03.5 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

03.5.1 COMPANY INFORMATION

COMPANY NAME, REGISTERED OFFICE

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

NATURE OF OPERATING ACTIVITIES

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

Zalando 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 self-designed private labels. Zalando's localized offering addresses the distinct preferences of its customers in each of the 15 European markets being served: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Spain, Sweden, Switzerland, Poland, and the United Kingdom. The logistics network with four centrally located fulfillment centers in Germany allows Zalando to efficiently serve its customers throughout Europe, supported by a warehouse in Northern Italy with a focus on local customer needs. Zalando's offering has been extended and enhanced with the Zalando Lounge, which offers registered members special articles at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt am Main, and Cologne serve as additional sales channels for remaining stock. Zalando was founded in 2008 and has its registered offices in Berlin.

03.5.2 GENERAL PRINCIPLES

APPLICATION OF IFRS

The consolidated financial statements of Zalando for the fiscal year from January 1 to December 31, 2016 were compiled in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU as of the reporting date. In addition, the provisions of Sec. 315a (1) HGB have been taken into account. The consolidated financial statements give a true and fair view of the group's financial performance and position.

GENERAL INFORMATION

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

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

03.5.3 NEW ACCOUNTING STANDARDS

EFFECTS OF NEW OR AMENDED IFRS RELEVANT FOR FISCAL YEAR 2016

The consolidated financial statements take into account all IFRS endorsed as of the reporting date and whose adoption is mandatory in the European Union. Of the standards and amendments subject to mandatory adoption for the first time, only the standards and amendments described below affect Zalando's reporting.

Accounting standards subject to first-time application in fiscal year 2016 have not had any material impact on Zalando's financial performance and position.

NEW OR AMENDED IFRS NOT APPLIED

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

Standard / interpretation		Impending change
Improvements to International Financial Reporting Standards 2016 (Annual Improvements 2014 – 2016)		Minor amendments to a large number of IFRS (IFRS 1, IFRS 12, IAS 28)
Amendments to IAS 7	Statement of Cash Flows	As a result of the Disclosure Initiative of the IASB, IAS 7 was clarified with regard to the disclosures on changes in respect of liabilities arising from financing activities.
Amendments to IFRS 2	Share-based Payments	The clarifications relate to the effect of vesting conditions on the measurement of a cash-settled share-based payment, changes in the classification of a transaction from cash-settled to equity-settled, and the classification of share-based payment transactions with net settlement features.
IFRS 9	Financial Instruments	IFRS 9 introduces a uniform approach for classifying and measuring financial assets. IFRS 9 relates to the characteristics of the contractual cash flows and the business model by which these cash flows are managed. The standard also provides a new risk provision model that now also accounts for anticipated losses for the calculation of the risk provision. Moreover, IFRS 9 contains new regulations on hedge accounting in order to better present the risk management activities of an entity, in particular with regard to the management of non-financial risks.
IFRS 15	Revenue from Contracts with Customers	The core principle of IFRS 15 is that an entity recognizes revenue to reflect the transfer of goods or services to customers at an amount that represents the consideration the entity expects to receive. Revenue is recognized when the customer obtains control over the goods or services. IFRS 15 also contains guidance on the presentation of contract assets or contract liabilities. The standard also requires additional disclosures, including a disaggregation of total revenue, on performance obligations, on reconciliations of opening and closing balances of net contract assets and contract liabilities as well as on significant judgments and estimates.
Amendments to IFRS 15	Clarifications	The clarifications relate to identifying performance obligations, principal versus agent considerations, and licensing of intellectual property as well as the exceptions to the application of sales-based and usage-based royalties and the transitional relief to IFRS 15.
IFRS 16	Leases	IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. For the lessee, IFRS 16 introduces a single accounting model in contrast to IAS 17. The new model requires the lessee to recognize assets and liabilities from all leases in the statement of financial position except for leases with a lease term of 12 months or less or leases of low-value assets (option). For lessors, IFRS 16 continues to distinguish between finance leases and operating leases for accounting purposes.

The IASB has issued other amendments of accounting standards that are not listed above (IFRS 4, IAS 12) and are not applied and do not have any material impact on Zalando's financial performance and position.

IASB effective date	Endorsed by the EU	Anticipated effects
January 1, 2018 (January 1, 2017 for Amendments to IFRS 12), early adoption on a case-by-case basis permitted	No	Application has no significant impact on the consolidated financial statements.
January 1, 2017, early adoption permitted	No	Zalando will make the additional disclosures.
January 1, 2018, early adoption permitted	No	Application has a minor impact on the consolidated financial statements. Early adoption is currently not planned.
January 1, 2018, early adoption permitted	Yes	The new classification model will lead to minor changes in some respects. However, the impact of these changes on the consolidated financial statements will be immaterial. The measurement of impairment losses on trade receivables considers the risk of default for customers in line with industry practices from the point of recognizing the revenue. Such an approach already mainly corresponds with the lifetime ECL (expected credit loss) approach of IFRS 9. The amendments relating to hedge accounting will lead to reporting relief in the assessment of the effectiveness of hedging relationships and the designation of the underlying and the hedging instrument. Zalando would not elect to apply this standard early.
January 1, 2018, early adoption permitted	Yes	The application of IFRS 15 is not expected to have any material effect on the consolidated financial statements of Zalando. There is neither any difference in the point in time when performance obligations are satisfied nor any differences in the pattern of how performance obligations are satisfied. Moreover, certain requirements, e.g. the measurement of revenue based on the expected satisfaction of performance obligations, have already been implemented. No early adoption is expected.
January 1, 2018, early adoption permitted	No	Application has no significant impact on the consolidated financial statements. In agreement with the decision not to apply IFRS 15 earlier, the corresponding clarifications have not been adopted either.
January 1, 2019, early adoption permitted	No	The new standard will have a material effect on the consolidated financial statements. The recognition of a right-of-use asset and a lease liability for leases previously recognized as operating leases will increase the balance sheet total. This will have a non-recurring impact on certain financial indicators upon transition, particularly the equity ratio and gearing ratio. Moreover, the recognition of interest expenses will burden the financial result. By contrast, EBIT will improve. Furthermore, the disclosures required in the notes will be extended. Zalando will apply the exemptions where permitted. These primarily relate to low-value and short-term leases as well as the licensing of software. Early adoption is currently not planned. Basically, for all lease payments, which are disclosed in Section 03.5.8 (5.) Other Notes – Operating Leases are subject to the new regulations.

03.5.4 PRINCIPLES OF CONSOLIDATION

BASIS OF CONSOLIDATION

The number of subsidiaries included in the basis of consolidation increased from 24 (prior year) to 32 on account of entities founded and acquired in fiscal year 2016. The acquisitions completed in fiscal year 2016 were not material.

REPORTING DATE OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements cover fiscal year 2016 on the basis of the reporting period from January 1 to December 31, 2016. Apart from abbreviated reporting periods due to the establishment of entities, the fiscal year of the consolidated entities also corresponds to the calendar year.

ACCOUNTING POLICIES

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

The basis of consolidation includes ZALANDO SE and its subsidiaries over which the company has control within the meaning of IFRS 10.

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

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

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

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

CURRENCY TRANSLATION

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

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

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

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

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

FOREIGN EXCHANGE RATES → 52

		Closing rate		Annual average rate	
	ISO Code	DEC 31, 2016	DEC 31, 2015	2016	2015
British pound	GBP	0.8562	0.7340	0.8195	0.7258
Danish krone	DKK	7.4344	7.4626	7.4452	7.4587
Norwegian krone	NOK	9.0863	9.6030	9.2906	8.9496
Polish zloty	PLN	4.4103	4.2639	4.3632	4.1841
Swedish krona	SEK	9.5525	9.1895	9.4689	9.3535
Swiss franc	CHF	1.0739	1.0835	1.0902	1.0679
US dollar	USD	1.0541	1.0887	1.1069	1.1095

03.5.5 ACCOUNTING POLICIES

INTANGIBLE ASSETS

Intangible assets are measured at amortized cost. The revaluation method has not been applied. All intangible assets, except for brands and domain rights, have a finite useful life. These are amortized over their useful life of three to eight years on a straight-line basis. The carrying amounts of brands and domain rights are immaterial from the group's perspective. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the residual values or the respective useful lives are taken into consideration prospectively when measuring amortization. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired (same applies to at-equity-investments).

