfillment cost ratio (as % of revenue)	23.3	25.9	-2.6pp
Marketing cost ratio (as % of revenue)	10.3	11.9	-1.6pp
EBIT (in EUR m)	207.0	89.6	> 100.0%
EBIT margin (as % of revenue)	5.7%	3.0%	2.7pp
Adjusted EBIT (in EUR m)	216.3	107.5	> 100.0%
EBITDA (in EUR m)	255.3	123.8	> 100.0%
Adjusted EBITDA (in EUR m)	264.5	141.7	86.7%
Net working capital (in EUR m)	-127.6	-2.6	> 100.0%
Operating cash flow (in EUR m)	275.8	119.4	> 100.0%

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

Zalando's most important performance indicators are revenue, EBIT, EBIT margin, adjusted EBIT margin, average basket size, as well as the number of orders. These are forecast for the fiscal year 2017 in Section 02.5 Outlook.

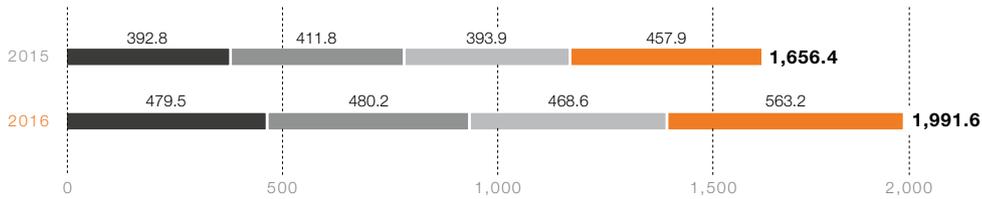
The rise in revenue is mainly attributable to a larger customer base and an increase in number of orders. As of December 31, 2016, the group had 19.9 million active customers. This corresponds to an increase of 10.9% compared to the prior year. The larger customer base ordered more frequently compared to the prior year with the average number of orders per active customers rising 12.9%. The higher number of customer orders, which increased by 25.2% was driven in particular by a 20.2% increase in site visits. 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 8.5 percentage points to 65.6% in 2016. The considerable rise in revenue was also driven by our continued focus on investing in the consumer and supplier proposition as well as in our technology and operations infrastructure.

02.2 REPORT ON ECONOMIC POSITION

SITE VISITS BY QUARTER (2015 – 2016)

→ 14

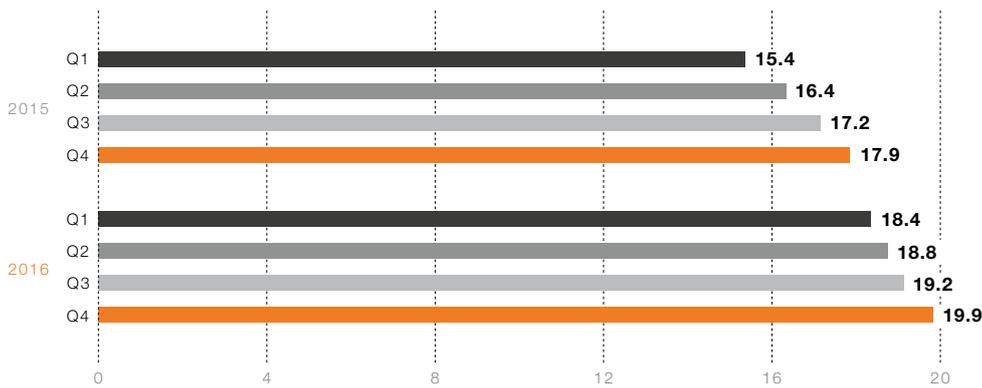
IN M



NUMBER OF ACTIVE CUSTOMERS BY QUARTER (2015 – 2016)

→ 15

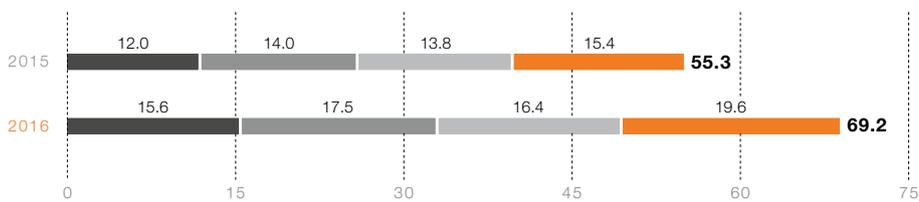
IN M



NUMBER OF ORDERS BY QUARTER (2015 – 2016)

→ 16

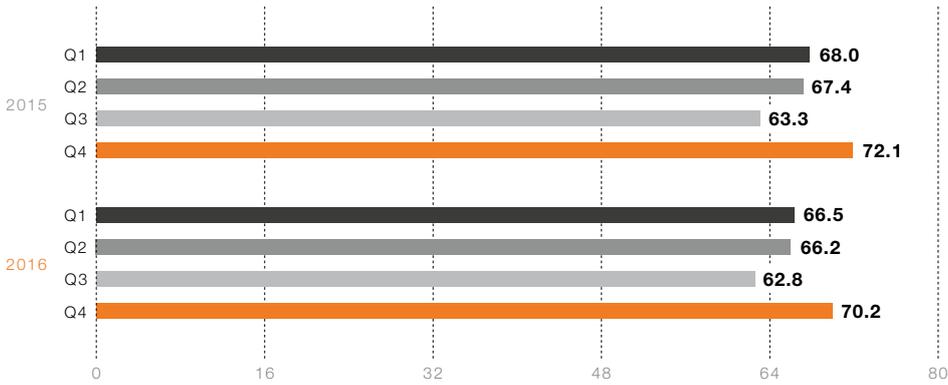
IN M



AVERAGE BASKET SIZE BY QUARTER (2015 – 2016)

→ 17

IN EUR



Zalando is profiting from a strong increase in active customers thanks to the larger assortment and the ease of mobile access to the offering. The close cooperation between Zalando and fast fashion brands, for example Ivy Park and Topshop, has helped raise the popularity of Zalando in the fashion sector.

Revenue by segment breaks down as follows:

REVENUE BY SEGMENT

→ 18

IN %

**7.0** [2015: 5.6]

Other

**49.8** [2015: 53.4]

DACH

**43.1** [2015: 41.0]

Rest of Europe



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In fiscal year 2016, 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 1,813.8m in 2016 (prior year: EUR 1,580.1m), equivalent to an increase of 14.8% compared with 2015.

The Rest of Europe segment generated revenue of EUR 1,570.2m in 2016 (prior year: EUR 1,211.6m). This corresponds to a 29.6% increase in revenue compared to 2015.

Revenue development was also supported by the Other segment, which mainly comprises the business activities of Zalando Lounge, Outlet sales channels, and projects derived from our platform initiatives.

**DEVELOPMENT OF EBIT**

The group recorded an EBIT of EUR 207.0m in 2016 (prior year: EUR 89.6m) which corresponds to an EBIT margin of 5.7% in 2016 (prior year: 3.0%) and represents an improvement of 2.7 percentage points. The strong EBIT margin is a result of a year-on-year improvement across major operating cost lines, especially the fulfillment cost ratio of 2.6 percentage points, as well as the marketing cost ratio of 1.6 percentage points.

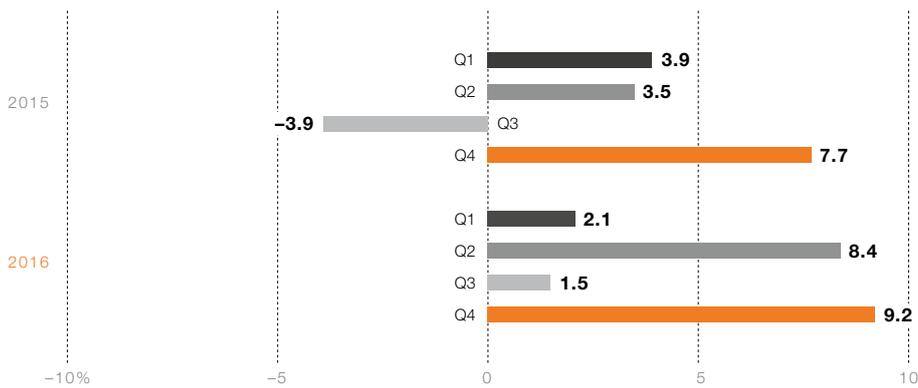


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EBIT MARGIN BY QUARTER (2015 – 2016)

→ 19

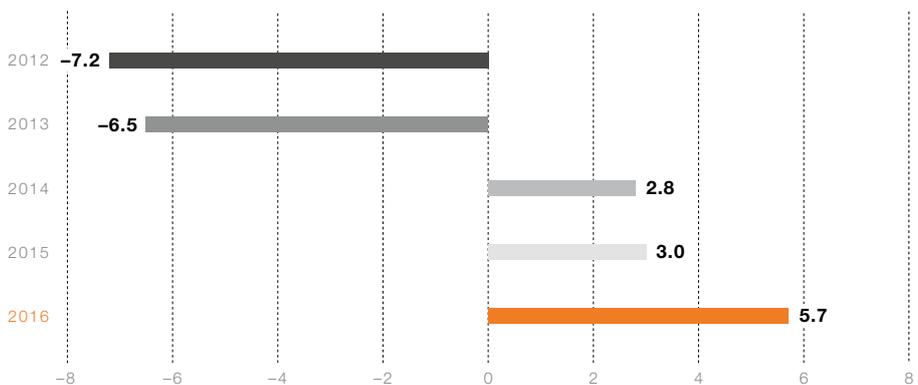
IN %



YEARLY EBIT MARGIN (2012 – 2016)

