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Zalando SE (ZAL.DE)

Capital Markets Day - Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Patrick Kofler

Team Lead-Investor Relations, Zalando SE

[Ladies and gentlemen, welcome to our fifth CMD here in our new headquarters in Berlin. Welcome here on the 28th February of 2019 with wonderful weather outside and wonderful results on Q4, which we released this morning and we are happy to present the details further. We are happy to see a lot of shareholders here and also our analysts, it's reporting season and for the very first time we broadcast the CMD on the web where you can follow it on the internet stream.

So I would like to kick of this CMD with Rubin, our Co-CEO and, Birgit, our SVP Finance, and they both can't wait to share the financials 2018 and Q4 details with you. Rubin, the floor is yours.]

Rubin Ritter

Co-Chief Executive Officer, Zalando SE

Thank you, Patrick, and also from my side a big welcome to all of you. Thank you for joining us today. We are really happy as this is one of the first events we do on our new campus. You might know that as of now our teams are really distributed, I think, across six, seven, offices in the city, and we're really thrilled to bring them back together in this nice location. And we hope that's really going to be a positive [impulse] for the company. And I think it's a great building to start the second decade of our company and I think it's also a great building to host Capital Markets Day. Especially, I would like to welcome Lothar Lanz, the Chairman of our Supervisory Board. He's sitting here in front and will be happy to get all of your questions during the coffee and lunch breaks. And I also would like to welcome Cristina Stenbeck, who is actually one of the earliest and biggest supporters of our company and we are really happy to have you here with us today as well.

So, with that, I will get started. Before we talk about the long term, we are going to start by looking back at the fourth quarter. So, we have the regular earnings call first time in a new format on stage, but the procedure is the same as always. We will start with the highlights and business update. I will cover that and then Birgit going to take us through our financials. I will then close with the outlook for the next year. And then of course we have time for your questions.

So, let's get started. Clearly, we are very happy about the fourth quarter results. As you all know, we had a challenging Q3, but I think we came right back with a really strong Q4. And I'm really happy to present those numbers. I think that we're a great finish of 2018. We were able to grow 25% in revenues to about €1.7 billion. We were able to grow even faster in GMV by 26% to more than €2 billion in GMV just in the fourth quarter.

You will notice throughout this presentation that GMV going forward will take a bigger role in our disclosure and we'll start to talk about GMV more, more openly now and Birgit will talk about that a bit later on.

And also our reach, our visits has grown significantly more than 30%. We reached almost 1 billion visits just in the fourth quarter. You know that for us that has a big strategic importance because ultimately, our brand partners wants to work – want to work with us because we built this European reach to European fashion consumers.

Certainly, we have been able to grow active customers really strongly. 1.3 million additional active customers in just one quarter. That's the strongest growth we have seen in over five years. We now have more – 26.4 million active customers. That's 6.5% of the entire European population. We saw that 82% of the traffic comes from mobile. I think that number speaks for itself. And we also saw a new all-time high in customer satisfaction in October. Actually, we saw yet again another all-time high in January. So also in terms of customer satisfaction we are tracking really well. Last but not least, the quarter was also clearly profitable with €118 million adjusted EBIT and that sort of growth compared to last year and a very solid 7% margin.

We also have two lowlights I want to bring up upfront to be very transparent about them. So the first one is that we continue to see this downward trend in the average basket. We have discussed a number of times what trends are leading that in terms of customer behavior, but also how the platform transition is adding to that trend. We will talk in this presentation but also later today about how we are working to tackle that and what we expect going forward.

The second lowlight we saw in the fourth quarter is that gross margin was down 1.5% year-over-year in this fourth quarter. I think also due to the challenging season start that we had in the industry overall. We feel that the discount level was maybe a bit elevated over all. So also our gross margin suffered from that in the fourth quarter.

Now, a couple of things I would like to highlight that happened in the last three months. I think the first one and the really strong Q4 I thought the cyber weeks and Black Friday really stood out. And that is for three reasons. First of all it was a really big commercial success for us. We're able to grow GMV by 60%. We're able to acquire 220,000 additional customers. By the way, those customers, sometimes people ask the question, are those unprofitable customers? Because they are quiet on Black Friday, we actually see that they have almost exactly the same KPIs in the weeks and months following the event, so they are profitable customers with good lifetime value. And also Black Friday for us was a profitable day. I think sometimes people think because of all the discounting, it might not be profitable, but actually for the volume that we drive with very little [audio gap] (00:04:28) just by driving it as a commercial event, it has been a very big commercial success overall.

I think secondly for us, it's a day that we use to really train ourselves for bigger scale. So in terms of our technology system, we want to check that they are really up for a significantly higher scale. So for example, we processed in the peak of the day 4,200 orders per minute and we shipped 2 million passes – 2 million passes as a result of this day, so it really shows that in terms of our infrastructure, we already now set up for significantly higher scale to come in the future.

The third reason why we really like this day was with the teamwork. Put this picture in as one example for it because it was really a day where different parts of the company come together. They plan for this event and then they really focus on executing it. There was like a situation room with more than 100 people that worked all day trying to figure out how to make this day a success, how to make sure that nothing breaks down. It has really worked out well and the spirit on this day was really outstanding.

The second operational update from the fourth quarter is really how we have been able to progress in terms of the platform transition. We talked about Zalando Fulfillment Solutions a number of times in our last earnings call, and here we also continue to see really steep growth. The curve on the right shows the growth in items that are shipped through ZFS and you can see that just from Q3 to Q4, it has grown by 50%. Now shipping 25% of all the items that come from the partner program. And already in Q1, we see that growth really continuing.

The second important piece has been to try to make sure to bring wholesale and partner program to a similar level in terms of customer satisfaction. We have seen in the past that partner program all of us had lower customer satisfaction and we have been able to bring that to a similar level, driven by the success of ZFS, but also driven by a stricter performance management towards our partners.

The third big success improvement is really across internalization. You know that we started the partner program in Germany, but we see that more and more partners are really interested to take their business international and by now about 40% of the volume happens outside of Germany.

The third topic I want to give a brief update on is the MOV in Italy and we have talked about that in the last earnings calls and I know it's something you're very interested in, so we want to make sure that we update you. I think if you take a long term view, the MOV is one of the areas where we start to step away from this one-size-fits-all approach.

When the business was started it was really one-size-fits-all, right? All the deliveries are for free, all the returns are for free, all the assortment like don't worry about it, just order online, it's super convenient. That was our message to customers. And I think that was exactly the right thing to do, to teach consumers that ordering fashion online is actually great, fun and it's super convenient.

But sometimes we have to think now that we are 10 years later and maybe some things have changed. Right? So for example, in the case of Italy, we have invested into a local satellite warehouse to make deliveries even faster. We are offering more and more lower price points because our customers want them. We are investing a lot to make the customer experience greater and greater. And I think as a result of that, we have to start to also deleverage the customers relationship a little bit and this is why we decided to introduce the MOV and you will – I think you will hear this theme about of the deleveraging our customer experience you will hear that a lot throughout the entire day. This is just one example.

The second thing I would like to highlight is that in my mind the MOV is also a customer centric decision because the fact that we were not able to serve orders with low item values profitably in Italy could mean two things. Either you just stop to sell those low price points or you charge for the delivery follow orders and I think to stop to offer the low price points really wouldn't have been a customer centric decision because we know our customers want them and we actually think they understand that they have paid for orders with a very low value.

And this is actually also what we see in the numbers. So our expectations actually have become true. We see that orders are slightly down by 8% but we see that the baskets are up 6%. So in terms of revenue the impact is probably around 2% negative. However, the profit contribution has increased by more than 10%. So these numbers are really in line with our expectations and we also saw that customer feedback, negative customer feedback was really low in the days and weeks after the introduction. So we feel this has worked out really well and on that basis we have decided to introduce MOVs also in Spain, UK and Ireland in the next step.

All right. Those were some operational highlights. And I would like to hand it over to Birgit to take you through the financials.

Birgit Harderer

SVP Finance & Indirect Procurement, Zalando SE

Thank you. So, before we dive into the financials I want to give a brief update on the GMV disclosure. As Rubin already alluded to it we will start disclosing GMV now on a quarterly basis. So why do we do that? The growing importance of the partner program and the volume that goes through our platform drive us now to disclose this figure because this is our internal KPI that we track very closely internal KPI that we track very closely to see the progress of the partner program and the platform unfolding.

So it's an internal KPI where we measure the net merchandise volume that customer spent with us net of returns after cancellations and including VAT. So in a way it mimics a share of wallet that we get from our customers that we also then use for the computation of market shares.

So how do we get now from GMV growth to revenue growth? So GMV growth in the fourth quarter as you know was 26% or a volume of over 2 billion. There are three main factors that impact the bridge from GMV growth to revenue growth. The first one is we do strip out the change or the growth in the merchandise volume of the pardoner program but we do include the commission in revenues.

Secondly, we do [indiscernible] (00:10:43) growth in B2B and other B2C revenue. So that is revenue associated with that if as sedums but also Plus our membership program or for example express or dining fees.

And then the third point is – and that depends on the quarter and the time periods, can be a plus or minus in growth rates – is the point of revenue recognition. So revenue under IFRS we recognize at the point of receipt, so once the customer physically gets the package she we recognize at the point of order. So when the customer puts in the order with us so that can mean when you read the last day of a quarter and we have a very high volume, that this volume is being captured in GMV but it's not yet captured in revenue, that will happen in the subsequent quarter because the customer hasn't yet received the package.

That leads us to revenue growth of about 25% in Q4. So you see in Q4 the gap between GMV growth and revenue growth was not major because yes, we had a strong increase in partner program. On the other hand though we had a revenue shift coming from Q3 into Q4 so supporting the Q4 revenue

growth rate. Depending on the quarter though, that difference can be larger or smaller depending on those three factors.

But now moving on to the numbers. We had a strong Q4 as Rubin already touched from a top line perspective. We grew GMV by 26%, revenue by 25% strongly supported by our biggest business the fashion store, growing also over 25%. We saw strong growth in all our segments. So, DAC region grew over 20% and rest of Europe grew over 30%.

We had multiple growth drivers during Q4, so, definitely we also had some spillover effect from Q3, which was fairly weak coming into Q4. We've also seen very strong Cyber Week. As Rubin just explained we've had strong end of season sale and throughout the whole quarter we've seen very good operational performance throughout all our teams.