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

Capitalized development costs are amortized over an anticipated useful life of an average of three years. Amortization of the asset begins when development is complete and the asset is available for use. Research costs are expensed in the period in which they arise. An impairment test is performed once a year as long as the asset is not completed, regardless of any indications of impairment. The same applies to goodwill acquired and intangible assets with indefinite useful lives.

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

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

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

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

From the perspective of the group, the assets being tested are immaterial and concern units outside of the core business of Zalando. The same applies to the sum total of the impairment losses arising from impairment testing.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recognized at cost and depreciated in accordance with their expected useful life using the straight-line method. Zalando treats changes in the residual values or useful lives that arise during use as a change in estimates. Depreciation is charged over the following useful lives.

USEFUL LIVES → 53

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

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

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

IMPAIRMENT OF NON-FINANCIAL ASSETS

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

CURRENT VERSUS NON-CURRENT CLASSIFICATION

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

An asset is classified as current when:

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

All other assets are classified as non-current.

A liability is classified as current if:

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

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

LEASES – THE GROUP AS LESSEE

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

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

Assets leased under operating leases are not recognized. Instead, the lease payments are expensed. Significant operating leases pertain to rented business and logistic premises in the group.

INCOME TAXES

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

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

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

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

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

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

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

INVENTORIES

Merchandise accounted for as inventories is recognized at cost pursuant to IAS 2. Cost is calculated on the basis of an item-by-item measurement, factoring in the additions from the point of view of the sourcing market or on the basis of the moving average price of the goods. Supplier payments that are to be classified as a reduction of cost reduce the carrying amount of inventories.

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

FINANCIAL INSTRUMENTS

GENERAL INFORMATION

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

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

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

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

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

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

FINANCIAL ASSETS

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

- loans and receivables,
- held-to-maturity investments,
- financial assets at fair value through profit or loss, or
- available-for-sale financial assets.

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

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

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

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

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

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

IMPAIRMENT OF FINANCIAL ASSETS

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

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

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

FINANCIAL LIABILITIES

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

Financial liabilities fall into one of the two following categories:

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

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

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

DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

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

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

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

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

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

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

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

FAIR VALUE HEDGES

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

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

CASH FLOW HEDGES

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

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

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

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

FAIR VALUE MEASUREMENT

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

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

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly.
- Level 3: Unobservable inputs for the assets and liabilities.

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

PROVISIONS

GENERAL INFORMATION

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

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

RESTORATION OBLIGATIONS

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

SHARE-BASED PAYMENTS

GENERAL INFORMATION

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

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

EQUITY-SETTLED TRANSACTIONS

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

No expense is recognized for awards that do not ultimately vest due to a service or performance condition not being fulfilled. Equity-settled payment models with market-related performance conditions and other conditions only affect the fair value of the payment on the grant date. These are treated as vested irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other service conditions are satisfied.

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

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

OTHER LONG-TERM EMPLOYEE BENEFITS

Other long-term employee benefits pertain to employee benefits (other than post-employment benefits and termination benefits) which do not in their entirety fall due within 12 months after the end of the reporting period.

The value of the liability recognized is calculated according to the projected unit credit method as the present value of the expected payments for vested benefits as of the reporting date. The present value of the liability is recalculated as of every reporting date. Changes are recognized through profit or loss.

REVENUE RECOGNITION

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

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

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

EXPECTED RETURNS

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

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

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

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

GOVERNMENT GRANTS

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

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

03.5.6 USE OF ESTIMATES AND ASSUMPTIONS

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

- identification and determination of write-downs of merchandise and receivables; see comments under Notes 03.5.7 (15.) and 03.5.7 (16.),
- setting the expected ratio of returns, see comments under Notes 03.5.7 (24.),
- the determination of the fair value of obligations from financial liabilities and share-based payments; see comments under 03.5.8. Other Notes – Risks from financial instruments and financial risk management as well as Note 03.5.7. (20.),
- the determination of the recoverability of deferred tax assets on unused tax losses; see comments under Notes 03.5.7 (8.) and 03.5.7 (27.).

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

03.5.7 NOTES TO THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME AND STATEMENT OF FINANCIAL POSITION

Further information Consolidated Statement of Comprehensive Income p. 123

(1.) REVENUE

REVENUE → 54

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Revenue from the sale of merchandise	3,553.1	2,923.0
Revenue from other services	85.9	35.1
Total	**3,639.0**	**2,958.2**

Zalando was able to significantly increase its revenue in all market segments. Revenue rose by 23.0%. The increase in revenue can be attributed primarily to a higher number of orders and a larger customer base.

(2.) COST OF SALES

COST OF SALES → 55

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Non-personnel costs	1,964.3	1,571.9
Personnel costs	65.2	52.2
Total	**2,029.6**	**1,624.0**

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

Cost of materials in the group totals EUR 1,823.4m (prior year: EUR 1,467.4m).

Zalando generated a gross profit of EUR 1,609.4m in the fiscal year 2016 (prior year: EUR 1,334.1m).

(3.) SELLING AND DISTRIBUTION COSTS

SELLING AND DISTRIBUTION COSTS → 56

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Non-personnel costs	1,005.2	936.8
Personnel costs	218.4	182.1
Total	**1,223.7**	**1,118.9**

In 2016, selling and distribution costs rose by EUR 104.8m to EUR 1,223.7m and pertain to fulfillment costs of EUR 847.8m (prior year: EUR 767.0m) and marketing costs of EUR 375.9m (prior year: EUR 351.9m). 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 has since continued to optimize and improve its steering of payment options and has changed its solvency score provider for better monitoring of fraudulent activities, resulting in lower allowances on trade receivables.

(4.) ADMINISTRATIVE EXPENSES

ADMINISTRATIVE EXPENSES → 57

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Non-personnel costs	71.8	46.6
Personnel costs	119.5	82.4
Total	**191.3**	**129.0**

The non-personnel costs primarily contain office expenses, depreciation, as well as legal and advisory expenses. The increase in personnel costs mainly results from higher administrational headcount to strengthen the Zalando platform.

(5.) OTHER OPERATING INCOME

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 (see Note 03.5.7 (28.)). Income recognized in that context amounted to EUR 10.6m (prior year: EUR 2.0m).

(6.) OTHER OPERATING EXPENSES

Other operating expenses of EUR 4.1m (prior year: EUR 7.0m) mainly stem from expenses relating to other periods as well as Supervisory Board remuneration.

(7.) FINANCIAL RESULT

FINANCIAL RESULT

→ 58

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Interest and similar income	2.1	1.2
thereof from hedging derivatives	3.2	0.8
thereof from trade and other receivables	0.3	0.2
thereof from other financial instruments	–1.4	0.2
thereof other interest and similar income	0.0	0.0
Interest and similar expenses	–11.8	–6.1
thereof from financial liabilities at amortized cost	–6.5	–4.9
thereof from hedging derivatives	–2.6	–0.7
thereof other interest and similar expenses	–2.5	–0.5
thereof from compounding of long-term provisions	–0.1	0.0
Result of investments accounted for using the equity method	–3.6	–1.6
Other financial result	–0.7	3.5
thereof from hedging transactions	–0.6	2.4
thereof from currency effects	–0.2	1.2
Financial result	**–14.1**	**–3.0**

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

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

(8.) INCOME TAXES

Income taxes include the deferred taxes and current income taxes paid or payable in the respective countries. They comprise trade tax, corporate income tax, solidarity surcharge and the corresponding foreign tax charges. 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 also remained at 14.7% in comparison to the prior year. This results in an effective tax rate for the group of 30.5% (prior year: 30.5%).

Current and deferred taxes are presented in the following table.