→ 20

IN %

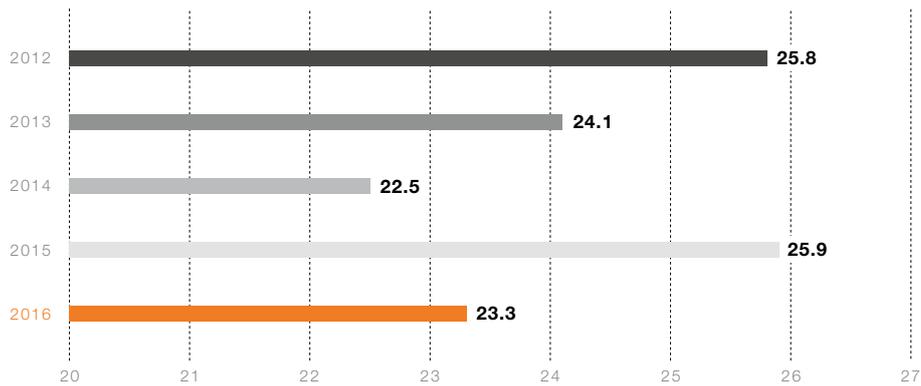


## FIVE-YEAR SUMMARY OF COST ITEMS (NON-ADJUSTED)

## FULFILLMENT COSTS (2012 – 2016)

→ 21

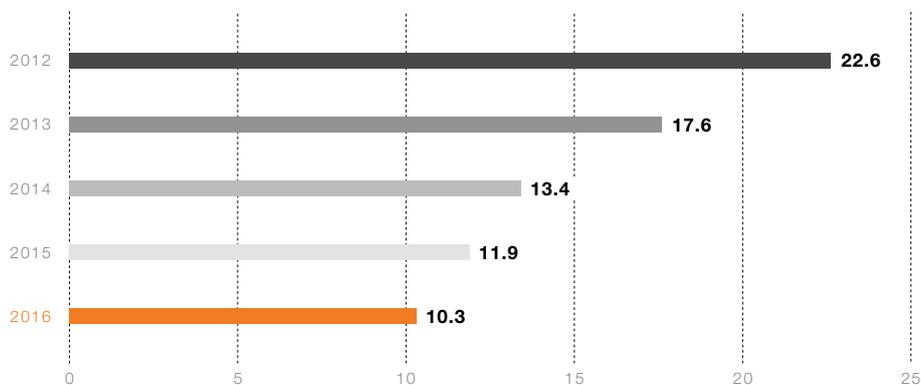
IN % OF REVENUE



## MARKETING COSTS (2012 – 2016)

→ 22

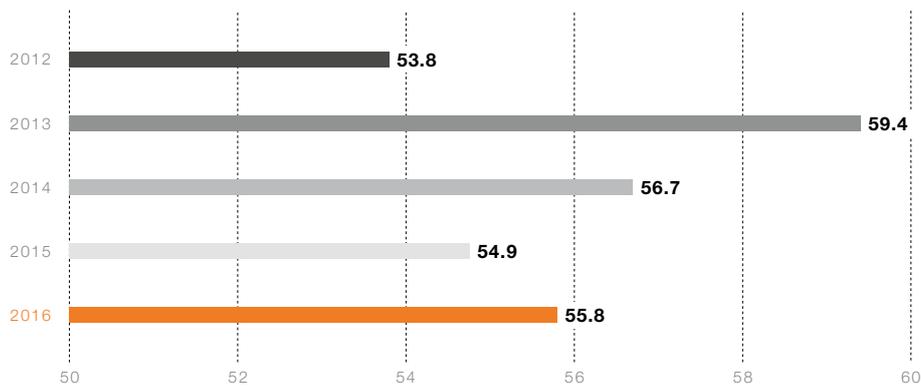
IN % OF REVENUE



## COST OF SALES (2012 – 2016)

→ 23

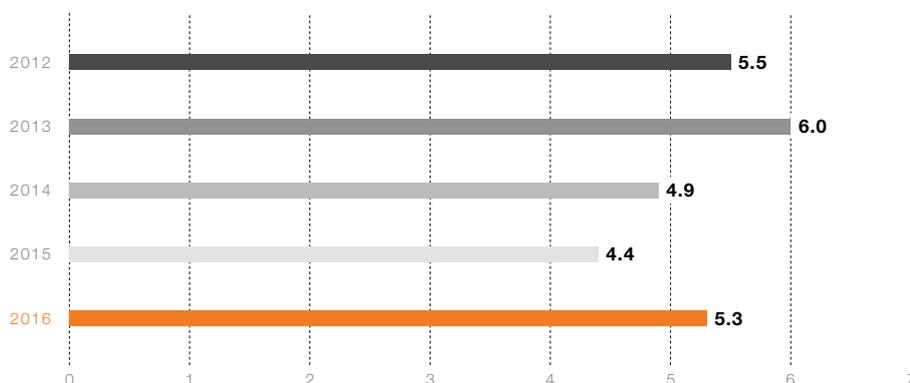
IN % OF REVENUE



## ADMINISTRATIVE EXPENSES (2012 – 2016)

→ 24

IN % OF REVENUE



Cost of sales rose by 25.0% year on year from EUR 1,624.0m to EUR 2,029.6m, roughly in line with the expansion of business. Gross margin is in line with our long-term anticipation. For 2016, the gross margin decreased slightly by 0.9 percentage points from 45.1% to 44.2% due to lower discounts in 2015. In 2016, 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. Economies of scale from continued negotiation successes with brand partners partially offset the aforementioned effects. Selling and distribution costs rose by 9.4% year on year from EUR 1,118.9m to EUR 1,223.7m. This corresponds to an improvement of 4.2 percentage points as a percentage of revenue, a declining ratio from 37.8% in 2015 to 33.6% in 2016. Selling and distribution costs consist of fulfillment and marketing costs.

The fulfillment cost ratio as a percentage of revenue improved by 2.6 percentage points from 25.9% in 2015 to 23.3% in 2016. The decrease in the fulfillment cost ratio is primarily a result of

lower payment costs, as last year's fulfillment costs had been negatively influenced by allowances for fraudulent receivables. Zalando put a strong focus on optimizing and improving its steering of payment options and has changed its solvency score provider for a better monitoring of fraudulent activities, resulting in lower allowances on trade receivables. At the same time, we continued to see operating leverage across components of the fulfillment cost line while Zalando continued to push forward with fulfillment investments, both in the consumer proposition and platform initiatives.

The marketing costs rose in absolute terms by EUR 24.0m to EUR 375.9m compared to the prior year due to selected brand marketing campaigns such as the co-branded Ivy Park campaign or our inaugural Bread&Butter event, and due to the increased business volume in general. However, relative to revenue, marketing costs decreased by 1.6 percentage points, resulting primarily from efficiency gains, in particular within performance marketing.

Administration costs increased from EUR 129.0m in 2015 to EUR 191.3m in 2016. The increase mainly results from higher headcount to strengthen the Zalando platform, and the associated office expenses.

Other operating income of EUR 16.7m (prior year: EUR 10.2m) largely comprises 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. Income recognized in that context amounted to EUR 10.6m (prior year: EUR 2.0m). In 2016, this issue was declared as a non-operating one-off effect and eliminated from adjusted EBIT accordingly. In the prior year, the effect was deemed to be immaterial for the income statement and was therefore not eliminated from the calculation of adjusted EBIT.

EBIT margin improved by 2.7 percentage points in comparison to the prior year, rising from 3.0% in 2015 to 5.7% in 2016. In absolute terms, EBIT increased by EUR 117.5m from EUR 89.6m to EUR 207.0m. The main drivers were the improvement of 2.6 percentage points in the fulfillment cost ratio, continued improvement of 1.6 percentage points in the marketing cost ratio and the improvement of 0.1 percentage points in other operating income relative to revenue. Operating performance remained strong, mainly as a result of continued operating leverage and efficiency gains in selling and distribution costs.

#### 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.

Zalando recorded an adjusted EBIT of EUR 216.3m in 2016 (prior year: EUR 107.5m), which translates into an adjusted EBIT margin of 5.9% in 2016 (prior year: 3.6%).

EBIT comprises the following expenses from equity-settled share-based payments. The non-operating one-time effects amounting to EUR 10.6m are recognized in other operating income. More information can be found in the notes to the consolidated financial statements.

## SHARE-BASED COMPENSATION EXPENSES PER FUNCTIONAL AREA

→ 28

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
<b>Equity-settled share-based payments</b>	<b>19.9</b>	<b>17.9</b>	<b>2.0</b>
Cost of sales	5.0	4.5	0.5
Selling and distribution costs	9.9	9.0	1.0
thereof marketing costs	5.0	4.5	0.5
thereof fulfillment costs	5.0	4.5	0.5
Administrative expenses	5.0	4.5	0.5

As expenses from equity-settled share-based payments remained almost stable when compared to the prior-year period, the increase in adjusted EBIT and the adjusted EBIT margin stemmed almost exclusively from the aforementioned profit drivers.

