

02.2 REPORT ON ECONOMIC POSITION

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

02.2.1 MACROECONOMIC AND SECTOR-SPECIFIC ENVIRONMENT

The mega-trend towards online shopping continued in 2016: The European online retail sector¹⁷ rose by 13.6% in 2016, outperforming the general retail industry which grew by only 2.6%. The European fashion retail sector¹⁸ closed the year with a trading volume of around EUR 425bn, up by 0.9% nominally, while the online fashion market rose by 9.1% to EUR 51bn, compared to the prior year.

The German market posted figures consistent with the European landscape, with the overall retail industry¹⁹ growing at 2.5% while online retail sales rose by 11.6% in 2016. Trading volumes declined by 0.2% in 2016 after a number of years of stagnant growth, reflecting adverse weather conditions: A mild January and a cold March, moving into a rainy summer and warm fall was only partly alleviated by increasing sales in the fourth quarter²⁰. Nevertheless, online fashion retailer increased sales by 7.4% in 2016, to a market value of around EUR 12.3bn²¹.

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

- Technological advancements are the key drivers behind the second wave of e-commerce that will spur further growth of the online fashion business. The market share of internet fashion retail is expected to continue to grow at the expense of traditional brick-and-mortar retailers.
- Europe remains a very attractive fashion market with a high concentration of affluent customers. In our major markets in Western Europe²², per capita spending on fashion amounted to EUR 780 in 2016, more than anywhere else in the world. Coupled with high population density, Western Europe leads with the highest spending per square kilometer on fashion, estimated at EUR 88.1k, compared to EUR 15.5k worldwide. Spending per square kilometer is an important indicator for online retailers, as it allows for faster delivery, at lower cost.
- Average gross margins for online fashion retailers range between 40% and 60%²³, considerably more attractive than average margins in other online product categories, such as electronics.



www.euromonitor.com

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

- The increased penetration of mobile devices and their extended range of applications have been a key driver for the strong growth in online retail trade, including online fashion. Smartphones and tablets provide access anytime and nearly anywhere, and consumers increasingly use these devices to shop for fashion. Forecasts for mobile commerce²⁴ illustrate that this trend is likely to continue, expecting an average annual growth rate of roughly 15.3% for the next five years.

02.2.2 BUSINESS DEVELOPMENT

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



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

As in previous years, Zalando put customer satisfaction as its main objective and invested significantly in its customer proposition, including mobile, brand, assortment, and convenience. Investment in infrastructure underpins Zalando's strength in technology and operations and enables the expansion of its platform strategy. Zalando's operational structure provides the best fulfillment experience for online fashion in Europe. In 2016, the company successfully launched a satellite warehouse in Italy. It already fulfills nearly 70% of orders for our Italian customers and significantly improved our customer proposition. Its success encouraged management to build another satellite warehouse close to Paris, France, which will start operations in the first quarter of 2017. In addition, there are plans for a third one, in Sweden, to be built in 2017 and further improve the Zalando experience for our customers in the Scandinavian markets. These facilities are operated by a third-party service provider. Construction of a large-scale (130,000m²) fulfillment center close to Szczecin, Poland, announced earlier in 2016, is expected to be completed in fall 2017.

Well over 1,000 individual brands have found a home at Zalando. Our technology provides the tools for the brands to design and control the content of their shops and obtain feedback and insights from their customers. Zalando has a team of over 1,600 dedicated technology engineers who develop and drive all critical processes in-house. Amongst other achievements, this allowed Zalando to significantly improve its mobile offering and to win the renowned Editor's Choice Award from Google Play for its Android App. An impressive 65.6% of visits to the Zalando online shop were conducted from a mobile device and the app was downloaded more than 28 million times in 2016.