INCOME TAXES → 59

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Deferred taxes	–47.9	47.1
Current taxes in Germany	–24.5	–12.2
Total	**–72.5**	**34.9**

Zalando has previously made losses, which may be carried forward to reduce the tax burden for future years. As of the reporting date, the Zalando group maintains unused corporate income tax losses of EUR 98.0m (prior year: EUR 193.6m) and unused trade tax losses of EUR 75.5m (prior year: EUR 179.5m). These primarily relate to ZALANDO SE. The amount of these unused tax losses depends on the final assessment by the applicable tax office.

The utilization of unused tax losses for which no deferred tax assets have been recognized in the past resulted in a positive effect on the tax result of EUR 0.3m in the reporting year (prior year: EUR 16.9m).

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

TAX RATE RECONCILIATION

→ 60

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Earnings before taxes	192.9	86.6
Income tax rate for the group	30.5%	30.5%
Expected tax expense (–) / tax income (+)	–58.8	–26.4
Share of taxes for:		
Non-deductible expenses	–6.8	–5.6
Recognition of previously unrecognized unused tax losses	0.0	52.3
Unrecognized unused tax losses	–3.8	16.9
Entities included using the equity method	–1.1	–0.5
Tax expenses (–) / tax income (+) relating to other periods	–0.2	–0.3
Tax rate differences	–1.5	–0.5
thereof share of subsidiaries with higher tax rates	0.0	0.0
thereof share of subsidiaries with lower tax rates	–1.5	–0.5
Changes in tax rates	0.0	–0.2
Other	–0.2	–0.7
Income tax expense according to the consolidated statement of comprehensive income	**–72.5**	**34.9**
Effective tax rate	*37.6%*	*–40.3%*

(9.) EARNINGS PER SHARE

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

The basic earnings per share remained the same as in previous year in line with the consistent net income for the period.

BASIC EARNINGS PER SHARE (EPS)

→ 61

	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Net income for the period (in EUR m)	120.5	121.5
Basic weighted average number of shares (in millions)	247.2	246.2
Total (in EUR)	**0.49**	**0.49**

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

DILUTED EARNINGS PER SHARE (EPS)

→ 62

	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Net income for the period (in EUR m)	120.5	121.5
Weighted average number of diluted shares (in millions)	256.3	254.2
Total (in EUR)	**0.47**	**0.48**

Employee options and contracts, which can be share-settled, were also taken into account in the calculation of the diluted earnings per share in fiscal year 2016. Those equity-settled share-based payments, which include performance conditions that had not yet been met as of the reporting date, are not, on the other hand, reflected in the calculation of the diluted earnings per share. As a result, the options granted within the scope of SOP 2014 and EIP in fiscal year 2016 were not taken into account in the calculation of diluted earnings.

(10.) PERSONNEL EXPENSES

PERSONNEL EXPENSES

→ 63

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Wages and salaries	390.5	266.5
Social security, pensions and other benefit costs	67.2	50.1
thereof pension costs	0.3	0.2
Total	**457.7**	**316.6**

The average number of salaried employees in the group was 11,036 in fiscal year 2016 (prior year: 9,205). Contributions to the statutory pension insurance scheme rose by EUR 7.3m to EUR 30.2m (prior year: EUR 22.9m).

(11.) INTANGIBLE ASSETS

Intangible assets developed as follows:

STATEMENT OF MOVEMENTS OF INTANGIBLE ASSETS 2016 → 64

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

STATEMENT OF MOVEMENTS OF INTANGIBLE ASSETS 2015

→ 65

IN EUR M	Capitalized development costs	Industrial rights, similar rights and assets as well as licenses	Goodwill	Prepayments and assets under development	Total
Historical cost					
As of Jan 1, 2015	**34.4**	**18.3**	**0.0**	**2.6**	**55.3**
Additions	13.9	15.2	0.0	9.2	38.3
Reclassifications	1.7	0.3	0.0	–2.0	0.0
As of Dec 31, 2015	**50.0**	**33.8**	**0.0**	**9.8**	**93.6**
Amortization					
As of Jan 1, 2015	**14.7**	**11.6**	**0.0**	**0.0**	**26.3**
Additions	12.2	6.3	0.0	0.0	18.5
As of Dec 31, 2015	**26.9**	**17.9**	**0.0**	**0.0**	**44.8**
Carrying amounts					
As of Dec 31, 2014	**19.7**	**6.7**	**0.0**	**2.6**	**29.0**
As of Dec 31, 2015	**23.1**	**15.9**	**0.0**	**9.8**	**48.8**

Additions mainly relate to capitalized development costs of EUR 57.7m (prior year: EUR 23.1m), of which EUR 36.4m is contained in prepayments and assets under development (prior year: EUR 9.2m). These mainly concern production costs for internally developed software.

Research costs were recognized directly in profit and loss.

Apart from goodwill (see below), brand names and domain rights of EUR 1.3m (prior year: EUR 0.7m) were assigned an unlimited useful life since there are no legal, regulatory, contractual, competition-related, economic or other factors that would limit the useful life.

Amortization of EUR 27.8m was recorded in the reporting period (prior year: EUR 18.5m). Of this amount, EUR 4.2m (prior year: EUR 0.7m) is recognized in cost of sales, EUR 19.5m (prior year: EUR 13.4m) in selling and distribution costs, and EUR 4.1m (prior year: EUR 4.4m) in administrative expenses.

IMPAIRMENT TEST FOR GOODWILL

In 2016 ZALANDO SE acquired Tradebyte GmbH and fully consolidated it for the first time on May 10, 2016. The goodwill of EUR 13.6m arising from the purchase price allocation was allocated to the Tradebyte cash-generating unit.

The recoverable amount of the cash-generating unit was determined at fair value less the costs of disposal. The fair value less costs of disposal was calculated using the DCF method (level 3) on account of the lack of observable market prices and level 1 inputs as defined by IFRS 13.

The key assumptions that form the foundation for the cash flows projected in the underlying business plan (detailed planning phase from 2017–2018; technical transition phase 2019–2030) are as follows:

- revenue growth: incremental decline in growth rates over the detailed planning phase and beyond (2019–2030),
- EBIT development: incremental increase in the EBIT margin over the detailed planning phase and beyond (until 2022) until the targeted operating margin is attained,
- long-term revenue growth: 1%,
- WACC after tax: 10.88%.

The recoverable amount exceeds the carrying amount by EUR 11.0m. In our opinion, it is highly unlikely that a change in the above assumptions would lead to the carrying amount of the cash-generating unit exceeding its recoverable amount. For this to occur, the WACC, for example, would have to increase by 4 percentage points or the operating margin would have to consistently fall short of the targeted figure by 5.5 percentage points.

(12.) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment were as follows:

STATEMENT OF MOVEMENTS OF PROPERTY, PLANT AND EQUIPMENT 2016 → 66

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

STATEMENT OF MOVEMENTS OF PROPERTY, PLANT AND EQUIPMENT 2015 → 67

IN EUR M	Plant and machinery	Other equipment, furniture and fixtures	Buildings on third-party land	Prepayments and assets under construction	Total
Historical cost					
As of Jan 1, 2015	**75.3**	**57.5**	**0.0**	**1.1**	**133.9**
Additions	4.2	16.4	0.4	12.0	33.0
Disposals	0.0	0.0	0.0	0.0	0.0
Reclassifications	21.0	–20.9	0.3	–0.4	0.0
As of Dec 31, 2015	**100.5**	**53.0**	**0.7**	**12.7**	**166.9**
Depreciation					
As of Jan 1, 2015	**7.4**	**15.5**	**0.0**	**0.0**	**22.9**
Additions	7.1	8.7	0.0	0.0	15.8
Reclassifications	1.2	–1.4	0.2	0.0	0.0
As of Dec 31, 2015	**15.7**	**22.8**	**0.2**	**0.0**	**38.7**
Carrying amounts					
As of Dec 31, 2014	**67.9**	**42.0**	**0.0**	**1.1**	**111.0**
As of Dec 31, 2015	**84.8**	**30.2**	**0.5**	**12.7**	**128.2**

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

Depreciation of property, plant and equipment came to EUR 20.4m (prior year: EUR 15.8m). Of this total, an amount of EUR 2.6m (prior year: EUR 2.2m) is recognized in cost of sales, EUR 14.2m (prior year: EUR 10.9m) in selling and distribution costs, and EUR 3.6m (prior year: EUR 2.7m) in administrative expenses.