**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

→ 29

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
<b>Revenues</b>		
DACH	1,813.8	1,580.1
Rest of Europe	1,570.2	1,211.6
Other	255.1	166.5
<b>Earnings before interest and taxes (EBIT)</b>		
DACH	221.4	92.2
Rest of Europe	-6.2	-10.2
Other	-8.1	7.5
<b>Other segment financial information</b>		
Adjusted EBIT DACH	226.3	101.9
Adjusted EBIT Rest of Europe	-3.3	-3.3
Adjusted EBIT Other	-6.7	8.9

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

SHARE-BASED COMPENSATION EXPENSES PER SEGMENT → 30

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
<b>Equity-settled share-based payments</b>	<b>19.9</b>	<b>17.9</b>	<b>2.0</b>
DACH	9.9	9.7	0.2
Rest of Europe	8.2	6.9	1.2
Other	1.9	1.3	0.5

NON-OPERATING ONE-TIME EFFECTS PER SEGMENT → 31

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
<b>Non-operating one-time effects</b>	<b>10.6</b>	–	<b>10.6</b>
DACH	4.9	–	4.9
Rest of Europe	5.3	–	5.3
Other	0.4	–	0.4

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

In 2016, revenue grew by 14.8% in the DACH segment, by 29.6% in the Rest of Europe and by 53.2% in the Other segment, compared to the prior year.



Corporate strategy

With an increase in EBIT margin of the DACH segment by 6.4 percentage points to 12.2%, the DACH segment showed strong profitability in 2016. This significant increase mainly results from lower allowances on trade receivables and operating leverage in fulfillment costs, as well as an improvement in marketing cost ratio and non-operating one-time effects in other operating income. The EBIT margin in the Rest of Europe segment improved by 0.4 percentage points from –0.8% to –0.4% and has almost reached break-even. The EBIT margin remained fairly stable as efficiency gains were offset by growth investments. The EBIT margin in the Other segment recorded a decrease of 7.7 percentage points, resulting in an EBIT margin of –3.2% in 2016. The decrease is mainly a result of continued investments in platform initiatives.

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 potential non-operating one-time effects. The DACH segment generated an adjusted EBIT margin of 12.5% in 2016. Compared to the prior year, the adjusted EBIT margin increased by 6.0 percentage points.

The Rest of Europe segment recorded just a slight improvement in the adjusted EBIT margin compared to the prior year, which rose by 0.1 percentage points from -0.3% to -0.2%. The Other segment showed lower profitability, recording an adjusted EBIT margin of -2.6% in 2016. In comparison to the prior year, the adjusted EBIT margin decreased by 8.0 percentage points on account of higher investments into our platform business initiatives.

## FINANCIAL POSITION

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



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### CONDENSED STATEMENT OF CASH FLOWS

→ 32

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
<b>Cash flow from operating activities</b>	<b>275.8</b>	<b>119.4</b>
<b>Cash flow from investing activities</b>	<b>-277.1</b>	<b>-196.5</b>
<b>Cash flow from financing activities</b>	<b>-2.9</b>	<b>1.5</b>
Change in cash and cash equivalents	-4.1	-75.7
Exchange-rate related and other changes in cash and cash equivalents	0.5	0.9
Cash and cash equivalents at the beginning of the period	976.2	1,051.0
<b>Cash and cash equivalents as of December 31</b>	<b>972.6</b>	<b>976.2</b>



Further information  
Consolidated Statement  
of Cash Flows  
p. 128

In the fiscal year 2016, Zalando generated a positive cash flow from operating activities of EUR 275.8m (prior year: EUR 119.4m). Further to an improvement in pre-tax income (which rose from EUR 86.6m in the prior year to EUR 192.9m in the reporting year), cash flow from operating activities increased largely due to a higher cash inflow from working capital. This was partly offset by the increase in income tax payments and cash outflows for VAT receivables.

The capital employed in net working capital decreased compared to the prior year and thus positively impacts the cash flow.

Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities decreased to a low amount of EUR -127.6m as of December 31, 2016 (prior year: EUR -2.6m).

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. Cash flow from investing activities further consists of cash invested 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, 2016 an amount of EUR 220.0m was invested in such term deposits (December 31, 2015:

EUR 155.0m). An amount of EUR 30.4m was invested in corporate acquisitions (prior year: EUR 16.8m).

As a result, cash and cash equivalents remained stable during the year, resulting in Zalando carrying cash and cash equivalents of EUR 972.6m as of December 31, 2016 (prior year: EUR 976.2m).

Free cash flow increased by EUR 21.1m from EUR 42.6m to EUR 63.7m compared to the prior year. The main factor in the increase is the higher cash inflow from operating activities and a less pronounced increase in cash outflows from investing activities.

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 – rose by EUR 61.4m in 2016.

### CREDIT FACILITY

On December 15, 2016, ZALANDO SE concluded a new 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, 2021 and may be extended until December 15, 2023. As of December 31, 2016, an amount of EUR 39.2m had been utilized for bank guarantees and letters of credit.

### NET ASSETS

The group's net assets are shown in the following condensed statement of financial position.

#### ASSETS → 33

IN EUR M	DEC 31, 2016		DEC 31, 2015		Change	
Non-current assets	392.6	15.5%	253.1	12.0%	139.5	55.1%
Current assets	2,145.6	84.5%	1,863.5	88.0%	282.2	15.1%
<b>Total assets</b>	<b>2,538.2</b>	<b>100.0%</b>	<b>2,116.5</b>	<b>100.0%</b>	<b>421.7</b>	<b>19.9%</b>

#### EQUITY AND LIABILITIES → 34

IN EUR M	DEC 31, 2016		DEC 31, 2015		Change	
Equity	1,407.5	55.5%	1,271.4	60.1%	136.1	10.7%
Non-current liabilities	32.5	1.3%	31.3	1.5%	1.2	3.9%
Current liabilities	1,098.2	43.3%	813.8	38.5%	284.4	34.9%
<b>Total equity and liabilities</b>	<b>2,538.2</b>	<b>100.0%</b>	<b>2,116.5</b>	<b>100.0%</b>	<b>421.7</b>	<b>19.9%</b>

In 2016, total assets increased by 19.9%. The balance sheet is dominated by working capital, cash and cash equivalents, as well as equity.



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Consolidated Statement  
of Financial Position  
p. 124

In 2016, investments in intangible assets amounted to EUR 80.0m (prior year: EUR 38.3m) while investments in property, plant and equipment totaled EUR 135.7m (prior year: EUR 33.0m).

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 in particular are supported using internally developed software. In fiscal year 2016, additions related to capitalized development costs of EUR 57.7m (prior year: EUR 23.1m), of which EUR 36.4m is contained in prepayments (prior year: EUR 9.2m).

Inventories in the fiscal year 2016 mainly represent goods required for Zalando's wholesale business. Despite the growth of business, inventories increased by only EUR 83.4m to EUR 576.9m against the background of a good sell-through of the fall/winter collection and enhanced steering of inbound deliveries.

Trade and other receivables as reported on December 31, 2016 are all current. The increase of EUR 66.3m to EUR 216.0m is primarily attributable to the higher volume in business.

Equity rose from 1,271.4 to EUR 1,407.5m in the fiscal year. The EUR 136.1m increase primarily stems from the net income for the period. In the reporting period, the equity ratio fell from 60.1% at the beginning of the year to 55.5% as of December 31, 2016 on account of the rise in total assets.

Current liabilities increased by EUR 284.4m in the reporting period. This increase is mainly attributable to trade payables and similar liabilities, which rose by EUR 274.8m from EUR 645.8m last year to EUR 920.5m 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 282.3m were transferred to various factors as of December 31, 2016 (December 31, 2015: EUR 170.9m). 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, improved to EUR -127.6m as of December 31, 2016 (December 31, 2015: EUR -2.6m). The improvement results mainly from the increase in trade payables, which reflects the higher business volume and the seasonal delivery peak, as well as an extended availability and utilization of reverse factoring lines. Furthermore, this development was supported by successful negotiations with our suppliers that resulted in extended payment terms.

#### OVERALL ASSESSMENT

The Management Board views the business development in 2016 very positively. 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 2016 and won additional market share. The EBIT margin increased substantially as a result of the strong performance. In view of the high operating leverage, Zalando continued to push forward with growth investments in its consumer proposition and platform initiatives.



Further information  
Consolidated Statement  
of Comprehensive Income  
p. 123

Overall, the company's targets in terms of revenue, EBIT and EBIT margin were met. The 2015 group management report anticipated adjusted EBIT margin in 2016 between 2.6% and 4.1%. During 2016, the increase in adjusted EBIT margin was stronger than forecasted and resulted in upward guidance adjustments during the year. The increased guidance for an adjusted EBIT margin of around 5.0% to 6.0% was met by year-end. Similarly, it was assumed that Zalando would report revenue growth at the upper end of its growth corridor between 20% and 25%. In this context, a strong increase in the number of orders and a similar level of average basket size was expected. The sales growth met our guidance as sales increased by 23.0%. Therefore, the group achieved its targets set in the 2015 group management report and even overachieved in some areas.

#### 02.2.4 EMPLOYEES

At the end of 2016, Zalando had 11,998 employees (prior year: 9,987), representing an increase of 20.1% on the prior year. The average headcount grew by 1,831 to 11,036. The significant growth was strongly driven by increasing headcount in the technology and operations departments.

Additional information regarding our sustainability strategy is provided in the separate Section 01.4 Corporate Responsibility.<sup>25</sup>



Further information  
Corporate Responsibility  
p. 20

<sup>25</sup> The sustainability report is not part of the audited combined-management report.