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

24) Euromonitor, Western Europe

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



Further information in the
Zalando City Guide
zln.do/en-b-and-b

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

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



Further information in the
Zalando City Guide
zln.do/en-partner-services

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

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

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



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

FINANCIAL PERFORMANCE OF THE GROUP

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

02.2 REPORT ON ECONOMIC POSITION

CONSOLIDATED INCOME STATEMENT

→ 25



Further information
Consolidated Statement of
Comprehensive Income
p. 123

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

OTHER CONSOLIDATED FINANCIAL INFORMATION

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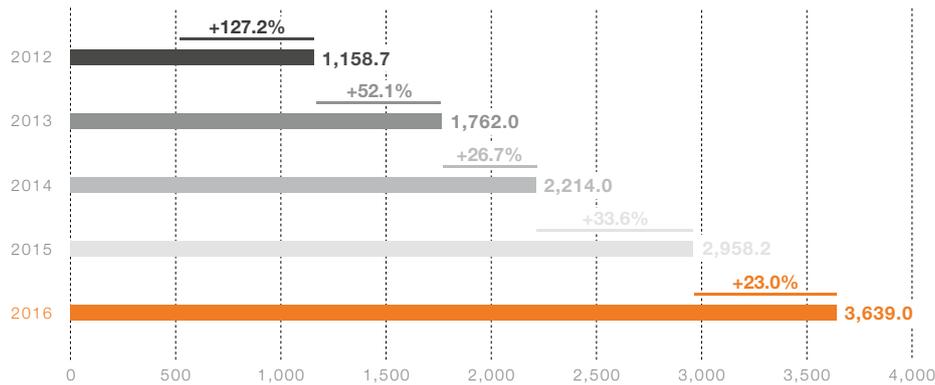
IN EUR M	JAN 1 – DEC 31, 2016	JAN 1 – DEC 31, 2015	Change
EBIT margin (as % of revenue)	5.7%	3.0%	2.7pp
Adjusted EBIT (excl. equity-settled share-based payments and non-operating one-time effects)	216.3	107.5	108.8
Adjusted EBIT margin (as % of revenue)	5.9%	3.6%	2.3pp
EBITDA	255.3	123.8	131.5
Adjusted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

DEVELOPMENT OF REVENUE

ANNUAL REVENUE GROWTH (2012–2016)

→ 12

IN EUR M

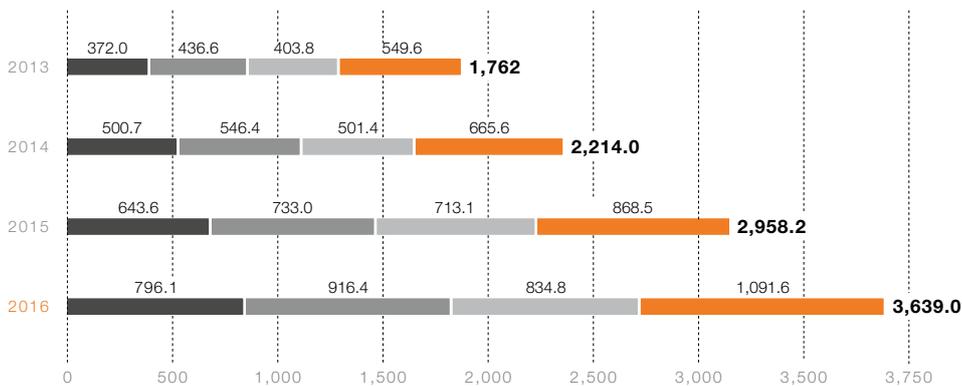


In 2016, Zalando increased its revenue by EUR 680.8m or 23% from EUR 2,958.2m to EUR 3,639.0m.

REVENUE BY QUARTER (2013–2016)

→ 13

IN EUR M



The variance in revenue over the course of the year reflects the seasonality of the business. Typically, the fall and winter collections are sold at higher prices than the spring and summer goods. This means that revenue levels tend to be higher in the second half of the fiscal year than in the first half. In addition, the second and fourth quarters tend to be stronger than the first and third quarters, as they do not contain the sale periods that are typically towards season end. At EUR 1,091.6m, group revenue in the fourth quarter was up 25.7% on the comparable period of the prior year (Q4 2015: EUR 868.5m). It was the first time that Zalando broke the one billion-euro barrier in a single quarter, a clear result of our customer focus.