That also led us to a good conclusion of this rather lumpy 2018. So, we finished the year with GMV growth of 21%, a revenue growth of 20% which is at the low end of our initial guidance, which was 20% to 25% nevertheless within the range. So, we grew market share. We grew scale by really pushing forward on our agenda to increase in scale and have more and more touch points with consumers and brands.

Growth was heavily supported by very strong customer KPIs. So, we see active customers growing strongly year-on-year and also quarter-to-quarter. So, we had 1.3 million more active customers quarter-on-quarter. We had the highest increase in over three years. So, we have to look at Q2 2013, which feels like ages ago. This is when we had a similar increase during a given quarter. We've also seen the share of wallet increase by close to 6% mostly driven by an increase in frequency, so purchase frequency by our customers over the last year went up over 12%.

What you – what you also see though is that the basket size trend, the downward trend continues, but we're working heavily to slow down this trend. There's two perspectives how you can tackle the trend. One is you increase basket size through measures like sizing. So, decreasing return rate and as such bringing that basket up. You will hear more later on, on that during the Capital Markets Day. Or we managed to deliver those smaller orders in a more economical way. So, things [ph] through MNV – MLV (00:14:26) that Rubin just talked about are also side effects, which we will talk about more later today

A brief last word on this slide. You will see that the metrics have slightly changed compared to what we reported before. Now they're all in sync with the GMV definition that we just discussed. So, it's now based on an order date and it's based on an LTM basis as all those stats here refer to an LTM time period.

Now, moving on to profitability. Also here, Q4 was a strong quarter. We delivered EBIT of roughly €180 million which means year-on-year, EBIT grew by over 5% and an EBIT margin of over 7%. When you look at the split in the Fashion Store, DACH and Rest of Europe, you will see that the decrease in margin was a little bit more pronounced in the DACH region versus the Rest of Europe region. And that is because of a higher overall discount level we've seen in the DACH markets compared to the rest of European markets.

Now, this strong Q4 performance also again helped us to finish the year on a good note, I would say, because we managed an EBIT of €173 million or a solid margin of over 3% which leaves us sort of well above the midpoint of the latest guidance that we had provided back in September.

Looking at the cost lines in a little bit more detail. As I mentioned before, the biggest impact we've seen in Q4 was in gross margin. We've seen a higher overall market discount level, we adjusted to that. And this is why you see gross margin 1.5 percentage points down year-on-year.

What you also see is that the trend in fulfillment costs continued. So we see higher cost year-on-year however at a much slower pace than what you've seen in the prior quarters. And there are three main reasons for that. The first one is we've had a very high transactional volume going through our systems, also logistics footprint which overall leaves us with more operating leverage in our systems.

So here you see the proof point of once you have a high capacity utilization, you definitely also see the benefit in your cost lines. Secondly, we had less split orders versus last year. Split order means when a customer orders let's say four items, we send not one package with four items but to be faster or more efficient from our perspective, we send two separate parcels to the customer which is obviously more costly. Given our setup and our strategy, we had less split orders in Q4, especially around Christmas period this year, and this is why we've seen lower costs compared to the prior-year period.

And last but not least, we've also seen a lower return rate which is a lot correlated with the higher discount rate we just talked about. So generally speaking, a customer if you get something for a good price. you're less inclined to return it, which is why we've seen return rate be a bit lower than in the prior-year period.

Lastly, on marketing, we do see marketing slightly up year-on-year by 0.4 percentage points also in absolute values, we're up about €30 million. That's as we said before. So we intended to spend more this Q4 with our 10-year campaign, Christmas campaigning but also with more focus on ROI-based performance marketing steering and this is what we did. Also with good success, we just talked about the customer KPIs where I mentioned the 1.3 million more inactive customers that we've seen during Q4.

Last but not least, and a quick view on the casual perspective. Both key drivers of cash flow came in according to our guidance. So we see negative working capital of about minus €84 million at the end of Q4, and we also had CapEx of €280 million during the full year. If you take it all together, the top line, the margin and here. the cash flow component perspective, you will see that we had strong free cash flow generation during Q4 of about 125 million which means for the overall year, we're close to breakeven from our free cash flow perspective. All in, our liquidity stayed very strong with over a billion euros at the end of the year.

With that, I'll hand it back to Rubin Ritter for the forward-look.

Rubin Ritter

Co-Chief Executive Officer, Zalando SE

Thank you. So, before we come to the outlook, I would just very briefly like to take a look back at 2018 overall. We already said that from a financial perspective, it was a bit sort of bumpy in terms of the performance in Q3. I think that's all sort of clear and understood. But I think if you take a step back, it's also a year of many achievements. And as you know, we have certain strategic priorities. We're going to talk more about them later during the day. But clearly, we want to continue to increase our scale. We want to continue to increase our reach to consumers who want to drive traffic. We want to drive them of orders. We want to drive number of active customers.

And I think on all of these dimensions, we have really made great progress to continue to grow our scale and also capture market share. Please keep in mind that also with the growth in 2018 we are growing three times as fast as the online fashion market overall, so we're really continuing to grow our market share. The second big priority was to make sure that our platform strategy really continues and that the transformation towards the partner program continues at fast pace here we had important proof points, the partner program does more than 10% of our business. If you look at it in absolute terms, that's about €600 million in GMB that has become really a sizable business. We have grown at a fair share to more than 25%. We have grown our marketing business by more than 60%. So I think in terms of the platform strategy many pieces are starting to flow into starting to fall into place and we have also tried to really plant the seeds for the growth of the future.

We have launched beauty which we think long term be a great opportunity for our company. We have launched two new markets and we have started to roll out [indiscernible] (00:20:24) which we had tested in 2017. But then, in 2018, really decided to roll it out step by step in Germany and we'll talk about later how much that really can be a driver of the company's growth and success in the future.

At the same time, obviously, there were learnings, right? I think we have to acknowledge that we are working in a pretty difficult environment overall. When you look like very macro level there are sort of concerns about the Brexit, there are concerns about recession if you look at our industries specifically there was a very strange seasonality in the year. So I think all of the things that we just have to with and I think the topic is in my mind that does not change the size of the opportunity. It doesn't change our direction. It just maybe makes the road to get there sometimes a bit more bumpy.

In terms of how we try to react to it, I think there are two thoughts that have become more important to us in 2018. The first one is I think in this type of environment it's important to be really focused around the investments that you're making. And I think based on the strategy that we will talk about in the next section, we are actually reviewing many of our activities to make sure that we really fund all our resources to those areas that are the most important and that will make the most difference to our customers and our growth in the future.

I think in other – we have taken this really to make sure that we are mindful in terms of our spending. So on 2018 we have done a lot of work to really review the growth of our overhead costs. And to make sure that over the next years that will continue to really grow significantly slower than revenues and therefore also giving us some operating leverage.

The second learning was around the basket size, we're already talked about that's how customer behavior. But also the platform transition is impacting that. And I think that continues to be a theme also in the next years of great focus. The third learning was around the platform transition. So I think it's something that we have to manage even more carefully and that we also have to communicate about even more. Because it's quite a substantial transformation that the business is going through. And I think we have to make sure that really everybody understands what we are doing.

Now, based on this let's come to the outlook for 2019 and sort of our lawyers always ask me to read that because they say it's so sensitive. So I'm going to read that now. But I think, overall the direction of the company really remains similar. We will continue to be very focused on growth and as described GMV will become the more important measure of our growth as the share of the partner program continues to increase.

W aim for strong GMV growth between 20% and 25% which is more than 3 times the growth rate of the online fashion market overall. This translates into more than €1.5 billion of additional GMV. We expect revenue growth to be at the low end of the 20% to 25% range. As the partner program continues to grow over proportionately. With regards to profitability, we expect the adjusted EBIT between €175 million and €225 million. This range implies a 15% growth of absolute EBIT at the midpoint of the range.

Furthermore, we anticipate net working capital to stay slightly negative at year-end and we continue to invest into logistics and technology and plan capital expenditure of around €300 million in 2019, somewhat below the level of 2018 in percent of revenues.

I would like to make one remark on the first quarter. As always please keep in mind that the first quarter is a sales quarter. Regarding growth, we expect GMV to be well in the growth corridor. At the same time we expect a very wide gap between GMV and revenues driven by a higher partner share in the end of season sale and some IFRS accounting shifts in revenues. As a result, we expect revenue growth well below 20%.

With that said, I would like to kick off the Q&A section. Patrick?

QUESTION AND ANSWER SECTION

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Thank you, Rubin. Thank you, Birgit. So, ladies and gentlemen, we're opening Q&A session now. As said before, [ph] the preference to be here (00:24:46) in the room and I'll see rise of hands. We have the beautiful [indiscernible] (00:24:49) over there, but I also have the beautiful Zalando [indiscernible] (00:24:51) which I'm going to throw at least in the fifth row and then we can start the questions. Please always wait for a microphone or a cube. And then, we'll go ahead. Magnus first.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)

Q

Thank you. Magnus Råman, Handelsbanken. I have a few questions but I will limit to two. On the gross margin you mentioned reasons for the weakness in Q4, elevated discount levels. But I think perhaps it is also explained to some extent by the Black Friday period that it has been increasing significantly as you show numbers on. And perhaps that could also be expected going forward. So, how do you think of that phenomenon and how that affects gross margins going forward? That's my first.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

So, I think you're right. It's – so those effects, probably the one-offs, in general, to have a higher discount rate in the market, what's the bigger effect of the two? But obviously also the growth on Black Friday and Cyber Week overall played a role in our gross margin. As I tried to explain, I think we have to take into account that really this Cyber Week and this Black Friday, so it is a different event where the economics changed a little bit because through the discounted offer, we are able to drive so much volume and so much traffic, that still it continues to be a profitable period for the company, just as with a lower gross margin.

Also in 2019, we expect Cyber Week to be big. I think there are also a number of levers that we can pull to make it even more successful. So in 2018, we included more and more the partners for partner program which is actually a great idea because then, we can also leverage their warehouse capacity and really make more volume. And I think we can do that even more in this year.