## 02.3 SUBSEQUENT EVENTS

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

## 02.4 RISK AND OPPORTUNITY REPORT

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

G4-14  
DMA Anti-Corruption

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

### 02.4.1 INTEGRATED RISK AND OPPORTUNITY MANAGEMENT SYSTEM

The Management Board of ZALANDO SE bears overall responsibility for setting up and operating an effective risk and opportunity management system for the Zalando group. This is ensured through the comprehensive and standardized management of all key risks and opportunities.

Zalando created a separate department to identify these at an early stage and to analyze, manage, monitor, and counteract them with appropriate measures. The Governance, Risk & Compliance (GRC) department continuously develops risk management instruments and the methodology.

The basis for successful risk management is group-wide standards for systematically handling risks and opportunities. These standards are defined in the GRC Manual and put into force by the Management Board. The GRC function coordinates the defined core process (GRC cycle), which ensures standardized procedures to assess, analyze, and report on risks and the management measures implemented. This ensures that risks and opportunities are documented throughout the company using a uniform method. The GRC cycle is designed to support decision-making by providing consistent, comparable, and transparent information.

The GRC function reports to the Management Board and to the audit committee of the Supervisory Board on the risk situation on a biannual basis. If critical issues arise, the regular reporting process is supplemented by ad-hoc reporting. All employees of Zalando are requested to manage risks in their activities intelligently and prevent risks that could jeopardize the company's ability to continue as a going concern. The Internal Audit team reviews the functional capacity and appropriateness of the risk management system regularly. In addition, the audit committee of the Supervisory

Board, with the involvement of the external auditors, also monitors the effectiveness of the internal control, risk management, and audit systems.

#### 02.4.2 COUNTERMEASURES AND INTERNAL CONTROL SYSTEM

Zalando reviews all identified risks and opportunities at least twice a year to determine whether they are up to date and, in some cases, more frequently, depending on their severity. The documentation is updated regularly in the comprehensive risk catalog, which is set up as a risk control matrix (RCM). Relevant countermeasures, controls, and responsibilities are assigned to each risk. The adherence and effectiveness of the relevant countermeasures and controls is assessed by the Internal Audit team as part of their scheduled audits of the applicable departments.

##### SYSTEM OF INTERNAL FINANCIAL REPORTING CONTROLS

In addition to the overall risk and opportunity management system described above, Zalando has implemented a more detailed system of internal financial reporting controls. Pursuant to section 315 (2) No. 5 HGB the key features of this system are explained below. It aims to identify, assess and manage all risks that could have a significant impact on the proper preparation of the separate and consolidated financial statements. As an integral component of the accounting and reporting process, the system of internal financial reporting controls comprises preventive, monitoring, and investigative control measures in accounting and operational functions which ensure a methodical process for preparing the financial statements. The control system is based on the various company processes that have a significant impact on financial reporting.

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

#### 02.4.3 RISK REPORTING AND METHODOLOGY

All risks identified are quantified based on their probability of occurrence and their potential impact and entered in the risk catalog (risk matrix). The probability assessment is based on a time horizon of one year after the assessment date.

The impact assessment is conducted either on a quantitative scale (preferred) or a qualitative scale (alternatively if risks cannot be quantified or qualitative outweigh quantitative aspects). Quantitative classes are based on a scale relating to the potential financial impact on profit (EBIT).



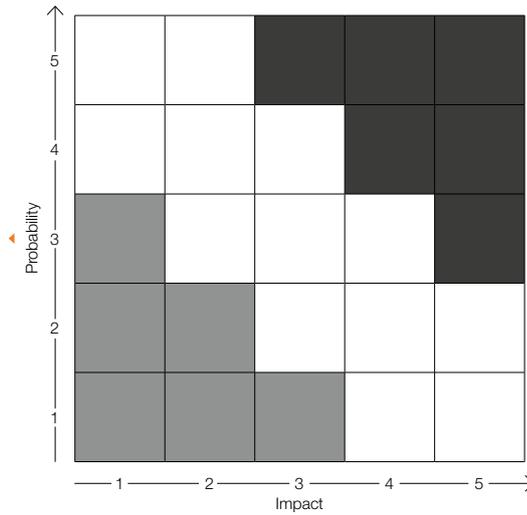
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Qualitative classes are based on criteria considering the impact on the company’s reputation or the effect of criminal prosecution (with special focus on compliance risks). The risks are presented net, meaning the risk-minimizing measures implemented are considered in the scoring of risks.

Risks are positioned in the risk matrix using the following approach:

PROBABILITY OF OCCURENCE (WITHIN THE FOLLOWING YEAR) → 35

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



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QUALITATIVE IMPACT (ALTERNATIVE) → 36

Class	Reputational Effect	Criminal Prosecution
1	very low	very low
2	low	low
3	medium	medium
4	high	high
5	very high	very high

QUANTITATIVE IMPACT (PREFERRED) → 37

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

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

All single risks and opportunities assessed as significant using the described methodology are described in detail in the section below. Overarching market opportunities and general opportunities are described in a separate section.

#### 02.4.4 OVERVIEW OF CURRENT RISKS AND OPPORTUNITIES

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

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

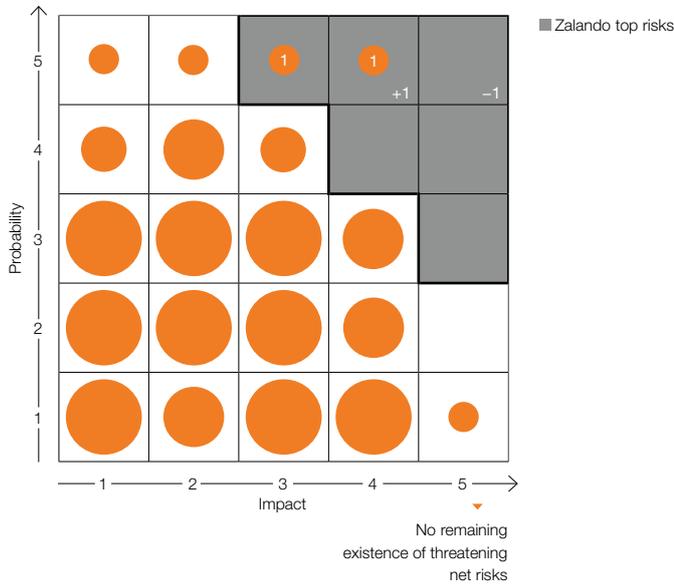
##### **RISKS WITH HIGH PROBABILITY AND HIGH IMPACT (TOP RISKS)**

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

These two risks were also top risks in fiscal year 2015, but the "Risks from bad debts/external fraud" were mitigated by new measures and additional measures are planned for the "Risks from a lack of business continuity management".

NUMBER OF NET RISKS

→ 25



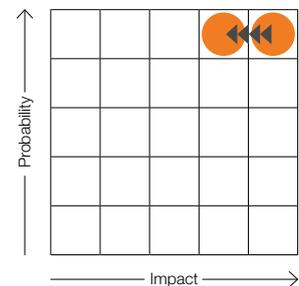
RISKS FROM BAD DEBT LOSS / EXTERNAL FRAUD (FOCUS ON PAYMENT TRANSACTIONS IN THE RETAIL BUSINESS)

The default risk is the risk that customers do not fulfill their contractual obligations and receivables remain unpaid. This can be the result of customers' payment habits or financial situation, or can be the result of fraud. An increase in fraudulent activities may also lead to an increase in bad debts. This risk is generally heightened for e-commerce companies that offer invoices as a payment method.

Overall, the default risk is distributed differently across the various countries, regions, and cities. To detect and prevent payment default and fraud early on, Zalando has a comprehensive payment and fraud management system in place. In addition, write-downs for trade receivables are recognized to a sufficient extent.

The risk remains significant as growing sales can lead to additional bad debt losses in absolute terms, even if the proportion of bad debts to total sales remains constant or even decreases, and Zalando is not able to completely prevent attempts at fraud. In addition, new fraud patterns with severe potential losses may arise.

We closely monitor future trends and continuously improve the collection processes. As a result of the improved countermeasures, the ratio of bad debt compared with revenue was reduced for 2016.

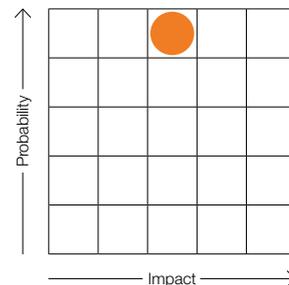


Probability: very high  
Impact: high (formerly impact was very high)

**RISKS FROM A LACK OF BUSINESS CONTINUITY MANAGEMENT (FOCUS ON TECHNOLOGY)**

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

We use configuration management, application management, and automated tests as essential countermeasures of managing the risk. Furthermore, Zalando uses monitoring systems and establishes and documents incident management processes. Monitoring systems and incident management processes are continuously being improved. A risk management system has been implemented for applications and systems. Outsourced services (e.g. data center) are integrated into the monitoring processes and adequate service level agreements are concluded. Zalando’s Business Assurance team is currently analyzing the dependence on applications and data streams and is working on additional countermeasures to reduce the probability and the damage of outages.