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



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KEY PERFORMANCE INDICATORS

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

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

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

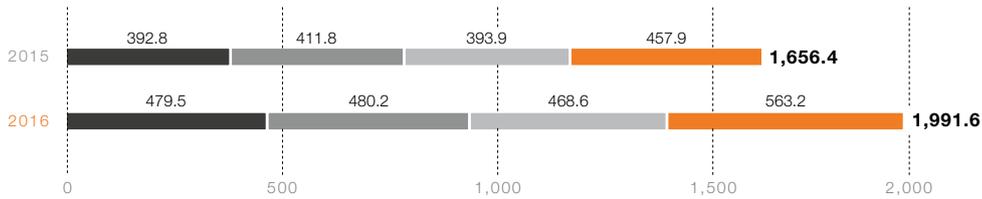
The rise in revenue is mainly attributable to a larger customer base and an increase in number of orders. As of December 31, 2016, the group had 19.9 million active customers. This corresponds to an increase of 10.9% compared to the prior year. The larger customer base ordered more frequently compared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

02.2 REPORT ON ECONOMIC POSITION

SITE VISITS BY QUARTER (2015 – 2016)

→ 14

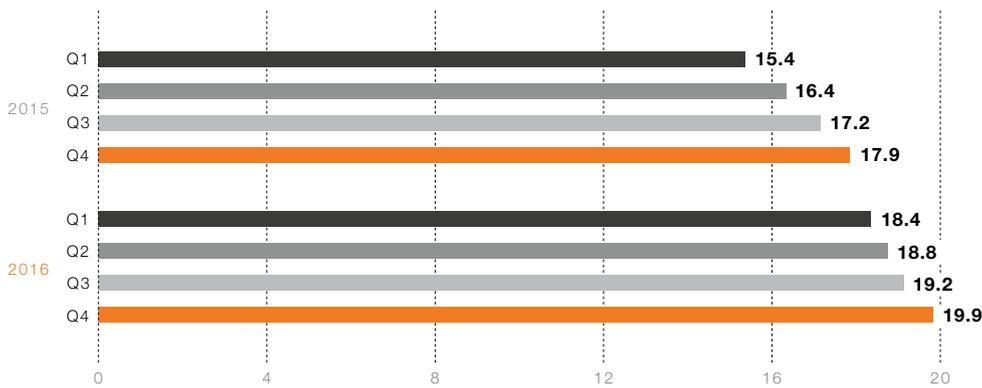
IN M



NUMBER OF ACTIVE CUSTOMERS BY QUARTER (2015 – 2016)

→ 15

IN M



NUMBER OF ORDERS BY QUARTER (2015 – 2016)

→ 16

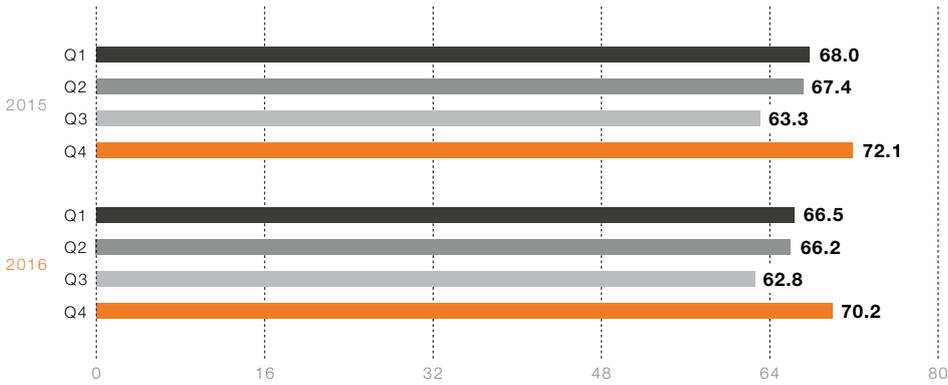
IN M



AVERAGE BASKET SIZE BY QUARTER (2015 – 2016)

→ 17

IN EUR



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

Revenue by segment breaks down as follows:

REVENUE BY SEGMENT

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IN %

7.0 [2015: 5.6]

Other

49.8 [2015: 53.4]

DACH

43.1 [2015: 41.0]

Rest of Europe



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In fiscal year 2016, DACH countries generated around half of the total annual revenue. At the same time, revenue recorded in the Rest of Europe and Other segments increased significantly, also contributing strongly to the overall revenue growth.