Also, I think we have started to really purchase specific products for this season, which obviously also could give us an even more positive tradeoff in terms of the gross margin going forward. So I think that even more levers we can pull to make it even more successful in 2019 and I think it's actually a good way to also drive the business.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)

Q

Right. And my second question with regards to CapEx and CapEx has increased substantially over the recent years, but now seems to have perhaps peaked and is declining in relation to sales. Can you give us an update on the status of your fulfillment footprint now because, I guess, that's the main driver to that CapEx increase that we've seen and elaborate a little bit about when you now aim for much higher partner program expansion and how that affects the need to expand fulfillment footprints in the coming years. Since also at ZFS is expected to grow, I guess.

Birgit Harderer
SVP Finance & Indirect Procurement, Zalando SE

A

Yeah. So, CapEx in the end is a function of mostly the fulfillment network that we build out. The current status is that we have 11 warehouses, five of those are still in ramp up phase or construction phase, the other six are fully on line as we speak right now.

What that means in terms of trajectory going forward? You've seen CapEx come in in our guidance a little bit lower than what we've said a year ago. I think there's two drivers behind that. The first one is we have found some more efficient set ups. For example, with inbound warehouses and those kinds of things to leverage the footprint we have more efficiently. And the second one is and we'll talk more about this this afternoon or afterwards is with sort of continued planning that we're doing around our five-year plan through 2023, 2024 now, we have put more granular assumptions behind our CapEx planning.

You mentioned the part of program ramp up, you mentioned the set of S-share. We will talk about our assumptions through the next couple of years in the following sessions. And so with that, we have concluded that we expect CapEx going forward at the 4% to 5% of revenue or so. And so, in the end, it will be in sync with the growth. You have seen this morning in the releases already that we have ambitious growth plans through this time period going to €20 billion GMV and that CapEx guidance is in sync with this growth expectation.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Can you pass it just like one more row behind you? So, it's benefiting – who sits in the first row gets first questions. Last row, last question. Keep in mind for the next session.

Andreas Inderst
Analyst, Macquarie Capital (Europe) Ltd.

Q

Okay. It looks I'm sitting quite well here.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Your name and your company, please, first.

Andreas Inderst
Analyst, Macquarie Capital (Europe) Ltd.

Q

Andreas Inderst, Macquarie. I have two questions. The first one, you mentioned a review of your cost base. Can you give us a bit more examples on that and maybe you can quantify the magnitude of your initiatives?

And my second question is around the MOVs you introduced it in Italy. You had quite good feedback. So you say. You introduced it now in three other markets. What is the outlook? Is there any chance you will introduce MOVs also in other markets? Thank you.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yes. So, on your first question I think as a company that is incredibly focused on growth, right? And when you're focused on growth you also – you have to invest a lot. And I think that is the right thing to do. But when you do it I think every once in a while you also have to remind yourself to be mindful of the cost base you are building and to check if it is in sync with the company you want to be in three or four years. And I think that is a process that we are going to, given that we have just updated our strategy. I think it is a good point in time to really make sure that we – that all our teams and all our initiatives are really targeting this direction, right? And wherever we have the opportunity to shift resources into those areas that really we think will have the biggest impact.

I think the second piece is that when we look at our long term plan obviously we want to build a highly scalable model, which specifically applies to the partner program. And I think also the same really has to apply to our cost base, right? To make sure that over the years, we really have this very strong habit to make sure that the business grows but our cost base grow significantly slower in order to have that operating leverage, also in order to have sort of leeway to really invest into our customer preposition and invest into those things that drive our growth.

So I wouldn't sort of make it too big of an update but I think it is something that every couple of years, it's important that we remind ourselves of this and make sure that everything that we spend is really focused on those areas where we want to make the biggest impact.

In terms of the MOV, I mentioned that we have launched three new markets. I think we will review the results in those markets as well. But then I think not only with respect to minimum order value but also with respect to other elements, we will try to be more and more of the average and also bit more segmented in terms of what we offer to which customer base and how we best [indiscernible] (32:19) our business in that way. Because as I tried to explain in the beginning, I think this approach of one size fits all. I think that's not the most successful approach for the next 10 years.

And as I also try to point out I think also customers know that they are more used to e-commerce, they use that maybe one service cost a bit more than the other service. And if you want extra fast delivery, maybe that has a price. So, if you always want to get the best, maybe you have to sign up for a plus. So, I think those steps that customers will understand and we have actually high hopes that it will make our business model even better.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE
A

Andreas, can you pass it on your right-hand side towards you? Thanks.

Andreas Inderst
Analyst, Macquarie Capital (Europe) Ltd.
Q

Side, first row.

Jürgen Kolb
Analyst, Kepler Cheuvreux SA (Germany)
Q

Jürgen from Kepler Cheuvreux. Two questions. First coming back to the MOV question, have you already introduced the MOV in Spain and these other markets or are you going to the end? Maybe in this connection also in what was the average order size in markets like Spain where you introduced the MOV, was it in the same area like in Italy or was it even lower than that.? That's the first one.

And the second one, may we challenge you maybe a little bit more on the guidance for 2019. First of all, on the top line, what are the drivers of that revenue growth that you're seeing, if you could break it down maybe into DACH and the other regions. And then also on the OpEx side, what are you seeing in terms of fulfillment ratio and also marketing ratio? Maybe some more additional wording without the lawyers listening, obviously.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE
A

Sure. So on your very first question, MOV is already introduced in those three markets that happened I think end of January. The second part of that question, average order size. As you know, we don't really like to disclose KPIs on individual markets. But on both Spain and Italy, you can assume that the average orders, this was below average.

In terms of the guidance for the running year, I would expect – I mean, over the last years you have seen sort of rest of Europe growing significantly stronger than that. That is something I would expect to continue. I think we have a number of really exciting local initiatives to make sure that we really foster growth in some markets for example we have been very focused on improving our proposition in France with Pay Later with the local satellite warehouse with the introduction of pickup points. So I think it's initiatives like this that continued to really drive growth by upgrading the customer experience in a way that is really exciting to customers.

In terms of the different cost lines, we already commented I think that on fulfillment costs we will continue to build out our footprint. We see this topic of increasing factor costs. So I think on the fulfillment cost line, we will continue to see some pressure even though I hope not to the same extent that it was the case in 2018. And I think in terms of marketing and gross margin, as always, we will try

As always, we'll try to steer it in the way that is optimal for the individual season so I would not like to give a too detailed outlook on that because I think there we want to reserve the liberty to really steer the season the best way possible.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE
A

And we'll go back to row two and also because Charlie just realized how [audio gap] (00:35:33) it is to sit in row two. So, Charlie, go ahead.

Charlie Muir-Sands
Analyst, Exane
Q

Great. Thank you very much. Two questions me please. Firstly, thank you very much for continuing to give some geographic disclosure around profitability. The DACH margin clearly came down and the rest of Europe margin remains stable at around zero last year. Can you talk though about what is remaining in that gap because you said the DACH region had a higher level of discounting maybe that was just Q4 but is the reason still that the rest of Europe is that profitable just that you are discounting more outside of Germany?

And then the second question is I wonder if you could give us an update beauty. I think it's been running about nine months now. Are you seeing good basket size, contribution and good traction overall? Thank you.

Birgit Harderer
SVP Finance & Indirect Procurement, Zalando SE
A

On the first question, the picture hasn't really changed. So the differences that we typically see between DACH and rest of Europe is the maturity like the different level of maturity of the different markets, right? So DACH with three fairly mature markets, rest of Europe with over 10 less mature markets. And so this is also why you see the biggest gap when you look at the margin or cost profile resides in the marketing cost line. So there in rest of Europe we have a much higher spending level than compared in the more mature DACH region.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yes. On your question on beauty I think we continue to see good progress on that category. A big focus right now is to really make sure that we built the right assortment because beauty is really is of a different market that we need to get into and build the same quality of relationships that we have with our partners on the fashion side. So I think that is right now the biggest focus, and we continue to have high expectations for the category long term.

On the other hand, you also have to keep in mind when you launch a new category on the business that already does €2 billion in GMV per quarter, there is some work to be done before it really makes a notable impact on the overall growth rate just because the numbers are so large. And so I think it will take a while, and we also need to be patient but really working closely with the brands and getting the right assortment in place. That's our main focus right now.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Charlie – Simon?

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Thank you. Simon Irwin from Credit Suisse. A couple of questions. First of which, you talked about de-averaging and profit protection, is returns kind of high up there in that list of things you'd need to address and how do you do that? Is it through kind of an individual credit limits and the way that you offer financing etcetera? Maybe you could just talk around that.

And the second is on same day. We have very mixed views from different retailers about their experience with same day. Some say customers don't care when I compare to pay for it. What's your experience of same day?

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Sure. On the first topic of return rates, of course that continues to be a big focus. As you know, returns is a sort of important element of our proposition. I think the most I don't see returns specifically primarily in the context of de-averaging. I think the biggest driver that we really have is our work around sizing and I think when we come to the customer section, we'll also have the opportunity to give some more details on how that work is going.

But I think that is really something where we see promising results with all the data that we are collecting and the customer feedback that we are collecting to make sure that we really minimize the size related to churns because that's also the part that is hurting both the customer because it's inconvenient, order the wrong size and it hurts us because we have to pay for the shipping. So, I think that's really our biggest initiative on that side.

With respect to same-day, what we see in our data is that it is important. We see that customers that we upgrade to same-day have better satisfaction, have higher repurchase rates. We also think that same-day is an interesting part of the Plus proposition. I think for the fashion category, typically it's maybe not as much of a must-have as, for example, I don't know, groceries or some of these more immediate categories. But I think there is a set of customers that really find it exciting to order something and then instantly be able to receive it. So, we continue to think it's, going forward, an important part of our proposition, but maybe not as important as in some other categories.

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

So, regarding the time, we're moving slowly into that. So, perhaps two more questions.

[indiscernible] (00:40:15)

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

Can you go to David? Next rule for you Andreas and Volker, first row, but also outside. Yeah? Yeah, yeah, yeah. We have three more sessions to learn. Yeah? Can you please wait, [ph] still the microphone is not yet on (00:40:38). Try again, please. Yeah.

David Schneider
Co-Chief Executive Officer, Zalando SE

A

[indiscernible] (00:40:50)

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

Well, we need to go back to...

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Okay. We need to throw it. Yes?