(13.) NON-CURRENT FINANCIAL AND NON-FINANCIAL ASSETS

Non-current financial assets mainly comprise restricted cash of EUR 12.9m (prior year: EUR 13.0m). Furthermore, other financial assets include the long term fair value portion of a derivative resulting from the interest in the proceeds from the sale of developed land owned by third parties (EUR 10.9m; prior year: EUR 2.0m)

Non-current, non-financial assets relate to the periodical deferral of expenses for payments already made.

(14.) INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

During the reporting period, Zalando increased its investments in associates. Increases mainly relate to the acquisition of an additional 16.4% stake in Anatwine Ltd., Cheltenham, UK. This purchase comprised existing as well as newly issued shares resulting from a capital increase of Anatwine.

The increase of the carrying amount from the further acquisition of shares in Anatwine Ltd. was partly offset by operating losses of the entity (EUR 3.6m, prior-year period: EUR 1.6m).

Anatwine Ltd. provides customized software integration services for fashion brands to enable the integration of their merchandise into online marketplaces.

(15.) INVENTORIES AND PREPAYMENTS

Inventories of merchandise, mainly consisting of the product groups shoes and textiles, are recognized at an amount of EUR 576.9m (prior year: EUR 493.5m).

Allowances of EUR 82.9m were recognized on inventories and the right to repossess goods associated with expected returns (prior year: EUR 71.4m). Expenses for allowances recorded on inventories came to EUR 95.3m in the reporting year (prior year: EUR 79.8m).

Prepayments pertain to prepayments for merchandise.

(16.) TRADE AND OTHER RECEIVABLES

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

On aggregate, the bad debt allowances developed as follows:

DEVELOPMENT OF BAD DEBT ALLOWANCES → 68

IN EUR M	DEC 31, 2016	DEC 31, 2015
Accumulated bad debt allowances as of Jan 1	**132.9**	**63.3**
Additions to portfolio-based specific bad debt allowance	28.1	80.9
Utilizations	–82.1	–11.4
Reversals	–7.0	0.0
Exchange rate effects and other changes	–0.2	0.1
Accumulated bad debt allowances as of Dec 31	**71.7**	**132.9**

Additions to bad debt allowances totaled EUR 28.1m in the reporting year (prior year: EUR 80.9m). Of the bad debt allowances recognized as of December 31 of the prior year, EUR 82.1m was utilized (prior year: EUR 11.4m) and EUR 7.0m reversed (prior year: EUR 0m). Bad debt losses for uncollectible receivables amounted to EUR 89.4m in the fiscal year (prior year: EUR 24.1m).

Bad debt allowances significantly decreased as prior year's allowances were negatively impacted by a higher volume of fraud. Zalando has since continued to optimize and improve 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.

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

(17.) CURRENT OTHER FINANCIAL ASSETS AND OTHER NON-FINANCIAL ASSETS

Other financial assets of EUR 245.8m (prior year: EUR 175.9m) mainly relate to financial investments with an original term to maturity of between three and twelve months of EUR 220.0m (prior year: EUR 155.0m). Furthermore, other financial assets include the market value of hedging instruments (EUR 7.3m, prior year: EUR 3.8m), see Note 03.5.7 (28.).

Other non-financial assets of EUR 133.1m (prior year: EUR 66.7m) primarily comprise VAT receivables of EUR 59.6m (prior year: EUR 21.0m), the right to repossess goods associated with expected returns of EUR 46.7m (prior year: EUR 34.5m), and deferred items at EUR 13.5m (prior year: EUR 4.9m).

(18.) CASH AND CASH EQUIVALENTS

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

CASH AND CASH EQUIVALENTS → 69

IN EUR M	DEC 31, 2016	DEC 31, 2015
Money market funds	477.9	439.7
Cash in bank	439.6	391.5
Short-term bank deposits	55.0	145.0
Cash on hand	0.1	0.0
Total	**972.6**	**976.2**

(19.) EQUITY

The parent company issued 247,255,868 ordinary bearer no-par value shares (Stückaktien auf den Inhaber) as of the reporting date (prior year: 247,059,518). Each share represents an imputed share of issued capital of EUR 1.00 and entitles the bearer to one vote at the company's annual general meeting.

During the fiscal year 2016, the issued capital of the parent company was increased by a total of EUR 0.2m to EUR 247.2m by making partial use of authorized capital 2013. It has been paid in full.

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

AUTHORIZED AND CONDITIONAL CAPITAL

→ 70

	Amount in EUR m	Number of no-par value shares	Purpose
Authorized capital 2013	2.9	2,865,775	Servicing of subscription rights from COPs and SOP 2011 until October 28, 2018
Authorized capital 2015	94.7	94,694,847	Cash or non-cash capital increases until June 1, 2020
Conditional capital 2013	9.8	9,817,500	Servicing of subscription rights from SOP 2013
Conditional capital 2014	6.7	6,732,000	Servicing of subscription rights from SOP 2014
Conditional capital 2015	73.9	73,889,248	Issue of convertible bonds and / or bonds with warrants until June 1, 2020
Conditional capital 2016	5.1	5,098,440	Servicing of subscription rights from EIP 2016

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

The share capital of the ZALANDO SE was conditionally increased by up to EUR 5,098,440 against contribution in cash and in kind by the issuance of up to 5,098,440 new non-par value shares with a pro rata share in the share capital of EUR 1.00 to fulfil subscription rights for shares of the company (conditional capital 2016). The conditional capital 2016 may be used to fulfil the subscription rights which have been granted – partly as a component of stock appreciation rights – in accordance with the resolution of the annual general meeting of May 31, 2016.

The capital reserve amounts to EUR 1,161.0m (prior year: EUR 1,140.9m). In the reporting year, contributions were made under the share-based payment plans in accordance with IFRS 2 of EUR 19.9m (prior year: EUR 17.9m).

Other reserves include effects from cash flow hedging of EUR –2.3m (prior year: EUR 1.9m) and deferred taxes on the resulting measurement differences of EUR 1.0m (prior year: EUR –0.6m). Due to cash flow hedging in the reporting year, income of EUR 3.6 (prior year: EUR –6.7m) was recycled from other reserves to revenue, and expense of EUR 0.1m (prior year: income of EUR 1.4m) to cost of sales. Moreover, expenses of EUR 0.2m (prior year: expenses of EUR 0.2m) from interest rate hedging were recycled to the financial result in the reporting year.

In December 2016, ZALANDO SE repurchased 20,000 treasury shares at an average price of EUR 34.63, which corresponds to a notional share in share capital of EUR 20,000 and thus 0.01% of share capital. Total repurchased shares per December 31, 2016 amount to a notional share in share capital of EUR 70,000 and thus to 0.03% of share capital.

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

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

(20.) SHARE-BASED PAYMENTS

The share-based payment awards granted by Zalando are primarily designed as equity-settled plans and to a limited extent as cash-settled plans.

EQUITY-SETTLED PLANS

Overview

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

The goal of this share-based payments is to reward the recipients' contribution to the value of the business and foster the long-term success of the company. This variable compensation package, with its long-term incentive and risk-based character, is a sensible way of tying together the interests of the shareholders and those of management.

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

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

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

SOP 2011

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

The options granted to the beneficiaries vest in tranches. They vest if the beneficiary is employed at Zalando for the entire vesting period of the respective sub-tranche. The last sub-tranche of SOP

2011 can be exercised in October 2018. The options are forfeited if the beneficiary leaves the group before the end of the vesting period. The beneficiaries have no claim to cash payment.

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

DEVELOPMENT OF OPTIONS (SOP 2011) → 71

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2015	**3,085,500**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	355,300	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2015	**2,730,200**	**5.65**
Options vested as of Dec 31, 2015	**1,720,400**	**5.65**
Outstanding options as of Jan 1, 2016	**2,730,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	187,000	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**2,543,200**	**5.65**
Options vested as of Dec 31, 2016	**1,870,000**	**5.65**

The options granted by the company can be exercised as of the vesting date. The beneficiaries can exercise vested options for an unlimited period. The weighted average share value on the date of exercise of an option exercised in the reporting period amounts to EUR 30.93 (prior year: EUR 26.34).