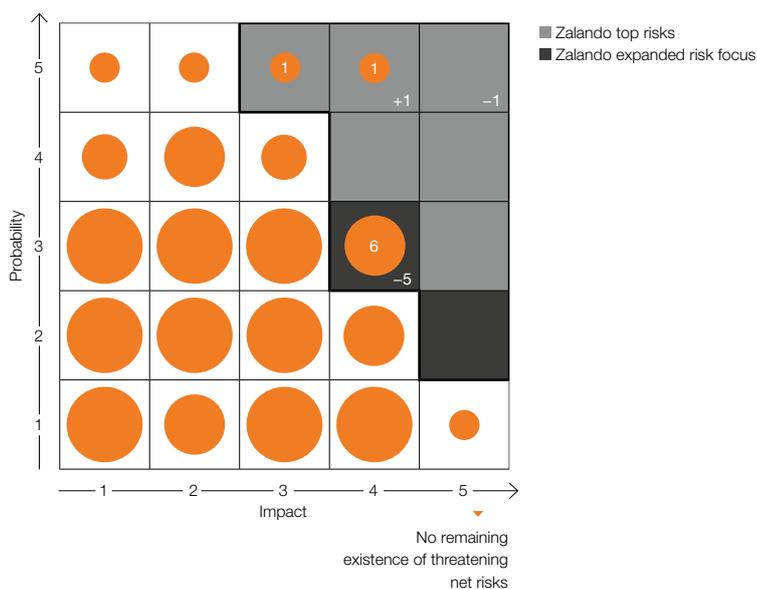
Probability: very high  
Impact: medium

**EXPANDED RISK AND OPPORTUNITY AREA**

Risks and opportunities delineated by the dark grey margin as shown in the matrix are considered to be significant risks due to the combination of a certain level of probability and a certain level of impact. The amount of significant risks was reduced from twelve to six compared with the fiscal year 2015, as additional implemented countermeasures are mitigating these risks. The only risk to increase was “Risks from changing regulatory requirements (or other basic market conditions) within the markets” which is therefore currently part of the expanded risk area.

NUMBER OF NET RISKS

→ 26



**RISK OF STRIKE**

Risks may emerge from strikes by workers in the operational functions. The risk depends on various internal and external factors, including the satisfaction of employees as well as union activities regarding the industry as a whole or Zalando in particular. Strikes can lead to costly backlogs and delays, as well as to increased fulfillment costs.

Zalando invests in good relationships with its employees and constructive exchanges to improve the work environment and conditions. Social standards have been implemented that are regularly audited to ensure the quality of working conditions.

Zalando is open to the principle of co-determination at fulfillment centers and maintains a continuous dialog with employees and work councils to further improve the working atmosphere.

**RISKS FROM INACCURATE FORECASTS AND PLANNING WITHIN CATEGORY MANAGEMENT**

Risks may arise due to insufficient coordination of the higher-level sales and sourcing planning. A lack of coordination and changes of plans may lead to planning errors. Furthermore, there is a risk that forecasts may be incorrect, meaning that predetermined budgets were calculated inaccurately. This, in turn, could lead to non-optimal budgeting and unfavorable sourcing activities.

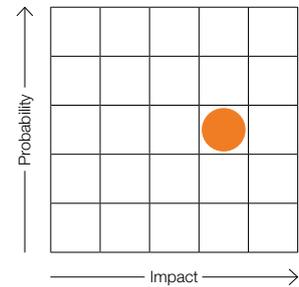
In Category Management, Zalando has set up a planning process on a rolling basis, which is carried out twice a year with regular updates during the seasons. The process is supported by analyses from Category Controlling, the Merchandise Planning function, and the Data Intelligence team. Basic planning is prepared by the teams responsible for country clusters in cooperation with the individual Category Management teams and brought into line with the higher-level category management planning.

The product-specific sales risk is countered through continuous sales analysis and budget adjustments. Zalando uses a detailed indicator system to identify negative discrepancies at an early stage and to implement appropriate measures in order to monitor and manage sales and stock levels. Additional flexibility can be achieved through follow-up orders. In addition, Zalando recognizes write-downs on inventories to a sufficient extent. The merchandise risk is an inherent risk of our business model and can have an impact anywhere along the value chain.

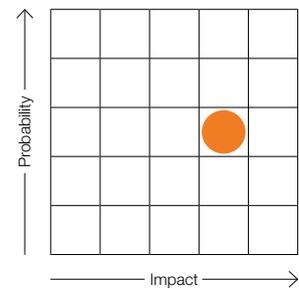
**RISKS OF MISSING MARKET OPPORTUNITIES DUE TO INSUFFICIENT BRANDING OF PRIVATE LABELS**

Insufficient branding and a non-uniform brand image may lead to losses as customers might no longer "identify" with one single brand. The revenue increase expected from a strong brand image and the associated cost savings from higher production volumes are the key factors in the assessment of this opportunity.

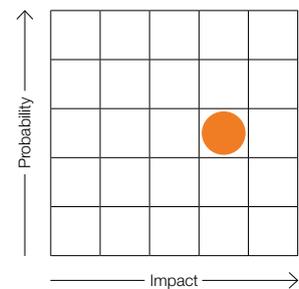
The respective brand teams allocate appropriate items selected from the entire product range to each brand to create a unique brand image. To enhance the marketing activities for the various brands appropriately, targeted customer analyses were performed to support the associated decision-making. Moreover, there is daily communication between the marketing teams and content departments regarding core brands on social media. In addition, Zalando has established dedicated brand shops for individual private labels included in the Zalando online presences.



Probability: medium  
Impact: high



Probability: medium  
Impact: high



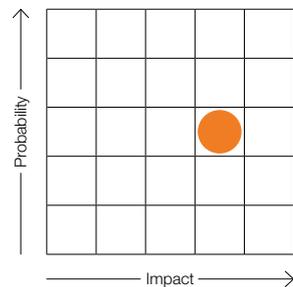
Probability: medium  
Impact: high

**RISKS FROM LACK OF “STATE OF THE ART” SHOPS AND SERVICE**

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

A significant overarching countermeasure is the establishment of the Customer Experience team within the technology department.

The team reveals and suggests relevant developments and adjustments and coordinates implementation with stakeholders and consequently ensures the continuous development of the shops.



Probability: medium  
Impact: high

**RISKS FROM CHANGING REGULATORY REQUIREMENTS (OR OTHER BASIC MARKET CONDITIONS) WITHIN THE MARKETS**

Risks can arise due to conducting business in various countries and the quickly changing regulatory environments in many of them. Potential risk scenarios involve additional costs for necessary adjustments (customs, product safety, working conditions, product offering, etc.) and penalties in the event that the adjustments are not made at all or not made in good time. In addition, other consequences of such changes (exchange-rate changes, unexpected customer behavior, reputational risks) can lead to more substantial losses.

The increased risk exposure is mainly driven by the fact that regulatory changes are currently being made to a great extent within the EU (e.g. triggered by the DSM (Digital Single Market) Initiative, the E-Commerce Sector Inquiry of the EU, attempts to address related issues within the member states, and by events subsequent to Brexit). Necessary amendments to processes and business cases can lead to costs or to reduced sales.

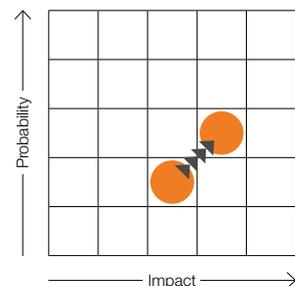
To reduce the impact of regulatory changes, Zalando has established a “Regulatory Watch” concept, whereby relevant regulatory and legal topics are allocated to the individual functions which have to ensure the monitoring of changes throughout the markets.

For the triggering events mentioned above, Zalando has initiated the following measures.

**DSM:** Zalando’s Public Affairs team has started a dialog with the external stakeholders at the EU in order to be up-to-date with the latest developments and to give feedback and its own input. New developments are monitored and examined by the Legal team for their possible impact on Zalando’s business case.

**EU E-commerce Sector Inquiry:** Zalando is monitoring the EU E-commerce Sector Inquiry and has provided the European Commission with the information it has requested.

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



Probability: medium  
(formerly probability was low)  
Impact: high  
(formerly impact was medium)

#### RISKS FROM ZALANDO'S LACK OF INNOVATION CAPABILITIES OR MISSED PRODUCT INNOVATIONS

The ability to promptly implement in-house-driven innovations as well as current market trends is a precondition for sustainable success. In addition to innovative strengths and the ability to implement them, it is essential to recognize and analyze trends and innovation opportunities, which, if missed, might lead to a loss of market share and decreasing competitiveness.

To counteract this risk, Zalando has defined programs and processes to support product innovations. To ensure innovativeness, a concept of agile software development (radical agility) was implemented that is refined by ongoing organizational changes.

In addition, Zalando's system architecture is continuously being improved to ramp up the flexibility for adaptations. Project proposals from the Customer Experience team and from the Product Management organization of the Technology department are implemented on an ongoing basis while projects concerning customer benefit are prioritized.

#### MITIGATED RISKS AND OPPORTUNITIES

During the two GRC-Cycles in 2016, each of the risks were assessed anew. As stated in the chapter Expanded Risk and Opportunity Area, six risks were mitigated by improved countermeasures to a level so that they currently are no longer considered significant. These risks are:

- Risk from inefficient internal logistics processes at fulfillment centers
- Risks from inaccurate personnel and capacity forecasts for fulfillment centers
- Risks from hazardous material/conditions in production with regard to private labels
- Risks due to safety deficiencies on sold products with regard to private labels
- Risks from scarcity of resources at fulfillment centers
- Risks of missing opportunities due to a lack of market knowledge and purchasing and negotiation capabilities within Indirect Procurement

Despite the fact that these risks are no longer part of the expanded risk area, they are still closely monitored by the respective departments and additional countermeasures are planned for implementation.