David J Gardner
Analyst, Morgan Stanley & Co. International Plc

Q

Thanks. David Gardner, Morgan Stanley. Two questions. Just on the guidance, given the increasing shift to marketplace, can you talk through the drivers of the negative working capital guidance? And secondly, so the CapEx also explicitly excludes M&A. So, could you just talk about where you would consider inorganic opportunities and how you're thinking about deploying capital organically versus inorganically?

Birgit Harderer
SVP Finance & Indirect Procurement, Zalando SE

A

You mind repeating your first question? It was a little bit tough to hear here.

David J Gardner
Analyst, Morgan Stanley & Co. International Plc

Q

Oh, sorry. There is guidance for negative net working capital, just given the shift to the marketplace. Can you just talk through the drivers of that?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

Do you want to take the first one or...

Birgit Harderer
SVP Finance & Indirect Procurement, Zalando SE

A

Yeah. So, on negative working capital, what you see with the Partner Program is that, obviously, we carry less inventory. At the same time, we carry less accounts payables because we don't have that merchandise where we have extended payment terms, so in a way, that's [ph] awash (00:41:53). Yes, we do offer obviously invoice payment within the Partner Program as well. At the same time, though, we're also getting more efficient in our overall inventory or working capital management, right?

And so, as we've said in prior periods as well, we do see continued efficiency gains in working capital but we're willing to, in a way, reinvest that through different payment methods, mostly different payment methods, into our customer proposition. And I would think about the Partner Program investment in a similar way.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

With respect to the second part of your question, organic growth versus inorganic growth. I think the reason why won't include M&A into our CapEx guidance is that it's just very difficult to plan, right? I mean, opportunities may come up or may not come up, so that's the reason why it's not included and we wanted to just point that out.

To us, I think both are viable options. Organic and inorganic growth, but as you know, as really our primary focus is on the organic growth because we think there's still so much to be done in really making our proposition better and growing the Partner Program and really focusing on managing this platform transition that very clearly, that is number one priority.

Unverified Participant

Thank you. So, looking at the time, and knowing that we're still having three sessions where you can ask still a couple of questions, I'm going to suggest that we're now going to do a short break. And please be back at – sharp – at 12 o'clock. Thanks for your attention.

David Schneider
Co-Chief Executive Officer, Zalando SE

Thank you.

All right so, let's move from this rather short term performance view to actually what's most important for us, the long term view, where we actually see our company heading the next five years.

If you look to the next five years, there's actually three key message that we like to discuss with you today. Number one, we very much believe in this huge opportunity of building the starting point for fashion. This one destination that customers gravitate towards for all their fashion needs. Number two, now, if we build a starting point, we assure that our platform of projects actually key to scaling our business. That's what Robert will describe in a little bit. And number three, our platform will translate into quite an attractive financial profile in the long run. And that translation to numbers then, Rubin is going to make.

So, if you asked me 10 years ago, where I'd see the company today, I would have made a huge understatement. I would never have guessed that we celebrated our [ph] 10th (00:44:36) anniversary with our teams on the [ph] airfield in Tempelhof (00:44:38). Would also not have guessed that we hold this Capital Markets Day here in this newly built campus, and for me, the coolest office in Berlin. And I think that's quite characteristic for us, that in a long timeframe, we underestimate actually what we can do. And that's why this quote from Bill Gates also resonates very well with us. He said that, people underestimate what they can do in 10 years.

However, there's also moments where we don't quite reach our targets. Now, we had those difficult moments. 2013, for example, was one of those. Also last year, Q3, we had a highly irregular season. But those short term challenges they didn't keep us from delivering like an extremely successful decade for the company.

So, for us it's actually extremely important to take this long term view and have like a strong vision, a strong picture in mind, because that's something where we draw a lot of personal motivation from. And we also believe that it's the right thing to do from a shareholder perspective to really create this long term value.

So, before we look ahead for the next five years, let's also very quickly reflect on the past five years, because I think we've built quite a strong foundation for the starting point. Now, for example, we have grown our customer base to now 26 million customer. We have doubled them in those five years' time. Now, we have not only grown the customer base, the customers are also a lot happier. We are at an all-time high in our Net Promoter Score. So, what do happy customers do? They shop more. So, we increased our GMV per customer. And while doubling the customer base, at the same timeframe, we have actually triple our revenues from €1.7 billion to €5.4 billion.

So, if you look at the next five years, we see this huge opportunity to really become an indispensable part in our customers' lives and also in the business from our [ph] concession (00:46:56) partners. For customers, we aim to be this one place to be whenever she thinks of fashion. And if she's looking for a [ph] concrete (00:47:04) shoe in size 38, if she wants a new jacket, if mahogany is her new favorite color, if she's excited about the release of a new sneaker, that's exactly where we want to be. In any of these moments, we want to be this very first place the customer goes to. So, we aim to be that starting point for fashion. Now, this is not entirely new. We have worked on that for years now and we are already on that way. It's rather about doubling down on that strategy and in our customers.

So, while I keep mentioning this word starting point, yeah, also to make it clear like what we actually mean by that. So, the starting point for us is the destination where customers actively naturally gravitate to, and whenever they want to shop a certain product or service. And you might know that from your own behavior. And if you have a Spotify app, that's your starting point whenever you want to listen to music. If you have Netflix, then that's your starting point when you want to get entertained. And I think those behavior is especially pronounced in an app world. How many apps do you download? How many apps do you actively use? So, we clearly aim to be one of these few apps. We aim to be the fashion app. And so, everybody who downloads that app, whenever you think of fashion, you should pull out your phone and hit that orange triangle.

So – and then, we also see that this general trend, it also holds very much true for fashion. In fashion, we know that people buy across many different brands. We see it in our own [ph] data (00:48:46). Almost every second order contains more than one brand. A female customer shops, on average, 13 different brands throughout the year with us. So – and if you take that jointly, like a general trend, few destinations and natural fashion behavior, I think it's super logical that people will not have 20 different apps for individual brands or occasions. Now, they're looking for this one place they go to.

And then, the good news for us is like if we want to build this starting point, we are already in a very leading position. Now, we are already top of mind. Whenever you asked someone in Europe where they would buy fashion, we're already way ahead of any competitor. Now, for example, in our DACH region, our unaided brand awareness is 2.5 times higher than the next best competitor. And we had 3 billion visits in 2018. So, that makes us already like the most visited fashion destination in Europe. But in, more importantly, customers come to us directly. It's not only that the traffic is increasing, but the share of direct traffic has gone up from 70% to, by now, 90%. And I think those numbers, they show quite clearly that we're already on that way of becoming the starting point.

All this is especially pronounced if you look at the usage of app. I mean, all customers clearly gravitate towards app. App has become our bigger sales channel already. By now, 44% of our GMV. And if you want to take an indicator for the future, look at young customers. Customers below 25 years old, they're already at 60% of their purchases through app. And then, those customers who pick the app, they're extremely engaged. They visit more frequently, they spend more time, they look at more products, they shop more, have 30% uplift in app users in GMV, and they're happier 8 points more in NPS.

I think if you look at all this, at the general consumer trends, at fashion behavior, and at our own data, it very clearly points in one direction that people are picking that one favorite place for fashion, and that we are in the best position of actually building the starting point.

But now, all of this is not entirely new. We had those ideas and those hypothesis already years ago. And we invested quite heavily into this. Just now, we see very clear proof points that this is actually happening and progress. Our early platform approach was a bit ample. Like, we tried out different customer propositions, we invested in different B2B services. So, now, it's rather about taking all those learnings and bundle those learnings, all our efforts, our investment in like one clear joined goal, that's become that starting point for fashion.

So, in order to do this, to realize this, I mentioned that our platform is quite crucial to scale our business. That's why I would hand over to Robert to explain a bit more how we'll aim to build that.

Robert Gentz

Co-Chief Executive Officer, Zalando SE

Yeah. Thank you, David. So, how do we achieve to become the starting point for fashion? We believe the only way is with a platform strategy that really aligns our interests with the interests of fashion brands, that enables them to help us to build the proposition for it. [indiscernible] (00:52:29) So, we believe the only way is to build a platform that [ph] straightly (00:52:33) that aligns our interest with the interests of fashion brands, that enable them to really help us build the proposition that qualifies for being the starting point for fashion for our consumers.

And ultimately, what customers want is like a flawless selection at one single destination. So, when they think of Zalando they can think of – like, if it's not on Zalando, it probably doesn't exist at all. And [indiscernible] (00:52:56) is when the ordering is as easy and convenient and fast as possible, as it possibly really can get. We'll discuss this customer proposition in more detail in our later section today.

But this degree of flawless selections, strong convenience, we can only offer by enabling very strong partnerships with our fashion brands, by connecting their warehouses, by servicing our warehouses to them, [ph] by – even connecting their offline stores first (00:53:19), by making them feel very comfortable to offer the entire storefront on Zalando, by putting them into the driver's seat of their business, putting them into the driver's seat of their brand on Zalando.

And we do that by giving our brands access to European digital consumer. So, more than 3 billion visits we had on Zalando in last year. 3 billion visits that are interested in fashion, highly relevant to the fashion brands. And by working with us, the fashion brand can easily focus on its core competencies, like building beautiful merchandise, driving its brand. And for the rest, they can really leverage our infrastructure, our reach – consumer reach, our expertise and technology, and our [ph] e-comm (00:54:05) infrastructure.

And we are then really in a sweet spot. So, the platform where everybody invests in. So, customers invest in the time, share their profile, tell us something [indiscernible] (00:54:19) to learn more about what they like in fashion, what they don't like. [ph] Grant investor (00:54:23) resources because it's the ultimate gateway for them to driving the digital business in Europe. And the more customers invest of it, the more brands invest into it, the more powerful our platform will get.

So, as we service our assets of consumer reach and technology to the brands, and in the same time, we also limit our inventory risk. So, our platform strategy is about creating win, win, win situations; wins for the consumers and customers; wins for the brands and wins for us.

So, we have been driving this deep transition of our models now for few years now. Then, 2018 was the year where we achieved a number of very important milestones. So, first, like our partner [ph] we're going to (00:55:09) reach the biggest scale in absolute terms and crossed more than €0.5 billion in GMV. So, now more than 10% of the consumer demand which is, of our platform, is actually fulfilled by the Partner Program.