SOP 2013

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

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

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

DEVELOPMENT OF OPTIONS (SOP 2013)

→ 72

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2015	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2015	**9,817,500**	**15.63**
Options vested as of Dec 31, 2015	**3,904,560**	**15.63**
Outstanding options as of Jan 1, 2016	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**9,817,500**	**15.63**
Options vested as of Dec 31, 2016	**5,856,840**	**15.63**

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

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

SOP 2014

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

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

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

DEVELOPMENT OPTIONS (SOP 2014) → 73

	Number	Weighted average exercise price (in EUR)
Outstanding options as of Jan 1, 2015	**5,310,800**	**17.72**
Options granted during the reporting period	1,279,100	24.87
Options forfeited during the reporting period	121,346	17.72
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2015	**6,468,554**	**19.13**
Options vested as of Dec 31, 2015	**1,828,789**	**18.32**
Outstanding options as of Jan 1, 2016	**6,468,554**	**19.13**
Options granted during the reporting period	342,450	31.60
Options forfeited during the reporting period	215,485	**22.91**
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**6,595,520**	**19.65**
Options vested as of Dec 31, 2016	**3,450,009**	**18.90**

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

The weighted average fair value of a new option granted within the scope of the SOP 2014 was EUR 7.10 in the reporting period (prior year: EUR 8.86). The fair value of the options comprises the intrinsic value and the time value multiplied by the probability that the performance target will be reached. The fair value of the options was calculated using the Black-Scholes option price model. The input parameters included in the calculation of the newly granted options are summarized in the following table:

PARAMETERS SOP 2014 → 74

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Weighted average share price (EUR)	29.23	27.80
Weighted average exercise price (EUR)	31.60	24.87
Expected volatility (%)	36.2	35.3
Expected life of option (years)	4	4.1
Expected dividends (%)	0.0	0.0
Risk-free interest rate for equivalent maturities (%)	0.0	–0.1
Probability of reaching the performance target (%)	95.2	94.5

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

EIP

The EIP was granted in fiscal year 2016 to the members of the management boards of affiliated companies and managerial staff members as well as selected proven key employees of the company and affiliated companies.

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

Under the EIP program participants are entitled to acquire a portfolio of performance shares and performance options. With regard to the performance options a distinction is made between ATM (at the money) and OTM (out of the money) performance options. The performance options provide a payout only in case of an increase of the business value. How the increase in value is calculated depends on whether an ATM or an OTM performance option is concerned. The management of Zalando aims to settle performance shares and performance options by issuing shares.

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

The ability to exercise the portfolio is tied to a number of conditions. Firstly, the participant has to be employed by the company during the vesting period. Secondly, the terms and conditions of the EIP must be met and thirdly, the waiting period must have expired.

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

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

The weighted average fair value of performance shares within the scope of the EIP was EUR 22.42 in the reporting period. The weighted average fair value of ATM performance options was EUR 5.59 and of OTM performance options was EUR 4.24.

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

PARAMETERS EIP 2016

→ 75

	JAN 1 – DEC 31, 2016
Weighted average share price (EUR)	24.61
Weighted average exercise price Performance Share (EUR)	1.0
Weighted average exercise price ATM performance option (EUR)	27.1
Weighted average exercise price OTM performance option (EUR)	32.52
Expected volatility (%)	36.0
Expected life of option (years)	4.0
Expected dividends (%)	0.0
Risk-free interest rate for equivalent maturities (%)	–0.6
Probability of reaching the performance target (%)	95.1

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

TOTAL EXPENSES RECOGNIZED FOR SHARE-BASED PAYMENT AWARDS

The expenses recognized for share-based payments awards in fiscal years 2016 and 2015 break down as follows:

EXPENSES FROM SHARE-BASED PAYMENTS

→ 76

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015
Equity-settled	19.9	17.9
Total expenses recognized	**19.9**	**17.9**

(21.) PROVISIONS

Provisions developed as follows in the reporting year:

DEVELOPMENT OF PROVISIONS

→ 77

IN EUR M	JAN 1, 2016	Usage	Addition	Interest expense	DEC 31, 2016
Restoration obligations	8.5	0.0	3.1	0.2	11.8
Other provisions	0.6	0.1	2.0	0.0	2.6
Total	**9.1**	**0.1**	**5.1**	**0.2**	**14.4**

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

The following table shows the maturities of the provisions at the end of fiscal year 2016:

MATURITY OF PROVISIONS → 78

IN EUR M	Due in: Less than 1 year	Due in: 1–5 years	Due in: More than 5 years	Total
Restoration obligations	0.0	0.9	10.9	11.8
Other provisions	1.7	0.5	0.3	2.6
Total	**1.7**	**1.4**	**11.2**	**14.4**

(22.) GOVERNMENT GRANTS

These pertain solely to grants related to income for personnel costs, and have fully been utilized as of December 31, 2016. Zalando has met all of the payment conditions, but has yet to claim the funds in full.

(23.) TRADE PAYABLES AND SIMILAR LIABILITIES AND PREPAYMENTS RECEIVED

Trade payables and similar liabilities rose by EUR 274.8m to EUR 920.5m.

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

Trade payables contain liabilities denominated in foreign currency in the amount equivalent to EUR 31.1m as of the reporting date (prior year: EUR 12.2m).

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

(24.) OTHER CURRENT NON-FINANCIAL LIABILITIES, OTHER FINANCIAL LIABILITIES AND LIABILITIES FROM INCOME TAXES

Other current non-financial liabilities of EUR 86.7m (prior year: EUR 66.1m) mainly relate to VAT liabilities of EUR 43.3m (prior year: EUR 39.5m) and liabilities from gift vouchers of EUR 17.3m (prior year: EUR 11.2m), as well as liabilities to employees of EUR 13.1m (prior year: EUR 9.4m). Liabilities from the sale of gift vouchers are recognized at the value of the anticipated utilization.

Other current financial liabilities of EUR 69.0m (prior year. EUR 71.8m) primarily comprise obligations to reimburse customers EUR 34.9m (prior year: EUR 46.1m) for returns as well as debtors with credit balances of EUR 22.8m (prior year: EUR 20.4m).

(25.) BORROWINGS

Borrowings are due to banks and relate to the financing of fulfillment centers. For more information, please refer to Section 03.5.8.1 Other notes – risks relating to financial instruments and financial risk management.

(26.) NOTES TO THE STATEMENT OF CASH FLOWS

The statement of cash flow shows how the group's cash and cash equivalents have changed over the reporting period as a result of cash inflows and outflows. Cash flows from operating, investing, and financing activities are divided according to their source and utilization. The change in cash flow from operating activities is derived indirectly from the earnings before taxes. Cash inflows and outflows from investing and financing activities are calculated directly.

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 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 negative cash flow 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 decreased by EUR 3.6m 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 the cash outflow from investing activities. Thus, operational and strategic investments are fully financed by the operating cash flow.

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. The increase was largely due to the cash inflow from operating activities.

(27.) DEFERRED TAXES

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

DEFERRED TAX ASSETS AND LIABILITIES → 79

	Deferred tax assets		Deferred tax liabilities		Net balance	
IN EUR M	DEC 31, 2016	DEC 31, 2015	DEC 31, 2016	DEC 31, 2015	DEC 31, 2016	DEC 31, 2015
Intangible assets	1.9	0.1	–20.6	–10.6	–18.7	–10.5
Property, plant and equipment	0.0	0.0	–3.4	–2.8	–3.4	–2.8
Inventories	0.0	0.0	–2.5	–1.2	–2.5	–1.2
Trade and other receivables	0.2	1.0	–6.7	–1.6	–6.6	–0.6
Provisions	3.2	2.4	0.0	0.0	3.2	2.4
Other financial and non-financial liabilities	5.0	1.7	–0.2	0.0	4.8	1.6
Unused tax losses	21.7	57.8	0.0	0.0	21.7	57.8
Total	**31.9**	**63.0**	**–33.5**	**–16.3**	**–1.5**	**46.7**
Netting	**–30.3**	**–15.5**	**30.3**	**15.5**	**0.0**	**0.0**
Total recognized deferred tax assets and liabilities	**1.6**	**47.5**	**–3.1**	**–0.8**	**–1.5**	**46.7**

Changes in the fair values of hedging derivatives (cash flow hedges) in equity had an equity-increase effect from deferred taxes of EUR 0.9m (prior year: EUR –0.6m), which are included in other comprehensive income.