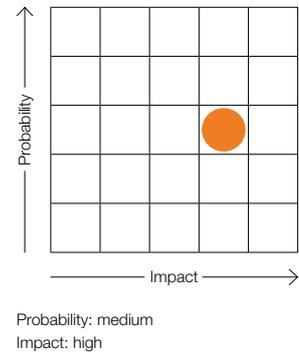
#### FINANCIAL RISKS

Zalando is required to describe its financial risks pursuant to section 289 (2) No. 1b HGB.

In the course of its ordinary activities, Zalando is exposed to counterparty risk, liquidity risk, and currency and interest rate risks. The aim of financial risk management is to limit the risks resulting from operating activities through the use of selected derivative and non-derivative hedging instruments. Derivative financial instruments are used solely for the purpose of risk management.

#### COUNTERPARTY RISK

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



The company addresses this exposure by distributing its derivatives financial instruments and cash held at banks over multiple financial institutions to minimize risk exposure to a single counterparty. Furthermore, the company sets maximum investment amounts in order to minimize the default risk.

#### 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 using 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 maximization of cash where it is needed.

#### CURRENCY AND INTEREST RATE RISK

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

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

Forward contracts are recognized as cash flow hedges if the conditions of hedge accounting are fulfilled. Once the hedged item has been realized as a cash flow hedge, the forward exchange contracts are used as fair value hedges to compensate for market value fluctuations of the outstanding trade receivables and trade payables and similar liabilities denominated in foreign currency. Forward exchange contracts are concluded with a term not exceeding 18 months. Derivative financial instruments are concluded and processed in accordance with internal guidelines that set out binding rules for the scope of action, responsibilities, reporting and controls.

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

The effects are analyzed on a regular basis. For example, if the euro had appreciated by 5% against the foreign currencies as of December 31, 2016, earnings before taxes would have been EUR 5.8m lower (prior year: EUR 5.4m). If the euro had depreciated 5% compared with the exchange rate as of December 31, 2016, earnings before taxes would have been EUR 6.4m higher (prior year: EUR 6.0m). The reserve for derivatives in group equity would have been EUR 34.6m higher (prior year: EUR 11.8m higher) if the euro had appreciated 5% compared with the exchange rate as of December 31, 2016. This reserve would have been EUR 38.2m lower (prior year: EUR 13.1m lower) if the euro had depreciated 5%.

**MARKET OPPORTUNITIES AND GENERAL OPPORTUNITIES****MACROECONOMIC DEVELOPMENT**

The European Commission projects 2017 eurozone growth of 1.5% and EU growth of 1.6%. Private consumption is expected to be one of the main drivers of growth during the forecast period. Labor market gains across important European economies will also contribute to an increase of disposable income in real terms<sup>26</sup>. The World Bank's forecast<sup>27</sup> is also optimistic, with growth in the region predicted to accelerate to 2.7% on average in 2017–19, driven by a recovery in commodity-exporting economies and improved confidence. This outlook is predicated on a continued, but modest, recovery in commodity prices and easing geopolitical tensions.

Notwithstanding this, the UK "leave" vote (Brexit) has raised the level of uncertainty. Although the market reaction to the Brexit shock was reassuringly orderly, the ultimate impact remains unclear, as the fate of institutional and trade arrangements between the United Kingdom and the European Union is uncertain<sup>28</sup>. With regards to the surge in the number of asylum seekers and refugees, the impact appears moderate from a purely macroeconomic perspective. In the medium to long term, the cost of failed integration, socially and politically, would potentially be markedly more important<sup>29</sup>.

In Germany, growth momentum is expected to be maintained<sup>30</sup>. The solid labor market, resilient exports and booming construction investment are expected to provide a boost to growth and drive private consumption. These developments give Zalando the opportunity to capitalize on a potentially favorable consumer climate arising from the growing economy and further reinforce its market position and increase revenue.

**GROWING FASHION MARKET IN EUROPE**

European online fashion sales<sup>31</sup> amounted roughly to EUR 51bn in 2016, making up 11.9% of all fashion retail. While the overall market for fashion in Europe (excluding Russia) remained virtually unchanged between 2011 and 2016, online fashion sales grew at a considerably faster rate with average annual growth (CAGR) of approximately 13.4% during the past 5 years. This trend is forecast to continue, as the percentage of people in the overall population who became familiar with digital technology at a young age will continue to rise.

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

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

The online retail market in Europe reported revenue totaling EUR 263.6bn in 2016, with a CAGR of 15.6% since 2011. While the online share of retail trade in the United States came to 10.5% in 2016, the online share of retail trade in Zalando's target market, Europe, rose from 4.2% in 2011 to 7.8% in 2016.<sup>32</sup>

As the online retail market continues to grow, Zalando's focus on providing customers with unique fashion experiences, convenient delivery services, and a product range tailored to local needs puts



Skip to p. 114



Corporate strategy

26) European Commission, Fall 2016 Economic Forecast  
27) World Bank, Global Economic Prospects, January 17  
28) International Monetary Fund, World Economic Outlook  
29) European Commission, An Economic Take on the Refugee Crisis  
30) European Commission  
31) Euromonitor, Europe excl. Russia  
32) Euromonitor International

the group in a favorable position to further expand its revenue and market share. Targeted marketing activities will complement these efforts and help to increase brand awareness, win new customers, and retain existing ones for the long term. Most importantly, the strategic realignment to move towards a platform business model will create new opportunities for growth. It is envisaged that the platform business model brings together different fashion stakeholders, which will in turn help to enhance selection, expand inspiration channels, and improve convenience services. Moreover, Zalando can continue to exploit the high online market potential for European fashion through its presence, which now extends to 15 European countries, and the constant expansion of its own product range.

#### MOBILE COMMERCE

Mobile devices have made a considerable contribution to the strong growth in online retail trade. This also applies to fashion sales, as customers have access to fashion products at any time and from virtually anywhere. Retail sales generated by mobile devices have grown strongly in Western Europe, from roughly EUR 9.3bn in 2012 to almost EUR 62.8bn in 2016. It is anticipated that this revenue will grow at an annual average growth rate of 15.3% to reach EUR 128bn in 2021.<sup>33</sup>

Mobile devices have become a core pillar of online retail companies and this will continue to grow in further in the coming years. Zalando uses mobile technologies to connect with consumers in new and innovative ways wherever they are. Zalando has developed apps to provide customers with multiple channels to engage, browse, and discover fashion. Most importantly, Zalando is using mobile technology to personalize and improve customers' shopping experience. Mobile apps are critical to expand Zalando's revenue and customer reach potential. They not only help Zalando to better connect with its customers, but they also open up new business opportunities. Developing mobile technologies can help Zalando to enter high traffic social media and chat platforms that are becoming new commerce destinations. To fully exploit these opportunities, Zalando is evolving into a Mobile First company in all respects.

#### SCALABLE LOGISTICS

Zalando continues to improve the customer experience in its markets by extending its fulfillment capabilities. The scalable logistics infrastructure is currently composed of four fulfillment centers in Brieselang, Erfurt, Lahr, and Mönchengladbach, which are strategically positioned within Germany to efficiently supply customers throughout Europe. The construction of the fulfillment center in Lahr is still ongoing, and the first manual operations have already commenced. A fifth fulfillment center in Szczecin, Poland is currently under construction. It will cover 130,000m<sup>2</sup> and is expected to start operations in fall 2017. The company's first satellite warehouse in Stradella, Italy, which started its operations in early 2016, already fulfills 70% of Italian orders. Zalando will start operations at another satellite warehouse close to Paris, France, in the first quarter of 2017. An additional function-specific fulfillment center, operated by service providers, was opened in Peine, Germany, as the central warehouse for private labels.

With floor space of more than 310,000 m<sup>2</sup>, the current fulfillment centers make it possible to process significantly higher revenue volumes than in fiscal year 2016.



Further information in the  
Zalando City Guide  
[zln.do/en-mobile](http://zln.do/en-mobile)



Further information in the  
Zalando City Guide  
[zln.do/en-infrastructure](http://zln.do/en-infrastructure)

33) Euromonitor International

### INNOVATIVE LOGISTICS

Zalando successfully organizes its logistics solutions itself. The underlying concept involves identifying any ways of making the shopping experience for customers even easier, faster, and more convenient. Zalando's logistics concept therefore constitutes a fundamental asset to its core business and a unique selling proposition.

Continuous improvements in logistics infrastructure and processes contribute to increasing delivery speed and expanding delivery options. This in turn results in greater convenience benefits, which are a key to increasing customer satisfaction.

This also opens up new business fields. As part of the platform strategy framework, Zalando is leveraging its logistics assets and expertise to strengthen and expand its engagement with brand partners. To do this, Zalando is opening up its operations infrastructure to brand partners via the Fulfillment by Zalando. Corresponding pilot projects are currently underway.

### SMART DATA

Zalando collects data and uses its internally developed analytical tools to optimize every aspect of the business. Data analyses are used in multiple ways: to forecast demand, provide consumers with the most personalized fashion purchase experience possible, set country-specific pricing, and to customize product offerings. This approach provides insights that can yield significant strategic benefits. Furthermore, with the aid of the data gathered, Zalando develops applications that enable all business units to constantly optimize their business processes.

The extensive reach of the Zalando Shop and its mobile applications can be used to gain an in-depth understanding of consumer behavior and purchasing patterns. This knowledge enables the brands to efficiently place the relevant advertising offers to their target groups. Zalando can provide its brand partners with tailored advertising with which they can address their target markets not only in the fashion store, but also on relevant third-party websites. By building up this expertise, Zalando can realize additional revenue potential and expand its field of business.