Our Zalando Fulfillment Solutions more than doubled its a share of our Partner Program since 2018. So, more than 25% of the items of our Partner Programs are shipped out of our warehouses, a better unit economics for our partners and greater customer satisfaction and brands still owns this business.

Our Marketing Services, ZMS, start to get heavily used and frequented by the brands. So, brands increasingly buy the visibility in our platform, they engage with us to drive more traffic from outside on their brand's destinations of Zalando, and they use as well our [ph] influencer service solutions (00:55:57) to actually tell their brand stories to the relevant customers.

In 2018 alone, our ZMS has grown by more than 60% year-on-year. And now, since we – as we'll optimize [ph] this product in social marketing and more (00:56:12), just in January alone, they have grown again 75% year-on-year. So, it continues to accelerate now.

Maybe even more important, 2018 was a year where we made big, great progress in solving the conceptual questions of how to scale a successful platform business on Zalando. As we're actively disrupting our own wholesale model, getting the scaling of the platform, a process very, very crucial to us.

So, and in the growth of the Partner Program, we have encountered three major challenges which, now, I think are resolved or where we have a clear path of how to resolve them going forward. So, first, the Partner Program fulfilled orders that are not fulfilled by our warehouses actually yielded a lower customer satisfaction than our own wholesale orders. This has now been resolved through a very strict performance management with our partners, and obviously as well with the scaling of ZFS where it really comes out of our warehouses. So, now the NPS of Partner Program and wholesale is on very similar levels.

Second, our Partner Program has lower profitability than the wholesale business on a GMV basis. Now, we target similar profitability on a GMV levels between wholesale and Partner Program as we continue to bundle like very attractive services, B2B services such as Fulfillment Solutions and our ZMS into this proposition.

And third, we are facing the challenge the scaling of Partner Program, obviously eats into the profitability of our wholesale business. So, we ship less items per order. And now, with the scaling of ZFS, we have a solution which enables both. So, it increased the profitability of our partners and, as well, it protects our wholesale business. So, going forward, this will reduce the negative impact it has on our unit economics. So, three major challenges, and all of them, we've either solve or have it very clear how to solve them going forward.

Speaking of Fulfillment Solutions, so we have plenty of capacity already in the process of building. So, our warehouse infrastructure of the 11 warehouses alone by 2021 will allow for the fulfillment of €12 billion GMV. But it's not only this unmatched scale of our footprint, this dense network also improves our convenience proposition to become increasingly fast to our customers. So, by 2020, we will have a share of 30% next-day orders. So, up from about – lower than 20% today.

So, no single fashion brand has such a network and no other dedicated infrastructure tailored to fashion allows for such a coverage in Europe. And this is what we are opening up increasingly to the fashion brands in order to drive their digital business in Europe.

Our Marketing Service (sic) [Marketing Services] (00:59:23) now have developed into the ultimate gateway for our brands to grow on the platform and drive their brand communication. And beyond the organic visibility of our rents, we enable them to connect directly to the Zalando consumers through ZMS. Over the past year, this business has grown very substantially. So, several hundreds of campaigns from our fashion brands are live every – like every single day at the same time on all – across all Zalando touch points and drive traffic to the brand's destinations on Zalando.

And over time, we added a lot of different services on the marketing value chain, where we increasingly we can make difference for consumers and, as well, for brands. So, for example, our Influencer product, Collabary, here we understand better than anybody else of what kind of fashion audience an influencer has, [ph] enterprising (01:00:17) campaign of which kind of campaigns to engage them for.

So, on Collabary, we have more than 5,000 in fashion influencers across Europe and we have provided coverage of more than 600 million followership on Collabary. And in Consumer Insights, another product, we provide brands with unparalleled insights into benchmark performance in Zalando. for example, how they do in the organic searches of Zalando.

But even more, we're as well building in data ecosystem that really enables them to – enables the brand to build a strong business based on our data insights. So, for example, one – recently, one big [ph] auto (01:01:00) brand designed new styles for the upcoming season in summer only based on our data insights that we've provided them with.

And probably, most importantly, we'll bring this all together in huge holistic large scale campaigns [indiscernible] (01:01:15) So, for example, Under Armour last summer engaged a European-wide female [ph] sports-themed (01:01:22) customer audiences in their 20s to increase the awareness for Under Armour. So, they reached with us 37 million unique female users and generated a great marketing return [ph] on invest (01:01:36).

So, I think, in summary, I'd like to sum it up. So, hundreds of our top brands are loyal customers of our ZMS services and a large and increasing proportion of them really drive their business, optimized their visibility on Zalando on a daily basis. So – and therefore, we are very, very convinced that ZMS will be a major part of the monetization of the platform going forward.

And with that, I will hand over to Rubin who will now translate you all this into the financial numbers.

Rubin Ritter

Co-Chief Executive Officer, Zalando SE

Okay. So, let's talk about some numbers. And what I would like to do in the third part of the presentation is really to explain to you how the platform transition can help us to build a superior business model in the long term. I think, like any big business transition or transformation, also this one has its costs and we have talked about some of that cost in sort of the first presentation, in the last earnings call. But this is really to bring across that we are convinced that the long term benefits will by far outweigh these costs. The long term benefits are increased scale, increased market share, and a really attractive margin and cash generation at scale.

So, this page in one form or the other, has been, I think, in every single investor presentation I have done over the last nine years. And I'm sure many of you know it. Sometimes the market is in the square and sometimes the market is the circle. It doesn't really matter. The key message is really to bring across how small we are compared to the opportunity that we have ahead of us. And I like this page actually most of all the pages because when I prepare for these sessions, I think this is the one that always also creates clarity in my mind that, really, there can only be like one number one priority goal for us, which is capturing market share and capturing growth as long as the window of opportunity is still there.

So, let's look at the opportunity. The overall fashion market in Europe is forecasted to grow to a level of more than €450 billion in the next 5 to 10 years. So, I think that's a big enough market. Compared to that, we are still tiny, like 1.5% market share.

Secondly, the online portion of that market is forecasted to continue to grow to more than 25% online share. That feels like a high number, but if you compare it to other consumer categories, it's actually not that high. So, consumer electronics in the U.S. already is above 30% and it's forecast to go above 40% in the next five years.

We have said before that our own ambition long term is to serve more than 5% of the overall European fashion market, which would correspond to about 20% of the online market. Now, why do we think that is feasible? I think there are two ways of explaining it. The first way is to look at other online aggregators and the market share that they have been able to achieve. Because, as David explained, we really want to be that online aggregator for fashion in Europe.

So, for example, 80% of hotel bookings online in Europe happen through Expedia or Booking.com. About 50% of the online book sales happened through Amazon. We know that Alibaba, in the Chinese online market, has a share of about 60%. So then, that gives you an ideas of how high some other of these platforms are aiming. So, I think, in that context, aiming for 20% of the overall European online fashion market doesn't seem out of reach.

I think the second way to explain it is actually to look at our own numbers. And as you know, we have already shown that we can reach a 5% market share of the overall market which we have already achieved for shoes in the DACH, which corresponds to probably a 25% share of the overall online shoe market in the DACH region.

So, this continues to be really high ambition, but I also think it's feasible. But we also know there are certain things that we really have to get right if we want to get to such a scale in the future. And those are the two things that David and Robert talked about. So, the first one is really to make sure that we are the starting point, that we are this destination that consumers automatically gravitate to whenever they want to shop fashion.

What does that mean financially, though? Yeah, so to just give you one example, we talked about how we already have more than 26 million active customers. That is already almost 7% of the European population. We are serving them with a share of wallet about – of about 25%. So, if we really are successful to build these deeper relationships and take the share of wallet up, that already yields quite some significant growth potential in the future. And we will need to achieve that if we want to come to something like 5% market share overall.

The second thing that we have to get right is really this platform transformation. That's what Robert explained. Because this really yields the much more scalable business model. Why is that? Because it creates very clear incentives and a very clear and efficient separation of tasks. The brands get in the driver seat, they get to do all the fashion, they get to do all [audio gap] (01:06:48), they get to do all the merchandising. And we really focus on those parts of the ecosystem that are highly scalable, reach technology, logistics infrastructure.

Now, what are some of the important milestones on this way towards a sort of our long-term ambition? We think there are two that I would like to point out. The first one is we want to grow to about €10 billion in GMV by 2020. I think that's a number that we also have talked about previously and that we continue to aim for. And then, we really want to take the business to a scale of about €20 billion by 2023/2024. So that means, we actually intend [audio gap] (01:07:30) the scale of this company in the next five to six years. I think there are a few companies in Europe that have this level of ambition to grow at such rates and already at such scale.

Now, on the journey, how will the business model mix evolve? So, we think that about 60% of the volume, equate to about €12 billion, will be through wholesale which is our current core business. We will continue to grow in order to reach this target [ph] that is set to (01:07:57) more than double the scale over the next five to six years. But, as Robert explained, we expect the Partner Program to actually grow faster because of its scalability to about 40% of our business. Right now, at about 10%.

Now, as you know, the high share of the Partner Program will mean that also GMV and revenue will be more different in the future because for the Partner Program share, we only account for the commission. So, we expect €20 billion in GMV to translate roughly into €13 billion in revenues, with a growing share of that coming from commission income, ZMS fees, and ZFS fees.

That also means that the CAGRs are going to be different. And we already hinted at that in the guidance today. So, we expect GMV to continue to grow at 20% to 25%, whereas revenue over the next five years will probably have a CAGR between 15% and 20%.

Now, building all of the scale, of course, also has a purpose of building scale now and then being able to enjoy the benefits of scale in later years. And I think that is already today something that really differentiates us from our online fashion pure-play competitors, our ability and willingness to invest today into the scalability of our business and to have the benefits sort of in the years to come.

Essentially, all parts of our business are a scale game. And so, reach and customer acquisition. David already talked about the vast reach that we have created in the European market. Now, think of a €20 billion scale, that means we would have more than 40 million active customers, that's more than 10% of the European population and aiming to serve them a really high share of wallet.

When we come to that stage, obviously, we will become even more interesting for our brand partners. So, already today, we have a really special partnership with them. What if we managed to get to such a scale, then imagine how really we'll be the number one digital channel to the European consumer.