Deferred tax assets on unused tax losses in the 2016 reporting year pertain to ZALANDO SE (EUR 21.4m; prior year: EUR 57.1m) and the subsidiary zLabels GmbH (EUR 0.4m; prior year: EUR 0.7m). The amounts recognized are based on the tax results expected in the planning period.

(28.) FINANCIAL INSTRUMENTS

CARRYING AMOUNTS OF FINANCIAL ASSETS / LIABILITIES AND THEIR FAIR VALUES 2016 → 80

IN EUR M	Category pursuant to IAS 39*	Carrying amount as of DEC 31, 2016	Amount recognized in the balance sheet pursuant to IAS 39: Amortized cost	Fair value not through profit or loss	Fair value through profit or loss	Fair value as of DEC 31, 2016**
Assets						
Cash and cash equivalents	LaR	972.6	972.6	–	–	–
Trade receivables	LaR	216.0	216.0	–	–	–
Other financial assets	LaR	246.7	246.7	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	7.3	–	6.2	1.1	7.3
Other derivative financial instruments	FVtPL	12.8		12.8		12.8
Liabilities						
Trade payables and similar liabilities	FLAC	920.5	920.5	–	–	–
Financial liabilities	FLAC	14.4	14.4	–	–	15.5
Other financial liabilities	FLAC	61.8	61.8	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	9.5	–	9.3	0.2	9.5

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

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

CARRYING AMOUNTS OF FINANCIAL ASSETS / LIABILITIES AND THEIR FAIR VALUES 2015 → 81

			Amount recognized in the balance sheet pursuant to IAS 39			
IN EUR M	Category pursuant to IAS 39*	Carrying amount as of DEC 31, 2015	Amortized cost	Fair value not through profit or loss	Fair value through profit or loss	Fair value as of DEC 31, 2015**
Assets						
Cash and cash equivalents	LaR	976.2	976.2	–	–	–
Trade receivables	LaR	149.7	149.7	–	–	–
Other financial assets	LaR	187.6	187.6	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	3.8	–	2.9	0.9	3.8
Other derivative financial instruments	FVtPL	2.0		2.0		2.0
Liabilities						
Trade payables and similar liabilities	FLAC	645.8	645.8	–	–	–
Financial liabilities	FLAC	17.6	17.6	–	–	18.4
Other financial liabilities	FLAC	72.9	72.9	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	1.1	–	1.1	–	1.1

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

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

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

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

NOMINAL AMOUNTS AND MARKET VALUES OF DERIVATIVE FINANCIAL INSTRUMENTS → 82

		Market value				
	Nominal value	Assets	Liabilities	Total	Nominal value	Market value
IN EUR M	DEC 31, 2016	DEC 31, 2016	DEC 31, 2016	DEC 31, 2016	DEC 31, 2015	DEC 31, 2015
Forward exchange contracts designated as hedging instruments	1,104.4	7.3	9.2	–1.9	295.5	3.1
Interest rate swaps designated as hedging instruments	8.8	0.0	0.3	–0.3	11.0	–0.4
Total	**1,113.3**	**7.3**	**9.5**	**–2.2**	**306.5**	**2.7**

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

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

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

In the event that all contractual partners fail to meet their obligations from the forward exchange contracts, there is no credit risk for the group as of the reporting date (prior year: EUR 3.0m).

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

In the reporting period, expenses from fair value measurement of financial instruments designated as a cash flow hedge of EUR –3.1m (prior year: EUR +1.8m) were recognized directly in equity.

NET GAINS AND LOSSES FROM FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

NET GAINS AND LOSSES FROM FINANCIAL INSTRUMENTS 2016 → 83

IN EUR M	From interest affecting profit or loss	From subsequent measurement affecting profit or loss			From disposal affecting profit or loss	Total 2016
		At Fair value	Currency translation	Allowances		
Loans and receivables	–0.5	0.0	–0.9	–28.1	5.1	–24.4
Fair Value through Profit or Loss	0.1	10.6	0.0	0.0	0.0	10.8
Liabilities in the category measured at amortized cost	–6.5	0.0	–0.1	0.0	0.0	–6.6
Total	**–6.9**	**10.6**	**–0.9**	**–21.1**	**–1.9**	**–20.2**

NET GAINS AND LOSSES FROM FINANCIAL INSTRUMENTS 2015 → 84

IN EUR M	From interest affecting profit or loss	From subsequent measurement affecting profit or loss			From disposal affecting profit or loss	Total 2015
		At Fair value	Currency translation	Allowances		
Loans and receivables	0.3	0.0	0.4	–80.9	–24.1	–104.3
Fair Value through Profit or Loss	0.0	2.0	0.0	0.0	0.0	2.0
Liabilities in the category measured at amortized cost	–5.0	0.0	–0.2	0.0	0.0	–5.2
Total	**–4.7**	**2.0**	**0.2**	**–80.9**	**–24.1**	**–107.5**

FAIR VALUE HIERARCHY

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

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

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

Other financial assets include an interest in the proceeds from the sale of developed land owned by third parties. This is measured at fair value through profit or loss using the income approach and level 3 inputs of the fair value hierarchy. As of December 31, 2016, it amounted to EUR 12.8m (prior year: EUR 2.0m).

OFFSETTING

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

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

NETTING OF FINANCIAL INSTRUMENTS 2016

→ 85

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

NETTING OF FINANCIAL INSTRUMENTS 2015

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IN EUR M	Gross amount	Amount netted in the statement of financial position	Net amount shown in the statement of the financial position	Associated amounts not netted in the statement of financial position	Net amount as of DEC 31, 2015
Financial assets					
Derivative financial assets	3.8	0.0	3.8	0.7	3.1
Financial liabilities					
Derivative financial liabilities	1.1	0.0	1.1	0.7	0.4

03.5.8 OTHER NOTES

(1.) RISKS RELATING TO FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

In the course of its ordinary activities, Zalando is exposed to credit risks, liquidity risks, and market risks (mainly currency and interest rate risks). The aim of financial risk management is to limit the risks resulting from operating activities through the use of selected derivative and non-derivative hedging instruments. The derivative financial instruments are used in the group solely for the purpose of risk management. Zalando would be exposed to higher financial risks if it did not use these instruments. The group's management is responsible for the management of the risks.

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

MARKET RISK

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

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

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

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

If the euro had appreciated by 5% against the foreign currencies as of December 31, 2016, earnings before taxes would have been EUR 7.3m lower (prior year: EUR 5.4m). If the euro had depreciated 5% compared with the exchange rate as of December, 2016 earnings before taxes would have been EUR 8.1m higher (prior year: EUR 6.0m).

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

FOREIGN CURRENCY SENSITIVITY ON PROFIT OR LOSS 2016 → 87

	Impact on profit or loss							
IN EUR M	CHF	GBP	NOK	PLN	SEK	USD	Other	Total
Exchange rate as Dec 31, 2016	**1.0739**	**0.8562**	**9.0863**	**4.4103**	**9.5525**	**1.0541**	**–**	
Increase 5% Exchange rate	–2.5	–1.0	–0.4	–0.9	–0.8	–1.3	–0.3	–7.3
Decrease 5% Exchange rate	2.8	1.1	0.4	1.0	0.8	1.5	0.4	8.1

The reserve for derivatives in group equity would have been EUR 28.1m 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 36.4m lower (prior year: EUR 13.1m lower) if the euro had depreciated 5%.

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

FOREIGN CURRENCY SENSITIVITY ON OTHER COMPREHENSIVE INCOME 2016 → 88

	Impact on other comprehensive income							
IN EUR M	CHF	GBP	NOK	PLN	SEK	USD	Other	Total
Exchange rate as Dec 31, 2016	**1.0739**	**0.8562**	**9.0863**	**4.4103**	**9.5525**	**1.0541**	**–**	
Increase 5% Exchange rate	23.8	1.7	4.1	5.1	5.9	–5.9	–	34.6
Decrease 5% Exchange rate	–26.3	–1.8	–4.6	–5.6	–6.5	6.5	–	–38.2

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

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

CREDIT RISK

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

There is no significant concentration of credit risk.