Over the last two years, Zalando has invested to expand and optimize its marketing capabilities. As part of these efforts, Zalando acquired Metrigo GmbH in 2015, a specialist for display marketing banners and real-time bidding, and nugg.ad GmbH at the beginning of 2016, a specialist for targeted marketing. Benefiting from these investments and Zalando's expertise and extensive consumer reach, Zalando Media Solutions GmbH was founded and provides brands with tailored marketing products.

### INNOVATIVE TECHNOLOGY

Technology is a core competence at Zalando. It is the foundation on which all platform products are based and underlies almost all business processes. Technologies are being constantly refined and offer a lot of room for innovation. Zalando puts a constant focus on improving consumer experiences and reducing value chain frictions in the fashion industry by leveraging its technology solutions.

For example, in cooperation with its brand partners, Zalando has opened over 2,500 individual brand shops since 2015 at which visitors can shop as if in an online flagship store. The brands interact directly with the customers, manage their picture, video and text content by themselves and obtain detailed insight into the browsing and shopping behavior of their customers.

By taking over Tradebyte Software GmbH and enlarging the stake in Anatwine Limited in 2016, Zalando has built up strong partnerships in technological solutions to connect marketplace partners to the platform more simply and effectively.



Further information in the  
Zalando City Guide  
[zln.do/en-brand](http://zln.do/en-brand)

The development of technological expertise and innovations facilitates not only the optimization of business processes, but also the ability to discover and exploit additional synergies and sales potential. Technology will be one of the main drivers of efficiencies for the fashion industry in the coming decade. In this context, Zalando intends to further consolidate its position as a technologically driven company and innovator. As part of this effort, Zalando seeks to address the needs of its brand partners and to offer more personalized channels to inspire buyers of fashion again and again.

#### LOCAL ALIGNMENT

Adapting Zalando's product range and services to meet local demand is a key factor in offering Zalando customers a stimulating and convenient shopping experience. This is critical for the group to succeed in the heterogeneous European market with its diverse regional tastes.

Zalando has developed various online offerings that are tailored to the local demands of customers. This also includes country-specific product ranges, an assortment in the online catalog that is tailored to local demands, visual marketing that is in line with local conditions, local payment methods, and fulfillment options. This country-specific alignment and a stronger adaptation to local customer needs sets Zalando apart from other companies. At the same time, the group uses a central platform and infrastructure for purchasing merchandise, its fulfillment, and technology for all of Europe. This approach offers opportunities to benefit from economies of scale, which in turn distinguishes Zalando from smaller, locally operating competitors.

#### FASHION EXPERTISE

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

In this context, Zalando runs the Zalon consulting service which offers customers fashion advice and inspiration directly from selected stylists when making their purchases.

With its internally designed labels, Zalando offers products whose life cycle is managed under one umbrella from the design phase right through to sale. Zalando has succeeded in creating popular brands with a loyal customer base and has started to increase sales by targeted marketing activities and additional distribution channels.

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

#### AN ATTRACTIVE PARTNER

Fashion brands value Zalando as a strategic partner because the group offers them direct access to the large European fashion market, a high number of site visitors, an in-depth insight into customer buying habits, smart logistics, digital services, and a clear focus on fashion. The platform lets them present their brands in an appealing way. The size and rapid growth of business have resulted in a self-reinforcing network effect: The frequency of visits to Zalando's online platform is extremely attractive for its brand partners, giving Zalando access to still more brands and greater choice in selecting its products. The wide selection of brands and products helps the company reach and win over new customers, which in turn attracts more brands. This then increases the number of visitors on the group's websites.

With about 200,000 products from more than 1,500 brands, Zalando offers its customers a wide choice of appealing fashion items. Sourcing teams work continuously with the brand partners to select attractive fashion products. As a result, around 1,000 new products are added to the online assortment on a daily basis, which keeps the selection constantly up-to-date and gives customers an incentive to discover new trends. The strong partnerships with fashion brands make it possible to offer not only a choice of international brands but also brands tailored to local preferences. Zalando can respond quickly to new trends thanks to the fast fashion brands in its assortment. Fast fashion products also offer the advantage of shorter lead times and greater flexibility.

#### PERSONNEL OPPORTUNITIES

Zalando's successful growth is based on the competencies and motivation of its employees. Due to the considerable growth of its core business, the penetration of new business areas, and the rapid international expansion, Zalando constantly needs to strengthen its winning team. Recruiting therefore plays a key role in human resources work. Recruiting highly skilled employees can help boost efficiency and foster innovation and creativity, thus increasing revenue and profitability.



Further information in the  
Zalando City Guide  
[zln.do/en-recruiting](https://zln.do/en-recruiting)

## 02.5 OUTLOOK

- Strong growth is once again forecast for internet retailing in Europe and Germany
- For 2017, an 8.7% increase in online fashion sales is forecast for Europe, while 9.8% is forecast for Germany
- Zalando aims to continue its course of profitable growth and capture further market share
- Revenue in 2017 is set to grow by 20% – 25%, the adjusted EBIT margin is expected to lie between 5.0% and 6.0%

### 02.5.1 FUTURE OVERALL ECONOMIC AND INDUSTRY-SPECIFIC SITUATION

European online retail is expected to see continued strong growth. For example, the European retail industry<sup>34</sup> is expected to achieve year-on-year growth of just 1.7% in 2017, while online retail is expected to grow 11.4%. The picture in Germany is similar. Retail is forecast to grow roughly 2.2% in 2017, whereas internet trade is expected to increase by 13.6%. The Association of the German Internet Industry<sup>35</sup> also predicted that more than half (53%) of German GDP will be comprised of e-commerce-related activities by 2017, a 16% leap from 2012 e-commerce activity levels.

The online fashion industry in Europe and Germany is also predicted to have continued growth. Fashion sales in Europe are expected to stagnate (growth of 0.5% to the prior year), while fashion sales in Germany are even expected to decline slightly (decline of 0.2%). In contrast, online fashion sales are expected to grow significantly faster in Europe and in Germany. Online fashion sales in Europe are expected to increase by approximately 8.7% in 2017, while predictions for Germany anticipate that the market will grow by 9.8% compared with the previous year<sup>36</sup>.

With the development of e-commerce models and the increasing openness of consumers to online shopping, Zalando expects the online fashion share to continue to grow strongly in 2017. Due to its wide brand awareness among European consumers, large customer base, strong supplier relationships, and infrastructure footprint, as well as its fashion and mobile technology capacity, Zalando is convinced that it is well positioned to benefit from these favorable market conditions for online sales. The high emotional factor that both brands and customers associate with fashion also provides independent and pure-play fashion e-commerce retailers, like Zalando, with a considerable edge compared to non-specialized e-commerce retailers.

34) Euromonitor, Europe excl. Russia

35) Association of the German Internet Industry

36) Euromonitor, Europe excl. Russia and Germany

### 02.5.2 FUTURE DEVELOPMENT OF THE GROUP

Zalando aims to continue its course of profitable growth in the future and to gain market share. With this goal, management has defined three investment areas for 2017 that will provide the basis for long-term success. We will focus on investing in the consumer and supplier proposition, as well as in our technology and operations infrastructure to ensure that the company can continue to grow by further expanding its market share and strengthen its competitive position. Management's financial strategy aims to increase revenue while retaining a solid level of profitability.

Against a background of continued online market growth, management forecasts revenue growth in a corridor of 20% to 25% in fiscal year 2017. Revenue in fiscal year 2017 is expected to grow primarily as a result of a further strong increase in orders. We do not anticipate any major year-on-year movements in the average basket size.

Management expects to achieve again strong profitability with an adjusted EBIT margin of 5.0% to 6.0% in fiscal year 2017 (unadjusted EBIT margin of 4.6% to 5.6%), despite continuing investment into the consumer and supplier propositions and infrastructure.

### 02.5.3 OVERALL ASSESSMENT BY THE MANAGEMENT BOARD OF ZALANDO SE

Overall, the Management Board views the developments in fiscal year 2016 and the economic position of Zalando as very positive. The group returned a profit once again at group level in the fiscal year. Zalando showed significant growth, made important long-term investments and achieved a strong level of profitability. The company has grown considerably in all markets and has improved its market position further. In 2017, Zalando expects to be able to continue the strong business performance seen in the past fiscal year.

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



End of the quick reader  
information

## 02.6 SUPPLEMENTARY MANAGEMENT REPORT TO THE SEPARATE FINANCIAL STATEMENTS OF ZALANDO SE

The management report of ZALANDO SE as a separate entity and the group management report have been combined. The following notes are based on the annual financial statements of ZALANDO SE, which were prepared in accordance with the provisions of the HGB and the AktG in conjunction with Article 61 EU CR 2157/2001.

### 02.6.1 BUSINESS ACTIVITY

ZALANDO SE is the parent company of the Zalando group. Its registered office is the corporate headquarters in Berlin. Its operating activities mainly include the development, sourcing, marketing, and retail sale of various types of goods, in particular clothing and shoes. Other responsibilities include management of the online shop, HR management, IT, finance management, and risk management.

G4-5

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

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

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

The services provided by ZALANDO SE comprise administrative and IT services.