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

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

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

DEVELOPMENT OF EBIT

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

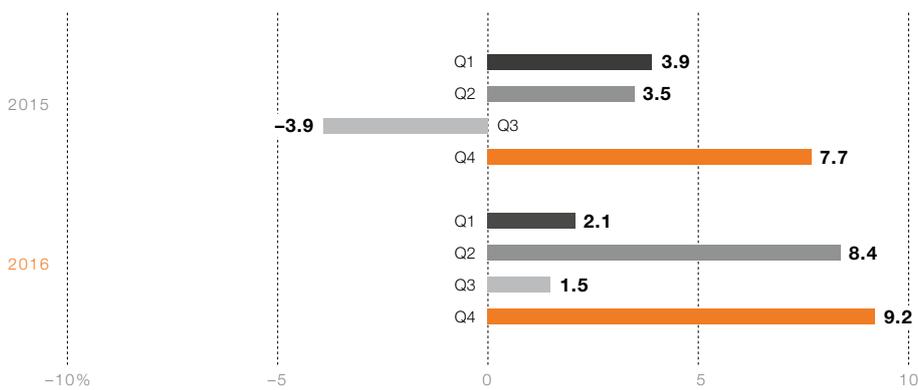


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EBIT MARGIN BY QUARTER (2015 – 2016)

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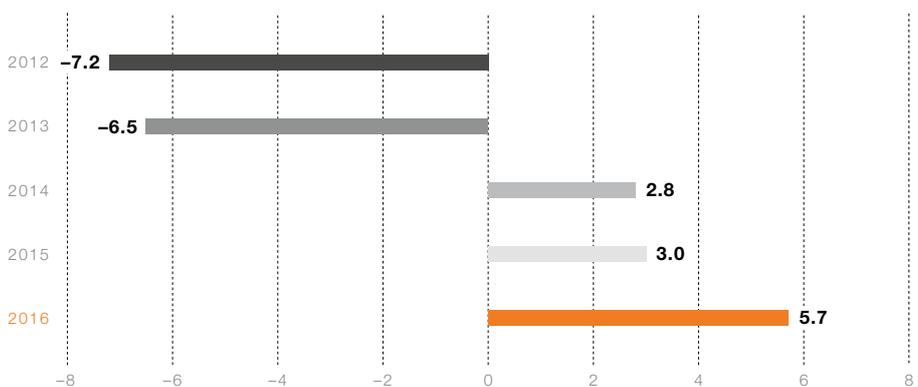
IN %



YEARLY EBIT MARGIN (2012 – 2016)

→ 20

IN %

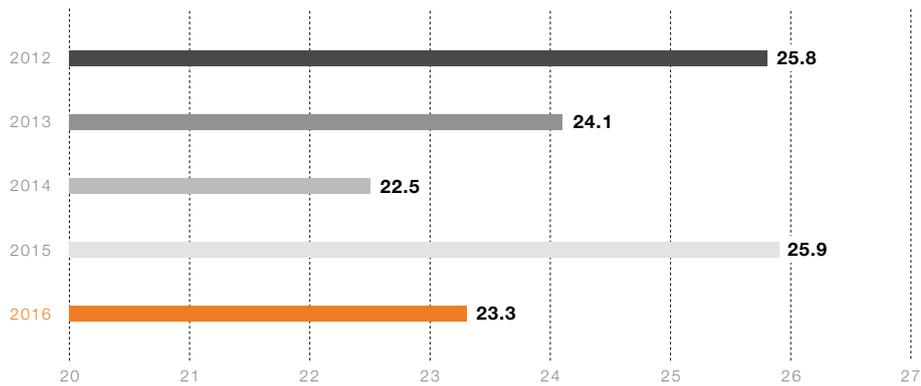


FIVE-YEAR SUMMARY OF COST ITEMS (NON-ADJUSTED)

FULFILLMENT COSTS (2012 – 2016)