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

LIQUIDITY RISK

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

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

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

The tables below show the contractually agreed (undiscounted) interest and principal payments for primary financial liabilities and for derivative financial instruments with their negative fair value. All instruments in the portfolio as of December 31, 2016 and December 31, 2015 and for which payments had already been contractually agreed were included. Planned figures for new future liabilities were not included. The floating-rate interest payments from the financial instruments were determined based on the interest rates most recently fixed before December 31, 2016 and December 31, 2015 respectively. All on-call financial liabilities are always allocated to the earliest possible date.

PAYMENTS FOR FINANCIAL LIABILITIES AND DERIVATIVE FINANCIAL INSTRUMENTS 2016 → 89

	Carrying amount	Cash flows 2017		Cash flows 2018–2021		Cash flows 2022 ff.	
IN EUR M	DEC 31, 2016	Interest	Repay-ments	Interest	Repay-ments	Interest	Repay-ments
Borrowings	14.4	0.4	3.2	0.8	11.2	0.0	0.0
Trade payables and similar liabilities	920.5	1.4	920.5	0.0	0.0	0.0	0.0
Other financial liabilities	71.3	0.1	69.0	0.2	2.3	0.0	0.0
of which from derivatives	9.5	0.1	9.2	0.2	0.0	0.0	0.0
Total	**1,006.2**	**1.9**	**992.8**	**1.0**	**13.5**	**0.0**	**0.0**

PAYMENTS FOR FINANCIAL LIABILITIES AND DERIVATIVE FINANCIAL INSTRUMENTS 2015 → 90

	Carrying amount	Cash flows 2016		Cash flows 2017–2020		Cash flows 2021 ff.	
IN EUR M	DEC 31, 2015	Interest	Repay-ments	Interest	Repay-ments	Interest	Repay-ments
Borrowings	17.6	0.5	3.2	1.2	11.7	0.1	2.7
Trade payables and similar liabilities	645.8	0.8	645.8	0.0	0.0	0.0	0.0
Other financial liabilities	74.0	0.1	71.8	0.3	2.1	0.1	0.0
of which from derivatives	1.1	0.1	0.7	0.3	0.0	0.0	0.0
Total	**737.4**	**1.5**	**720.9**	**1.5**	**13.8**	**0.2**	**2.7**

CAPITAL MANAGEMENT

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

Capital management and its objectives and definition are based on key performance indicators derived from the consolidated financial statements in accordance with IFRS. Zalando defines the equity ratio key performance indicator as the ratio of equity to total assets and the net working capital key performance indicator as the sum of inventories and trade receivables less trade payables and similar liabilities. The equity ratio stood at 55.5% as of the reporting date (prior year: 60.1%) and net working capital came to EUR –127.6m as of the reporting date (prior year: EUR –2.6m). The company achieved the key performance indicator targets set by management in both the fiscal year and in the prior year.

COLLATERAL

Zalando pledged financial assets of EUR 12.9m as collateral in the reporting period (prior year: EUR 14.0m). They mainly relate to collateral in connection with lease and loan agreements. The collateral provided may be drawn upon by the beneficiaries should the group not be able to fulfill its payment obligations.

(2.) INFORMATION ABOUT RELATED PARTIES

Zalando identified the related parties of ZALANDO SE in accordance with IAS 24.

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

These goods and services give rise to liabilities of EUR 59.2m as of the reporting date (prior year: EUR 40.1m). Of this amount, EUR 59.2m (prior year: EUR 40.1m) is due to a reverse factoring provider on account of reverse factoring agreements between Zalando and related parties. As a result, there are no trade payables or similar liabilities due directly to related parties (as of December 31, 2015: EUR 0.0m). However, trade receivables from related parties amount to EUR 0.4m.

Merchandise of EUR 122.7m was ordered from related parties in the reporting period. The order volume totaled EUR 98.2m in the comparative period of the prior year. In addition, goods totaling EUR 2.7m were sold to related parties. The cost of services received came to EUR 0.3m in the reporting period (prior year: EUR 0.5m).

Furthermore, there are loan receivables against a related party totaling EUR 3.5m.

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

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

MEMBERS OF THE MANAGEMENT BOARD → 91

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

MEMBERS OF THE SUPERVISORY BOARD → 92

Supervisory Board	Profession held	Member of the Supervisory Board since
Lothar Lanz (Chairperson of the Supervisory Board)	Supervisory Board member, in particular Axel Springer SE, Berlin	Feb 10, 2014
Lorenzo Grabau (Vice Chairperson)	CEO of Investment AB Kinnevik, Stockholm, Sweden	Dec 12, 2013
Anders Holch Povlsen	CEO of Bestseller A / S, Brande, Denmark	Dec 12, 2013
Kai-Uwe Ricke	Entrepreneur	June 3, 2014
Alexander Samwer	Entrepreneur and founder	Dec 12, 2013
Konrad Schäfers	Product Manager ZALANDO SE, Berlin	June 2, 2015
Dylan Ross	Lead of Men's Nordic Buying Office ZALANDO SE, Berlin	June 2, 2015
Beate Siert	Interim Lead Sourcing & Recruiting Core ZALANDO SE, Berlin	June 2, 2015
Jørgen Madsen Lindemann	President & CEO of Modern Times Group MTG AB, Stockholm, Sweden	May 31, 2016

Further information Report of the Supervisory Board p. 8

The term of office of Cristina Stenbeck expired on May 31, 2016.

The members of the Management Board and Supervisory Board only receive remuneration relating to their function as persons in key positions. In fiscal year 2016, expenses of EUR 5.9m were recorded for the members of management who hold key positions in the group (prior year: EUR 8.4m). Of this amount, EUR 5.3m is attributable to share-based payment awards in fiscal year 2016 (prior year: EUR 7.8m). The expenses for share-based payment awards are calculated using graded vesting, which means that the planned expense gradually decreases over the course of the vesting period. All other remuneration is classified as short-term benefits.

The share-based payments were granted in the fiscal years 2011 and 2013. They can vest over a certain period of time and will be included in the total remuneration over this time period based on the service rendered in the respective fiscal year. The share-based payment awards granted to key management personnel are included in the plans explained in Section 03.5.7 (20.) of the notes to the consolidated financial statements.

RENUMERATION OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD OF ZALANDO SE

Total remuneration of the Management Board totaled EUR 0.6m in fiscal year 2016 (prior year: EUR 0.7m). No new option rights were granted to the Management Board in fiscal year 2016 (prior year: 0 options). Further information regarding Section 314 (1) No. 6a HGB can be found in the remuneration report, which is presented in the corporate governance report and is part of the combined management report.

Further information Remuneration Report p. 61

The members of the Supervisory Board received remuneration of EUR 0.6m in fiscal year 2016 (prior year: EUR 0.6m). The Management Board and Supervisory Board propose to the annual general meeting granting remuneration in accordance with the provision contained in Art. 15 of ZALANDO SE's Articles of Association.

(3.) CORPORATE GOVERNANCE DECLARATION

The declaration by the Management Board and the Supervisory Board regarding the Corporate Governance Code pursuant to Section 161 AktG of December 2016 is published on the company's website.

(4.) AVERAGE NUMBER OF EMPLOYEES

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

AVERAGE NUMBER OF EMPLOYEES → 93

	2016	2015
Commercial	1,347	1,058
Operations	6,620	5,885
Technology	1,439	841
Other	1,630	1,420
Total	**11,036**	**9,205**

(5.) OPERATING LEASES

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

The expenses recognized from operating leases came to EUR 34.5m in the reporting period (prior year: EUR 28.5m). Future minimum lease payments under non-cancelable operating leases are shown in the following table:

FUTURE MINIMUM LEASE PAYMENTS → 94

IN EUR M	Less than 1 year	1–5 years	More than 5 years	Total
Dec 31, 2016	**42.8**	**97.0**	**49.2**	**189.0**
Dec 31, 2015	26.5	92.9	54.8	174.2

The future minimum receipts from non-cancelable operating sub-leases are as follows.