## 02.6.2 ECONOMIC SITUATION OF ZALANDO SE

The results of operations of ZALANDO SE presented in the following income statement broken down by the type of expense reveal not only an increase in revenue, but also a significant improvement in the operating result in the reporting period.

## INCOME STATEMENT OF ZALANDO SE

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G4-9  
G4-EC1

IN EUR M	JAN 1 – DEC 31, 2016	In % of sales	JAN 1 – DEC 31, 2015	In % of sales	Change in percentage points
Revenue	3,650.7	100.0%	2,950.8	100.0%	0.0pp
Own work capitalized	45.2	1.2%	22.4	0.8%	0.5pp
Other operating income	50.7	1.4%	80.8	2.7%	-1.3pp
Cost of materials	-2,043.3	-55.9%	-1,621.1	-54.9%	-1.0pp
<b>Gross profit</b>	<b>1,703.3</b>	<b>46.7%</b>	<b>1,432.9</b>	<b>48.5%</b>	<b>-1.8pp</b>
Personnel expenses	-227.4	-6.2%	-170.4	-5.8%	-0.5pp
Amortization and depreciation	-27.0	-0.7%	-22.1	-0.7%	0.0pp
Other operating expenses	-1,245.9	-34.2%	-1,148.8	-38.9%	4.7pp
<b>Earnings before interest and taxes</b>	<b>203.0</b>	<b>5.6%</b>	<b>91.6</b>	<b>3.1%</b>	<b>2.5pp</b>
<b>Financial result</b>	<b>-4.4</b>	<b>-0.1%</b>	<b>-0.6</b>	<b>0.0%</b>	<b>-0.1pp</b>
<b>Earnings before tax</b>	<b>198.6</b>	<b>5.4%</b>	<b>91.0</b>	<b>3.1%</b>	<b>2.4pp</b>
Income taxes	-65.7	-1.8%	36.2	1.2%	-3.0pp
<b>Net income for the year</b>	<b>132.9</b>	<b>3.6%</b>	<b>127.2</b>	<b>4.3%</b>	<b>-0.7pp</b>
EBIT margin	5.6%		3.1%		2.5pp

In the reporting period, Zalando increased its revenue by EUR 699.9m to EUR 3,650.7m. The 23.7% increase in revenue is the result of the higher number of orders (25.5%) and a larger customer base. Zalando continued its positive development in all markets. Furthermore, income mainly from intercompany charges of EUR 44.1m was reclassified from other income to revenue according to German Transformation of the EU Directive Act.

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

## REVENUE OF ZALANDO SE BY SEGMENT

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G4-9

IN EUR M	JAN 1 – DEC 31, 2016		JAN 1 – DEC 31, 2015		Change	
DACH*	1,952.0	53.5%	1,665.6	56.5%	286.4	17.2%
Rest of Europe**	1,698.7	46.5%	1,285.2	43.5%	413.5	32.2%
<b>Total</b>	<b>3,650.7</b>	<b>100.0%</b>	<b>2,950.8</b>	<b>100.0%</b>	<b>699.9</b>	<b>23.7%</b>

\*) As in fiscal 2015, DACH countries include Germany, Austria and Switzerland.

\*\*) As in fiscal 2015, the Rest of Europe comprises the Netherlands, France, Italy, the United Kingdom, Poland, Belgium, Sweden, Finland, Denmark, Spain, Norway, and Luxembourg.

The significant increase of EUR 22.8m in own work capitalized in the reporting year was due to the large number of development projects.

The cost of materials rose by EUR 422.2m to EUR 2,043.3m, in line with the expansion of business. The increase of 1.0 percentage points in the ratio of the cost of materials to revenue to 55.9% can be primarily attributed to higher discount rates in fiscal year 2016. Overall, ZALANDO SE generated a gross profit of EUR 1,703.3m in fiscal year 2016 (prior year: EUR 1,432.9m).

Personnel expenses rose by EUR 57.0m to EUR 227.4m, in line with the rise in the number of employees. As of December 31, 2016, the headcount increased by 692 on the prior year from 3,237 to 3,929 employees.

Other operating expenses primarily include marketing expenses as well as shipping and fulfillment costs. The cost ratio as a percentage of revenue improved by 4.7 percentage points from 38.9% in 2015 to 34.2% in 2016. The decrease in the fulfillment cost ratio is a result of lower payment costs, as last year's fulfillment costs had been negatively influenced by allowances for fraudulent receivables. Furthermore, marketing costs decreased mainly resulting from efficiency gains, in particular within performance marketing.

The EBIT for the year of EUR 203.0m (prior year: EUR 91.6m) can mainly be ascribed to the improvement of 4.7 percentage points in the other operating expenses.

The financial result comprises income from profit transfers of EUR 4.4m (prior year: EUR 2.3m) mainly from the profits generated by the outlets in Berlin, Frankfurt, and Cologne during the reporting period.

Income taxes include the deferred taxes and current income taxes paid or payable. They comprise trade tax, corporate income tax and solidarity surcharge. As in the prior year, the statutory corporate income tax rate, including solidarity surcharge, for the assessment period 2016 in Germany was 15.8%. The applicable trade tax rate was 14.8% as in the prior year.

Current and deferred taxes are presented in the following table.

INCOME TAXES <span style="float: right;">→ 40</span>		
IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Deferred taxes	-41.8	48.3
Current taxes in Germany	-23.9	-12.1
<b>Total</b>	<b>-65.7</b>	<b>36.2</b>

ZALANDO SE has previously made losses, which may be carried forward to reduce the tax burden for future years. As of the reporting date, ZALANDO SE maintains unused corporate income tax losses of EUR 78.6m (prior year: EUR 188.6m) and unused trade tax losses of EUR 60.4m (prior year: EUR 174.5m). The amount of these unused tax losses depends on the final assessment by the applicable tax office.

**NET ASSETS AND FINANCIAL POSITION**

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

**ASSETS** → 41

IN EUR M	DEC 31, 2016		DEC 31, 2015		Change
Non-current assets	461.8	17.9%	205.5	9.8%	256.3
Current assets	2,091.8	81.3%	1,840.0	87.7%	251.8
Prepaid expenses	15.4	0.6%	6.9	0.3%	8.5
Deferred tax assets	4.5	0.2%	46.3	2.2%	-41.8
<b>Total assets</b>	<b>2,573.5</b>	<b>100.0%</b>	<b>2,098.7</b>	<b>100.0%</b>	<b>474.8</b>

**EQUITY AND LIABILITIES** → 42

IN EUR M	DEC 31, 2016		DEC 31, 2015		Change
Equity	1,444.0	56.1%	1,290.8	61.5%	153.2
Special items for government grants	0.1	0.0%	1.3	0.1%	-1.2
Provisions	237.2	9.2%	203.5	9.7%	33.7
Liabilities	890.5	34.6%	602.2	28.7%	288.2
Deferred income	1.7	0.1%	0.9	0.0%	0.9
<b>Total equity and liabilities</b>	<b>2,573.5</b>	<b>100.0%</b>	<b>2,098.7</b>	<b>100.0%</b>	<b>474.8</b>

The total assets of ZALANDO SE rose by around 22.6% as a result of the further increase in business volume. The assets primarily consist of current assets, specifically inventories, and cash and cash equivalents.

In fiscal year 2016, capital expenditures focused on intangible assets (EUR 53.8m) and financial assets (EUR 220.0m). Investing activities were financed exclusively from own funds.

In fiscal year 2016, inventories mainly comprised merchandise used in the core operational business of ZALANDO SE.

As of December 31, 2016, ZALANDO SE's trade receivables were up EUR 99.2m to EUR 303.2m.

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

In the past fiscal year, ZALANDO SE generated positive cash flow from operating activities of EUR 252.9m (prior year: EUR 80.8m). Further to an improvement in pre-tax income, cash flow from operating activities increased largely due to a higher cash inflow from working capital. This was partly offset by the increase in income tax payments and cash outflows for VAT receivables.

Cash flow from investing activities in fiscal year 2016 was mainly driven by capital increases in subsidiaries that were used to invest in the fulfillment infrastructure, as well as to further expand the respective business segments of the subsidiaries. In particular, investments were made in the fulfillment centers in Mönchengladbach, Lahr, and Szczecin and in intangible assets (mainly software and licenses) as well as in property, plant and equipment, primarily for furniture and fixtures.

The equity ratio stood at 56.1% (prior year: 61.5%).

Provisions and liabilities increased by EUR 321.9m to EUR 1,127.7m in line with the expansion of business. As of December 31, 2016, this figure mainly pertains to provisions for product return claims, outstanding invoices for fulfillment and marketing expenses and trade payables.

Reverse factoring agreements are in place with various suppliers and with several financial institutions. Under these agreements, the factor purchases the respective supplier receivables due from Zalando. Supplier claims against Zalando based on these agreements totaling EUR 282.3m had been transferred to the factor as of December 31, 2016 (prior year: EUR 170.9m); this amount is recognized in the balance sheet under trade payables.

### 02.6.3 RISKS AND OPPORTUNITIES

The business development of ZALANDO SE is subject to largely the same risks and opportunities as the group. ZALANDO SE fully participates in the risks of its subsidiaries. Statements made by the Management Board on the overall assessment of the group's risk situation thus also summarize the risk situation of ZALANDO SE. The description of ZALANDO SE's accounting-related internal control system and risk management system stipulated in section 289 (5) HGB is provided in the risk and opportunity report of the group.

### 02.6.4 OUTLOOK

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

Berlin, February 24, 2017

Robert Gentz      David Schneider      Rubin Ritter