Data and technology clearly is a scale game. Scale gives us the ability to really invest like nobody else in technology innovation. Scale gives us access to the biggest pool of data that the European fashion industry ever has seen. And logistics, I think it's super clear, over the last years we have invested a lot of money, a lot of CapEx into really building the number one fulfillment infrastructure for fashion e-commerce. And if we continue to do this, we believe we build an asset that the entire fashion industry can rely on.

We think that scale will result in a [ph] bigger resilience (01:10:33) of our business model, but also more attractive long-term margins. And I think this is a page – I think you will find this stage interesting because we will visit the discussion around target margin. In the last years, always the question came up what does the Partner Program, how does it contribute to your target margin? How does it change your target economics? And we have not answered that question in great detail because we always felt the Partner Program is too small, but we think now it has reached the scale that we can maybe give some more disclosure on this topic, and it will maybe help you to better understand what we are trying to achieve.

First of all, I have to make one big disclaimer that this is a target model discussion, right, so we are talking about the profitability potential of our business once we reach something like a steady state, so, for example, once we start to grow in line with or slightly faster than the online fashion market. It is not realistic to achieve a margin like this when you are still continue to outgrow the market by a factor of three or four.

Okay. So, with that disclaimer, let's take a look at some numbers. So, first, big part of our business: wholesale. We expect the wholesale margin in our target model to be between 6% and 8%. That is slightly lower than the number that we communicated in the IPO. Why is that? It's really the impact from this transformation, that driving a business model where wholesale is not 100% but only part of the business leads to some complexities for this wholesale business, for example the impact on the basket that we already have discussed.

The second business model comes into play which is the Partner Program. We expect this to have really high target margin of 20% to 25%. Why is that? First of all because it's a commission income. So, the commission that we book is actually – has a really high gross margin. Secondly it's because of the scale ability of this business model that we talked about. And it's also because of the high profitability of some of the additional revenue streams that will come into this, for example Robert already talked about our Zalando Marketing Services.

On a Group level, if you take those two together, that would lead us to a target margin of 10% to 13%, so I think a very healthy double-digit target margin level. The negative effect of the transformation on wholesale will be overcompensated by the positive effect of bringing a more scalable business model into the mix. I also would like to point out that compared to what we discussed during the IPO, of course, one great benefit of this is that we will be able to enjoy this target margin on a much higher revenue base because we just continue to grow the business for even longer time if we go for this €20 billion target picture.

Now I quickly would like to point out some of the key assumptions that have gone into this matter. So, number one is for the purpose of this model we have assumed Partner Program share of about 50% of GMV. The reality is that in the very long term, we don't really know what exactly it will be. It could be 60/40; it could be 40/60. The reality is also in that model it doesn't make the biggest difference because in terms of the profitability relative to GMV, the two models actually turn out to be similar.

The second assumption, ZFS share, we forecast at about [ph] 75% (01:13:53) of the items shipped through the Partner Program. That is pretty high, but we think the model is really proving to have great benefits, as well it benefits of our customers. It benefits our brand partners because it makes their fulfillment more feasible and cheaper because they get to leverage our scale. And for us, it mitigates some of the negative impacts on our wholesale business. Assumption number three is that we think ZMS can be a really big part of our business in the long term. We estimate these revenues to be at about 3% to 4% of GMV and we think this is a really highly profitable revenue stream which I think is backed up if you look at many other marketing platforms that you can see. The fourth assumption is coming back to scale, that we will see operating leverage really across all cost lines and fixed cost progression. I think that's quite clear. And last, but not least, if you want to translate this into cash flow, we would assume working capital to be broadly neutral and CapEx only slightly above depreciation and amortization because [indiscernible] (01:14:56) continue to grow with the online fashion market.

Okay, to summarize this, maybe to go to the cost lines where you see these arrows. So, in getting this target margin, we assume gross margin to be higher compared to today, mainly driven by the nature of our commission income and ZMS income. We expect fulfillment costs to be around similar. We will continue to invest into convenience. We'll also continue to see [ph] sector cost (01:15:24) going up. That's also baked into this but we also will have some additional revenue streams that don't have any logistics costs, for example, the commission income or ZMS fees.

Our marketing costs, we think long-term we'll continue to see operating leverage. I think as we have seen also in the last years as our active customers grows and gets more and more active that makes our marketing more efficient. [indiscernible] (01:15:48) expenses we will see [ph] this scale (01:15:51) benefits and I think here also we come back to something I said earlier in the earnings call that going forward we put really high emphasis to make sure that our business really scales faster than our cost base.

This was a lot of information? Should I repeat it? No? Okay, great. So, we have talked about the target margin. Now really to underline this is not something that will happen sort of next year or the year after or the year after but really to talk a little bit about our transition towards the target margin, how do we think that conceptually. So, in my mind there are phases. The first one we call the transition phase where really most of that reshuffling towards the platform business is happening. So, that will be sort of the next two, three years. In that time, we expect to continue to grow 20% to 25% of GMV. We expect a margin level somewhere between 2% and 4% which is driven by the continued investment into that strong growth and also the adverse effects on the short term that we see for managing this transformation.

From a cash perspective, we expect to be cash flow negative driven primarily by the CapEx which we expect to be between 4% and 5%, also driven by continued investment into ZFS and [ph] digital growth (01:17:05) of our wholesale business.

After that, we want to continue to grow fast. Of course eventually growth rates might start to come down. So, after this transition phase that's actually where we would expect then margin levels to increase as especially the benefit from ZMS and the commission income starts to kick in and starts to have a bigger and bigger effect on the P&L. And then so the third phase, someday in the future we would expect to reach that target model. However, in combination with the growth that is roughly in line with the market.

Now, obviously these are big targets. There are many things we have to get by to get there. There are many exciting projects that we want to work on. And in that context, we actually discussed and agreed with the supervisory board to extend the management board in order to have even more execution, even more expertise in that group. So, going forward, Robert will be focused on marketing and sales, which was also his focus in the very early days of Zalando. David, that's not a very big surprise, he will continue to focus on our assortment and continue to work with our brand partners because that is such an important part of our business. I will start to focus more on strategy and long term projects, so, I'll step a bit away a little bit from the very operational mode and get more into a long term mode.

And we'll have two new members in our team, one will be Jim who's sitting in the first row in the red sweater. You will also have the chance to meet him over lunch and you will also see him in the customer section which comes next. He will join our team as CTO. We think it's really important to have his technology and product expertise in our team. And then the fifth member will be David Schröder joining as CFO. He is like whenever we talk about our logistics network, so, he's the main driver behind that over the last nine years. And we really think he has proven that he knows our business extraordinarily well and this is why we think he will be able to really help us to also steer our business well from a financial perspective. We're excited to start to work in that setup as of April 1.

Now, maybe to, at the end, summarize again what we have said in this session. We started off by saying our vision is really to be the starting point for customer, the destination that all the customers, the app that all the customers naturally gravitate to when they think of fashion.

Secondly, we have explained that the major building block of getting there is the platform transformation and we have talked about the building blocks, Partner Program, ZMS, ZFS. And then we have closed it up by explaining how that really will lead into a very attractive long term business model characterized by high margin, double-digit margin and high-cash generation at scale.

We think that this is the right path forward. This is the best path to create the most value for customers, the most value for our brand partners and the most value for our shareholders in the long term, and this is why we're really excited about this direction.

And with that, we can come to your questions.

QUESTION AND ANSWER SECTION

Patrick Kofler A
Team Lead-Investor Relations, Zalando SE

So, we are going to open for questions. The rule is still the same [indiscernible] (01:20:32) we'll see when the queue comes up. So, you got lots of information on [indiscernible] (01:20:38) so we'll start directly the Q&A with the row number 2. Please state your name and the company. Go ahead.

Charlie Muir-Sands Q
Analyst, Exane

Yeah. Thank you very much. Charlie Muir-Sands from Exane. I just wanted to get back to your business model and probably doing some of the math on the back of a [ph] five packet (01:21:00). But the way I interpret it was that you expect to get say roughly €12 billion of revenues from wholesale, 60% of the €20 billion...

Rubin Ritter A
Co-Chief Executive Officer, Zalando SE

Of GMV – €12 billion of GMV...

Charlie Muir-Sands Q
Analyst, Exane

Yeah. So, that's the wholesale model, so that would be €12 billion of revenue, so, that €1 billion in revenue is from everything else.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Not quite...

Charlie Muir-Sands
Analyst, Exane

Q

And that's on €8 billion of GMV, which is only 12.5% margin, not the 25%, and your fulfillment costs are clearly more than 12.5%. So, I just want to sort of understand that.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

So, the important thing of GMV to keep in mind is that as it is measuring what really customers are spending, it includes VAT, right. So, €12 billion wholesale translates into rough – GMV translates into roughly €10 billion in revenues. Most companies use that definition and it's also helpful because when you talk about market share, right, and that's the logic that we use, the market also includes VAT.

Charlie Muir-Sands
Analyst, Exane

Q

Right. And sorry, so those margins at the bottom of the page you talked about with percentages of GMV [indiscernible] (01:22:07)

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

[ph] Those are percentages of revenues (01:22:09), like our adjusted EBIT margin, that will also not change going forward is sort of as percent of revenues. So, when you look at it as percent of revenues, there is a big difference. And as I try to explain that is primarily because of this commission mechanism, that you get the commission and you don't really have any cost associated to that. So, the gross margin is really high and that leads to very high margin relative to revenues. If you look at the two relative to GMV, the difference is much smaller.

Charlie Muir-Sands
Analyst, Exane

Q

And then second question is about the CapEx, a year ago you were talking about CapEx sort of 6%, 6.5% of sales. Now you're talking 4% to 5% and not just this year but sort of the next few years. Can you talk about – is this a structural level of efficiency you've found relative to your previous budgets, or is this about phasing?

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

I think there's probably two effects. One is really that we have – because of these high CapEx levels we have put more work into figuring out how we can build this network in a more efficient way. So, I think Birgit mentioned also in this earnings call this morning that we will have for example inbound distribution centers which will increase the turnover that we have in the sort of fulfillment center and, therefore, make our network more efficient. So, that is something that we have incorporated into our planning.

We have also adjusted the phasing a little bit because we felt in some areas we are too conservative to maybe have some capacity coming in too early. And I think a third effect is that we're just in the process of doing this long-term model. We have also made our long-term CapEx planning maybe a bit more granular. And as a result, we come out slightly lower.