→ 21

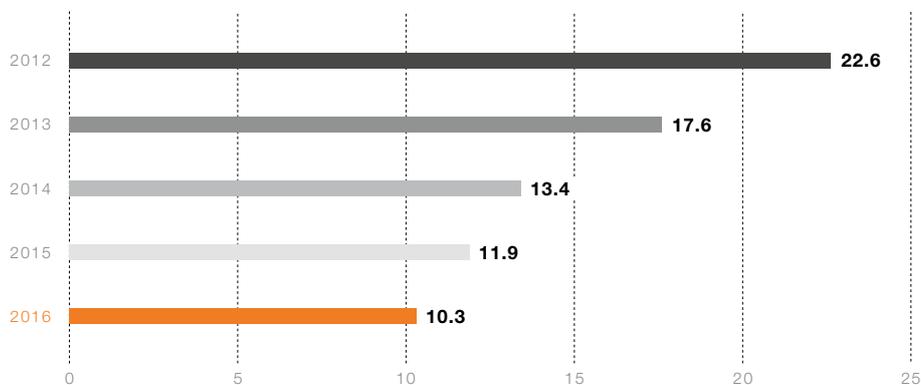
IN % OF REVENUE



MARKETING COSTS (2012 – 2016)

→ 22

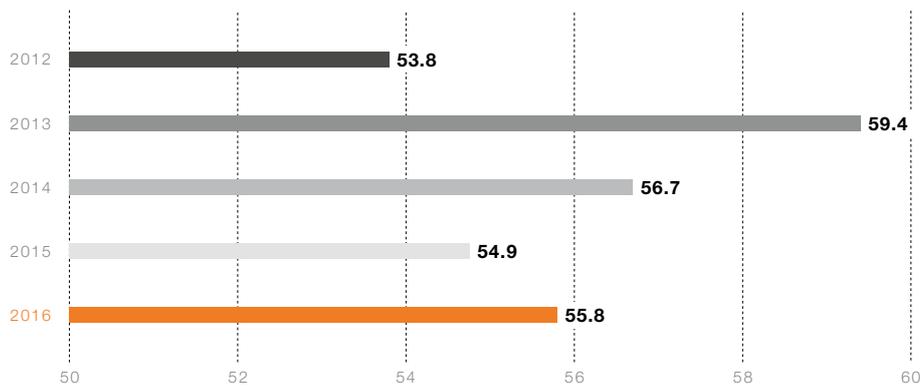
IN % OF REVENUE



COST OF SALES (2012 – 2016)

→ 23

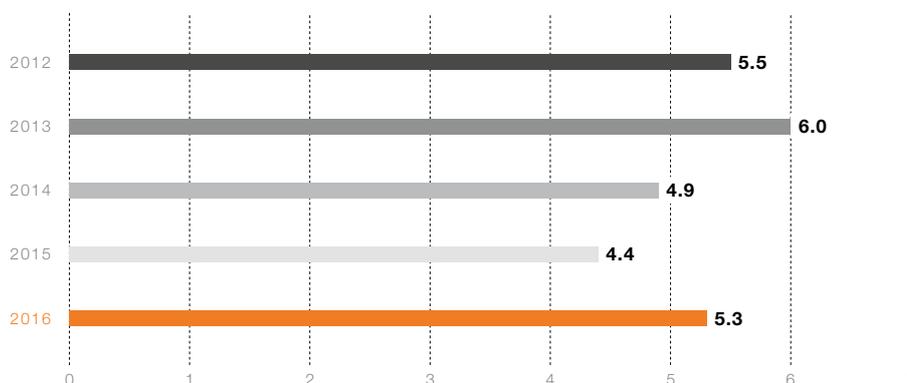
IN % OF REVENUE



ADMINISTRATIVE EXPENSES (2012 – 2016)

→ 24

IN % OF REVENUE



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

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

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

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

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

Other operating income of EUR 16.7m (prior year: EUR 10.2m) largely comprises changes in the fair value of a derivative resulting from the interest in the proceeds from the sale of developed land owned by third parties. Income recognized in that context amounted to EUR 10.6m (prior year: EUR 2.0m). In 2016, this issue was declared as a non-operating one-off effect and eliminated from adjusted EBIT accordingly. In the prior year, the effect was deemed to be immaterial for the income statement and was therefore not eliminated from the calculation of adjusted EBIT.