FUTURE MINIMUM LEASE RECEIPTS → 95

IN EUR M	Less than 1 year	1–5 years	More than 5 years	Total
Dec 31, 2016	**0.0**	**0.0**	**0.0**	**0.0**
Dec 31, 2015	0.1	0.0	0.0	0.1

(6.) INFORMATION REGARDING THE AUDITOR

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

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

— EUR 0.5m for the audit (separate and consolidated financial statements) (prior year: EUR 0.5m),
— EUR 0.3m for other assurance services (prior year: EUR 0.2m) and
— EUR 0.0m for other services (prior year: EUR 0.1m).

(7.) SHAREHOLDINGS

ZALANDO SE's direct and indirect shareholdings in its subsidiaries as of December 31, 2016 can be summarized as follows:

LIST OF SHAREHOLDINGS → 96 G4-17

No.	Company	Company domicile	Currency	Share of equity held by*	Share in capital in % 2016
Subsidiaries					
1	zLabels GmbH	Berlin	EUR	Directly	100.0
2	Zalando Operations GmbH	Berlin	EUR	Directly	100.0
3	Zalando Logistics SE & Co. KG	Brieselang	EUR	Directly 2	99.0 1.0
4	Zalando Logistics Mönchengladbach SE & Co. KG	Mönchengladbach	EUR	Directly 2	99.0 1.0
5	Zalando Logistics Süd SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
6	Zalando S.A.S.	Paris, France	EUR	Directly	100.0
7	Zalando Customer Care DACH SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
8	Zalando Customer Care International SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
9	Zalando Content Creation SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0

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NO.	Company	Company domicile	Currency	Share of equity held by*	Share in capital in % 2016
10	Zalando Payments SE & Co. KG (formerly: MyBrands Zalando eStyles SE & Co. KG)	Berlin	EUR	Directly 2	99.0 1.0
11	Zalando Fashion Entrepreneurs GmbH	Berlin	EUR	Directly	100.0
12	Zalando Lounge Service GmbH	Berlin	EUR	Directly	100.0
13	Zalando Outlets GmbH (formerly: zOutlet Berlin GmbH and zOutlet Frankfurt GmbH)	Berlin	EUR	Directly	100.0
14	Zalando Ireland Ltd.	Dublin, Ireland	EUR	Directly	100.0
15	Zalando Finland Oy	Helsinki, Finland	EUR	Directly	100.0
16	Zalando adtech lab GmbH (formerly Metrigo GmbH)	Hamburg	EUR	Directly	100.0
17	Bread&Butter GmbH & Co. KG	Berlin	EUR	Directly	100.0
18	Portokali Property Development III SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
19	Fashion Connectivity Technologies GmbH	Berlin	EUR	Directly	100.0
20	Mobile Fashion Discovery GmbH	Berlin	EUR	Directly	100.0
21	Zalando Media Solutions GmbH	Berlin	EUR	Directly	100.0
22	Bread&Butter Tradeshow Verwaltungs GmbH	Berlin	EUR	18	100.0
23	zLabels Trading Ltd.	Hong Kong, Hong Kong	HKD	1	100.0
24	zLabels China Trading Co. Ltd.	Dongguan City, China	CNY	23	100.0
25	ifansho Holding GmbH	Berlin	EUR	Directly	100.0
26	nugg.ad GmbH	Berlin	EUR	21	100.0
27	Zalando Logistics Operations Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
28	Tradebyte Software GmbH	Ansbach	EUR	Directly	100.0
29	Zalando Logistics Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
30	Zalando Lounge Logistics SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
31	zLabels Trading Southern Europe S.L.	Torrellano (Elche), Spain	EUR	1	100.0
32	zLabels LP GmbH i.G.	Berlin	EUR	1	100.0
Associated companies					
33	Anatwine Ltd.	Cheltenham, United Kingdom	GBP	Directly	36.4
34	Le New Black SAS	Paris, France	EUR	25	33.2

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

(8.) DISCLOSURE EXEMPTIONS

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

(9.) SEGMENT REPORTING

Reporting on the business segments is in line with the internal reporting. The reporting to the top body of management of ZALANDO SE for purposes of internal control fundamentally corresponds to the principles of financial reporting described in Section 03.5.3 in accordance with IFRS.

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

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

SEGMENT REPORTING 2016 → 98

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

SEGMENT REPORTING 2015

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IN EUR M	DACH	Rest of Europe	Other	Total 2015
Revenue	1,580.1	1,211.6	166.5	2,958.2
Cost of sales	–828.4	–706.6	–89.0	–1,624.0
Gross profit	**751.6**	**505.1**	**77.4**	**1,334.1**
Selling and distribution costs	–593.6	–467.3	–58.0	–1,118.9
Administrative expenses	–68.0	–49.2	–11.9	–129.0
Other operating income	5.6	4.4	0.2	10.2
Other operating expenses	–3.5	–3.2	–0.2	–7.0
Earnings before interest and taxes (EBIT)	**92.2**	**–10.2**	**7.5**	**89.6**

Of the total revenue generated in the DACH region, Germany accounts for 61.9% (prior year: 65.3%). In the Other reporting segment, Germany accounts for 39.2% of total revenue (prior year: 42.4%). The non-current assets of the group are mainly located in Germany.

Cost of sales include valuation allowances of inventories for the DACH segment of EUR 41.5m (prior year: EUR 38.3m), for the Rest of Europe segment of EUR 42.2m (prior year: EUR 34.0m) and and for the Other segment of EUR 11.6m (prior year: EUR 7.6m)

The selling and distribution costs contain valuation allowances of trade receivables and write-downs due to uncollectible receivables for the DACH segment of EUR 14.1m (prior year: EUR 76.0m), for the Rest of Europe segment of EUR 7.6m (prior year: EUR 27.4m), and for the Other segment of EUR 1.1m (prior year: EUR 1.6m).

Total expenses include depreciation and amortization of property, plant and equipment and intangible assets for the DACH segment of EUR 21.5m (prior year: EUR 18.8m), for the Rest of Europe segment of EUR 17.3m (prior year: EUR 13.0m), and for the Other segment of EUR 9.5m (prior year: EUR 2.4m).

The other operating income includes fair value changes from an interest in the proceeds from the sale of developed land owned by third parties. These changes are allocated as follows.

NON-OPERATING ONE-TIME EFFECTS BY SEGMENT → 100

IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
Non-operative one-time effects	**10.6**	**–**	**10.6**
DACH	4.9	–	**4.9**
Rest of Europe	5.3	–	**5.3**
Other	0.4	–	**0.4**

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

(10.) SUBSEQUENT EVENTS

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

(11.) AUTHORIZATION OF THE FINANCIAL STATEMENTS FOR ISSUE

The consolidated financial statements and group management report of ZALANDO SE are published in the Bundesanzeiger [German Federal Gazette]. The consolidated financial statements and the group management report were authorized for issue by the Management Board on February 24, 2017.

Berlin, February 24, 2017

The Management Board

Robert Gentz David Schneider Rubin Ritter

03.6 RESPONSIBILITY STATEMENT BY THE MANAGEMENT BOARD

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

Berlin, February 24, 2017

The Management Board

Robert Gentz David Schneider Rubin Ritter

03.7 AUDIT OPINION

We have audited the consolidated financial statements prepared by ZALANDO SE, Berlin, comprising the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated statement of cash flows and the notes to the consolidated financial statements, together with the combined management report for the fiscal year from January 1 to December 31, 2016. The preparation of the consolidated financial statements and the combined management report in accordance with IFRS as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB ["Handelsgesetzbuch": German Commercial Code] are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and the combined management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with Sec. 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting and in the combined management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the combined management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the entities to be included in consolidation, the determination of the entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the combined management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRS as adopted by the EU, and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the group in accordance with these requirements. The combined management report is consistent with the consolidated financial statements, complies with the legal requirements and as a whole provides a suitable view of the group's position and suitably presents the opportunities and risks of future development.

Berlin, February 24, 2017

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

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