I think, in general, our philosophy is still to continue to invest into this footprint because we think it's a great asset and it's a great differentiator. But we think it actually will be a bit cheaper than we initially thought which is good.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

[indiscernible] (01:24:04) Magnus first.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)

Q

Okay. Magnus Råman, Handelsbanken. Perhaps I can get back to the initial part of the presentation with the young [ph] active (01:24:15) customers that you mentioned being positive more – visiting more frequently, ordering more, et cetera. Could you also perhaps shed a bit of light on the profitability of those younger customer cohorts if they order more frequently? Is the average basket size of this customer audience lower, returns, rates, is it higher et cetera?

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

Yeah. So, we're going to share like some of the later cohorts analysis in the session right after where we not single out on apps or something but like in terms of like last year.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)

Q

Okay, so, a cliffhanger on that one. And then on the Partner Program, you mentioned here that the share of ZFS is now 25%, [ph] input (01:25:03) 75%. Could you perhaps describe how come you believe that such a large part of your partners would like to utilize your fulfillment services since larger brands should possibly have a quite large fulfillment footprint themselves and be willing to utilize their own?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

Do you want to take that?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

I can take that. By the way, we also covered that quite in detail in the session, but to give you the short answer for brands, it's a huge economic benefit, A. Because imagine the Partner Program, how it works. If you have an order from a customer, you have several items, and then the partner has to ship one or two of them. So, it's a lot of like single-item shipments, and the logistic costs relative to that order, very high. So, now if you move that in into our own infrastructure, we bundle the package. So, suddenly the partner, they only have to pay maybe a third of this logistic spend, yeah.

So, for them, it's highly more attractive and we've experimented it with partners actually. We have, let's say [indiscernible] (01:26:12) partners, for example. We started in a Partner Program model but low price points are quite challenging in that model.

So, now they moved into ZFS, so that makes it extremely more attractive for them, it gives a lot more reason to actually then invest additionally in wide assortment, better availability, or even ZMS. And I think just to complete the second part, many brands for them they very actively use our infrastructure because the capabilities are a lot further along than their own and that's why we even start offering that, we're even able to ship then for example to their own e-comm so they can actively use our capabilities.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)

Q

So, for example, would Massimo Dutti be prepared then to ship in [indiscernible] (01:26:58) Massimo Dutti parcel?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

I mean it's [indiscernible] (01:27:05) Massimo, for example, [indiscernible] (01:27:08) two different models. So, all of the younger and lower price points moving to ZFS. Massimo is actually in pure Partner Program. So, that works because the price points are higher, so, economics are better and of course they might also care more about branding. But even for them, I think they also take all those learnings we do with the other brands. So, it's also in quite [indiscernible] (01:27:32) discussion if that's actually even though better model for them to go.

Tushar Jain
Analyst, Goldman Sachs International

Q

Yeah, hi, this is Tushar from Goldman Sachs. Two questions, just trying to understand within your assumptions of GMV, how much cannibalization impact are you taking on the wholesale side of the business given only the 50% of Partner Programs are incremental orders? I'm assuming the rest is cannibalizing the wholesale channel?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

Sorry, I didn't understand the question.

Tushar Jain
Analyst, Goldman Sachs International

Q

So, I'm just thinking of the Partner Program [ph] increases (01:28:04) so dramatically. Do you see a impact of cannibalization happening in the wholesale channel? You need to adjust your purchasing because people might be more – I mean more skews are being listed on the Partner Program. They're picking up skews on the Partner Program and not actually picking up the skews from the wholesale side of the program. [ph] Does that impact gets in or no (01:28:23)?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

Yeah, I can also take that. In terms of like if you look at last year for example, of our Partner Program, $190 million is actually a backfill mechanism. So, those [indiscernible] (01:28:37) things we have already bought and the partners only ship them once we're sold out. So, that already makes up quite a proportion. Imagine those would be customers that would've left unhappy or didn't find like the size available.

In the [ph] additional styles (01:28:55), we do look at brands quite carefully. I mean we have a segmentation logic where actually you see how relevant our brands, how much incrementality do they actually add. And we have strong brands like I mean Massimo Dutti, we have Mango. In fact, in those cases where we see they add a lot of benefit. We also see still like although we have already quite a wide assortment if we add more relevant brands, we also see that this actually drives volumes. So, we see a lot of incremental value and not necessarily undermining what we have in our wholesale.

Tushar Jain
Analyst, Goldman Sachs International

Q

Second question in terms of your long term gross margin assumption that's going up. So, can you just clarify, are you expecting wholesale gross margin to go up as well or it's just incremental Partner Program just adding the gross margin development?

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

We think also in a business that grow so much in scale like our wholesale business, of course there will be opportunities to improve gross margin from – so more scale, optimized pricing, I think there are so many, many ideas. But really the big effect of course comes from the shift in business model, right. All of a sudden, that 40% of the GMV with a very high gross margin, obviously that's a much bigger effect.

Tushar Jain
Analyst, Goldman Sachs International

Q

I mean, the reason I'm asking because during the IPO, your gross margin was between 45% and 47%. Currently, it's close to 42%. So I mean, to get to the 6% to 8% EBIT margin, is it all operating leverage and the OpEx cost it is much higher than what you expected during the IPO process [indiscernible] (01:30:22)

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yeah, there would be some improvement in gross margin. We actually expect to also see that over the next years, I think 2018 for several reasons also was a bit tougher for the gross margin. Also as we discussed, of course, to invest in gross margin, to offer great prices and to invest into marketing are really to some extent the same thing, they just show up in different cost lines. So, maybe that's also something to keep in mind.

Tushar Jain
Analyst, Goldman Sachs International

Q

Thank you.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

[ph] Paul, please (01:30:51)

Paul Bonnet
Analyst, Bank of America Merrill Lynch

Q

Hi. Paul Bonnet from Bank of America Merrill Lynch, two questions from me. You assume the marketing spend to go down in the long term but some of it will have to relate to GMV on the Partner Program. So, ultimately, it means on GMV, they go down even more because in revenue they come down. Can you explain that a little bit?

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yes, if I understood you correctly, marketing would come down faster as a percent of GMV than as a percent of revenues, right?

Paul Bonnet
Analyst, Bank of America Merrill Lynch

Q

Yes, but you're assuming your long term expectations...

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yes.

Paul Bonnet
Analyst, Bank of America Merrill Lynch

Q

...that in percentage of revenues it goes down, so I mean...

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yeah, exactly. So, which is the effect, we also have seen over the last five years, right. I think five years ago we started at I think it was like 12% or something and now we are of more towards 6%, 7%. And I think that the main driver behind that is just building this customer base means you acquire new customers once but then they stay with you and grow their spending which is then not necessarily tied to marketing spending. So, if you look at the last years, we have been keeping our absolute spending roughly stable but grown our revenues and then you have this effect.

I think more recently in the fourth quarter specifically, we have increased our absolute level of spending because we thought – we saw a good ROI investment opportunities and marketing. So, you might also see some of that but really for the long term, I think it's pretty clear that we'll come down as a percent of revenues.

Paul Bonnet
Analyst, Bank of America Merrill Lynch

Q

Thank you. And second question from me, about the economics of the Partner Program plus Zalando Fulfillment Solution at present, can you let us know a little bit not in 5 to 10 years but is it kind of accretive as a package right now on a relative and absolute level?

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yeah, but I think in general we have the earnings call to talk about Q4 [ph] and like the (01:32:39) next year and I think now we really try to talk about the next five years, right. And I think there the story of ZFS is pretty clear and I think the progress we're making is really fast. I can understand that you're really interested in next quarter, so, maybe let's talk about it over lunch. But I would like – let's focus here on the five-year questions, maybe.

Paul Bonnet
Analyst, Bank of America Merrill Lynch

Q

Okay. So, in five years you think Zalando Fulfillment Solution plus Zalando Partner Program will be what? Because it's not going to be 20%, 25% in five years, right? It's a 10-year target, but we don't really have clarity over a three-year to five-year view even.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

So, for five years, the answer is yes – sorry, for the target model, the answer is yes. And I think also when you think further out, as the Partner Program continues to pick up and we see – I mean the growth rates of ZFS are just really strong, right. I mean, we already and generally we again see the share is picking. So, I think that is something that can also – will have an effect also in the coming years because, as David mentioned, it really creates this win-win for partners and for ourselves.

Paul Bonnet
Analyst, Bank of America Merrill Lynch

Q

Thank you.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Can we pass it to Volker up there?

Volker Bosse
Analyst, Baader Bank AG (Broker)

Q

Thank you. Volker Bosse, Baader Bank. Looking at your targets from a [ph] product goods (01:33:54) perspective, first, on beauty, how much beauty sales have you factored into your targets and could you share with us your first experience about cross-selling experience between fashion and beauty?

And second also, how much incremental new product segments have you factored in, for example, home accessories, what's your view on that to expand in this kind of direction? Is that part of your long-term guidance already? Thanks.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yeah. So, first of all, when we talked about market share, right, with 5% that we purposefully just focused on the fashion market, right, so they more than €500 billion -€450 billion in 5 to 10 years, that's only fashion. Beauty will come on top of that. Home accessories and furniture will come on top of that. So, I think those are opportunities to further expand our target market.

We have not included that yet because we think beauty is just too early. I mean, to be honest, we don't know how big it's going to be in 5 to 10 years. We think it can be significant, but I think it doesn't make sense now to start to forecast any market shares there. Although I think in principle, I don't see like a structural reason why we shouldn't be able to aim for similar market shares in the long term.

When I think about the sort of ambition of €20 billion, I hope that beauty will actually help us to some extent to get to that very high ambition and maybe also sort of home appliances will help us in some way at some point to get to that ambition. But in terms of the market share, we have not included it into the target market.

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Again, I can also add a bit from a partner perspective. I think beauty is like an extremely interesting case. I mean from a consumer perspective, I think it makes sense because it's very related to fashion and from an industry perspective. That's why it's also so highly interesting because we have this access to all those fashion customers and that is something that beauty brands they usually don't get because they work with other pure play beauty partners [indiscernible] (01:35:52) especially interested in actually getting that fashion angle in.