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

ADJUSTED EBIT

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

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

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

SHARE-BASED COMPENSATION EXPENSES PER FUNCTIONAL AREA

→ 28

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

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

RESULTS BY SEGMENT

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

CONSOLIDATED SEGMENT RESULTS

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

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

SHARE-BASED COMPENSATION EXPENSES PER SEGMENT → 30

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

NON-OPERATING ONE-TIME EFFECTS PER SEGMENT → 31

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

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

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



Corporate strategy

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

ADJUSTED EBIT BY SEGMENT

In order to assess the operating performance of the segments, Zalando management also considers EBIT and EBIT margin before expenses for equity-settled share-based payments and potential non-operating one-time effects. The DACH segment generated an adjusted EBIT margin of 12.5% in 2016. Compared to the prior year, the adjusted EBIT margin increased by 6.0 percentage points.

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

FINANCIAL POSITION

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



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CONDENSED STATEMENT OF CASH FLOWS

→ 32

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



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

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

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

The cash outflow from investing activities mainly results from investments in the logistics infrastructure relating primarily to the fulfillment centers in Mönchengladbach, Lahr, and Szczecin and capital expenditures on internally developed software, as well as furniture and fixtures. Cash flow from investing activities further consists of cash invested in term deposits with an original term of more than three months and is therefore presented in cash flow from investing activities. As of December 31, 2016 an amount of EUR 220.0m was invested in such term deposits (December 31, 2015:

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

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

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

Zalando's liquidity position – as the sum of cash and cash equivalents plus term deposits with an original term of more than three months but less than twelve months – rose by EUR 61.4m in 2016.

CREDIT FACILITY

On December 15, 2016, ZALANDO SE concluded a new revolving credit facility in the amount of EUR 500m with a group of banks renewing its EUR 200m revolving credit facility secured in 2014. This facility can be drawn in various currencies. The revolving credit facility can be utilized for general business purposes (including acquisitions) as well as for guarantees. The facility expires on December 15, 2021 and may be extended until December 15, 2023. As of December 31, 2016, an amount of EUR 39.2m had been utilized for bank guarantees and letters of credit.

NET ASSETS

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

ASSETS → 33

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

EQUITY AND LIABILITIES → 34

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

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



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

Key components of the software used by the group are developed internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes in particular are supported using internally developed software. In fiscal year 2016, additions related to capitalized development costs of EUR 57.7m (prior year: EUR 23.1m), of which EUR 36.4m is contained in prepayments (prior year: EUR 9.2m).

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

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

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

Current liabilities increased by EUR 284.4m in the reporting period. This increase is mainly attributable to trade payables and similar liabilities, which rose by EUR 274.8m from EUR 645.8m last year to EUR 920.5m in the reporting period. The increase is largely due to deliveries of merchandise in light of the higher business volume and longer payment terms. Moreover, under reverse factoring agreements, suppliers' claims against Zalando totaling EUR 282.3m were transferred to various factors as of December 31, 2016 (December 31, 2015: EUR 170.9m). These items were recognized in the statement of financial position under trade payables and similar liabilities.

Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities, improved to EUR -127.6m as of December 31, 2016 (December 31, 2015: EUR -2.6m). The improvement results mainly from the increase in trade payables, which reflects the higher business volume and the seasonal delivery peak, as well as an extended availability and utilization of reverse factoring lines. Furthermore, this development was supported by successful negotiations with our suppliers that resulted in extended payment terms.

OVERALL ASSESSMENT

The Management Board views the business development in 2016 very positively. Zalando consciously focused on growth opportunities, made key strategic investments, and yet remained clearly profitable in the process. The Zalando group increased its revenue markedly in fiscal year 2016 and won additional market share. The EBIT margin increased substantially as a result of the strong performance. In view of the high operating leverage, Zalando continued to push forward with growth investments in its consumer proposition and platform initiatives.



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

02.2.4 EMPLOYEES

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

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



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²⁵ The sustainability report is not part of the audited combined-management report.