And for us it opens up I think a whole new world. We have partners like Estée Lauder, those international players coming onboard and those are also the players that are very interested for example in doing joint marketing, like ZMS for example is super relevant service for them to actually target the digital audience. So, that's why [ph] we have a fixed effect of that (01:36:17) into that calculation. But I mean this is really I think that opens up like new interesting opportunities.

Volker Bosse
Analyst, Baader Bank AG (Broker)
Q

So, have you already experienced that the cross-selling experience is working as you expected?

David Schneider
Co-Chief Executive Officer, Zalando SE
A

The what?

Volker Bosse
Analyst, Baader Bank AG (Broker)
Q

The cross-selling opportunities.

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Okay. Yeah. I mean beauty of course it's still – I mean it's fairly small in comparison to [indiscernible] (01:36:42), I mean that's the general idea. We have all those fashion customers and we know those customers. I mean we know they purchase a lot of beauty items. So, now we have to increase awareness. So, if you look at the past months, I mean it's been very quiet. I mean we have not pushed it on them yet. We actually start campaigning it for example now in April, we actually started more actively communicating. Because I mean, it's a bit of [indiscernible] (01:37:12) to get like the offer, and the assortment [indiscernible] (01:37:15) too much. But in general, I mean that's I think overall our game. Once we have that access, once we have customers quite locked in, then we can offer them more and more and get more and more of their, basically of their wallet, their overall spend for the year.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE
A

We have one more question from Dan [indiscernible] (01:37:40) row 7.

Dan Homan
Analyst, Citigroup Global Markets Ltd.
Q

Thanks, Patrick.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

[indiscernible] (01:37:44)

Dan Homan
Analyst, Citigroup Global Markets Ltd.

Q

Dan Homan from Citi. A couple questions, first of all on ZFS. I think previously you've spoken about you charge ZFS at a logistics margin rather than charging it sort of fully loaded commission basis like Amazon would do for its partners. Is that something you minded to change over the next few years if ZFS grows?

And then related to that, do you think the terms that you gave on ZFS are fairly generous to the brands? And do you think in your planning assumptions, have you assumed better terms for yourselves as you go forward?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

I can maybe start with the second. I'm not sure if I've got the first one completely right. So, for ZFS, it's not our main business. I mean we're not a logistics company generating our margin through that. I mean, of course it's an additional add-on, but it's always – it's a means. Because we think by offering that, it's a huge incentive for partners, like I said, because we add capabilities they don't have.

Economically, it's way better for them, so that incentivizes partners to actually go all-in to really show all their assortment, go into a lot of availability. So, we believe that's hugely beneficial for customers also in terms of convenience for customers and ultimately that it pays out in our platform because we do more in GMV, again more access, monetize for example through marketing. So, overall, ZFS is rather [ph] like means (01:39:19) and that's why we also [ph] tried it (01:39:20) in a way that it's attractive for partners that it actually makes sense for them to very actively invest into it.

Dan Homan
Analyst, Citigroup Global Markets Ltd.

Q

Okay. So, in your long-term planning assumptions on margin, you don't expect to charge the partners more than you are at the moment for ZFS, you can keep the commission rates or logistics rates where they are?

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Yeah, I think on ZFS I think the assumption is pretty similar to what David just explained. I mean it is earning a good margin. It's a viable business in itself but it's not I think our main way of earning money in the future especially if you – if you compared your margin profile for example on Zalando Marketing Services, right. And I think those are the areas where in terms of margin improvement, I think there will be significantly more upside as we scale it.

Volker Bosse
Analyst, Baader Bank AG (Broker)

Q

Okay. Right. And then maybe if I can just squeeze one more in the follow-up. Again, on the relationship with the brands. You've obviously gained a huge amount of scale over the last few years. When you're talking to the brands, what's the most important terms that you're trying to get from them? Is it better pricing, better cash profile, or is it availability product, exclusive products? Where do you prioritize your relationship with the brands and what you asked them for?

A

Yeah. So, for us, it's very clearly on the customer side. I mean, we say we want to be that starting point for fashion, so product access. That's one of the most important things. And I think that's also one of the biggest differentiators we have. So if we go to brands, I mean what we ask for is, yes, we want to [ph] make it (01:40:51) all relevant brands onboard, and with the brands, we want to get all the relevant styles and that's not easy. If we talk to Nike or Adidas like to really get us full access, later styles, new stuff, even exclusives. So, product access, the first priority. And then the second priority would also be around content and really create like those exciting experiences because that is also something if we want to personalize the experience more to our now 26 million customers, we need a lot of exciting fresh stories, and that's what we need.

And of course, I mean and the third, I think the economic results. I mean we aim for a model that is actually attractive for both ends. And we need – of course, we want to have our margin, but we also have to find a model that actually provides a good return for brands because I think we have a very different relationship not so much like this supplier-retailer type of thing, but it's rather like those partnerships we want to create like those situations where it makes sense for brands to actively invest into us.

Patrick Kofler

Team Lead-Investor Relations, Zalando SE

I think that it was a good conclusion of that session, also looking onto my watch and being a timekeeper here, so between you and the lunch, it's just me. Two more remarks. The lunch will be upstairs, so you need to walk up the stairs there. We start back sharp at 2:00 PM here. And lastly our management board members as well as the new ones, Tim as well as David, will be around during lunch if you have any further questions. Regarding David, if you're asking for a new guidance, don't think he's also agreed with that one as you don't get a new guidance during lunch from [indiscernible] (01:57:43) With that, enjoy our lunch. Thanks.

So welcome back after the lunch break. We hope you enjoy the variety of lunch there and also enjoy the waffles up there. Since Zalando was founded back then in 2008, one of the most important mindsets was always to put the customer into the center and absolutely first. And with next session, Robert and Jim will give you an idea how we're going to handle and how the customer development have evolved over the last years, so it's going to evolve also in the future.

Robert, the floor is yours.

Robert Gentz

Co-Chief Executive Officer, Zalando SE

Yeah, we come back from the lunch break, as well as from my side, I hope it was great. So, welcome to the second part of our Capital Markets Day. So joining me on stage is now Jim Freeman. We talked about him. So Jim joined Zalando initially like in April 2018 and prior to his work at Zalando, he was responsible for launching and scaling the Amazon Prime Video, and as well a lot of communication experiences on Alexa and Echo devices. So we are super excited that Jim is now taking over the role of our CTO as of April 1st and driving these customer propositions really to the scale that we will talk about now.

So as we explained in the main presentation, we believe that being the starting point for European fashion is the big prize to win. And we want to take a deeper look at the customer side of our strategy, focusing on very much three key messages.

First, we have made very strong progress and being the starting point for fashion for customers, which is evidenced by healthy development of our customer base. Second, that will be the starting point. We double down on our compelling customer experience and we continue to invest in them in our key areas of our proposition. And, third, going forward, we prioritized our goal of being the starting point for every – for our most committed customers over being just another fashion destination for many.

So we do this by – we achieve this by differentiating our customer proposition going forward and investing into the Zalando Plus. So let's jump right into it. We've made strong progress towards being the starting point for fashion which is evidenced by a very healthy development of our customer base.

So, as you know in the past, we have been super successful in winning more and more customers. And as we shown you already in the first presentation today, we more than doubled our active customer base since 2013. And only in the first quarter alone of last year, we added 1.3 million more active customers, which is the biggest net increase of active customers for five years. And as you know, these customers shop more and more often with us so the order frequency now sits at 4.4.

And this all is actually very much done by our ever increasing focus on customer satisfaction. So from 2013 to 2018, we've managed to increase our NPS for our customers by 40 percentage points and even on January, it has peaked another all-time high.

Last year, we shared this [ph] card (01:46:27), I mean with you for the first time and you were pleased to see that now. So today one year later, we wanted to present you with an update on that and you can clearly see that the positive trends that we discussed with you last year are very much still intact.

So in this chart, you see the total GMV per cohort per order year. And on the gray, the light gray actually shows the cohorts that we have acquired before 2014 and second on top of that are the cohorts that we acquired in the years thereafter.

So what does this chart actually tell us about our customers? So, first, old cohorts grow again over time. Once the cohort has digested the network sure enough the first year, they then grow again. So on average 5% per year. And second, the first year churn is already coming down. So last year, we [ph] told that the (01:47:22) churn in the first years for 2014 to 2016 cohorts has actually come down 25%. So I'm now pleased to actually sound like the 2017 cohort , actually their first-year churn was even 13% lower than the one from 2016.

The third, every new cohort spending is bigger than the spending of the previous ones. So since 2015, each year, our new cohort spending was an average 8% larger than the spending of the previous year's cohorts. And lastly, it was even 10% higher.

So I think this really confirms that our customer base continues to be very, very healthy and this also confirms that it does not only make sense to invest in new customer acquisition, it makes as well sense to invest into the development of our customer. So really to create deep relationships with them and become their starting point for fashion is what we focus on and this is really the prize to win for us.

So how do we define the starting point for fashion? So the starting point for fashion is, first, is ultimately the brand for this nature and service that people have in mind where they gravitate to. So when thinking about discovering fashion, getting advice, getting inspired or just buying fashion, where do people actually start this fashion journey to? So where do they go to?

And we are the starting point for fashion for our customers when we are top of mind, when we are on top of conservation, and, ultimately, as well the top choice for our customers. And we are doing great in all these areas, in these aspects of the proposition already. So we're the most known fashion brand in Europe. So, we have an unaided brand awareness of staggering 70%. In some markets, even 80%. And we're not only the most known brand, we're as well the most visited one. There's more than 3 billion visits, 90% of this is coming direct, so keeping that naturally gravitated to us.

And when it comes to top choice, our share of wallet was very great. So, at 26 million customers, which is 6% of the European population, they spend on average about €250 with us, which is roughly like 25% of the annual fashion spend. So, this is great, but it's actually far from the potential of our platform.

If you think about like how many searches when you win – searching the Internet, how many searches didn't you start on Google? So, how much music didn't you actually listen to on Spotify when you are subscribed to Spotify? Or how many hotel rooms didn't you really book on Booking.com?

So, as a platform, when you really manage to deliver on all the customer wants and needs, there's actually no reason to go anywhere else. So, you're not limited in 25%, 30%. You're only limited by 100%. So, in delivering on these reasons, why our customers would spend another 75% with us and why another 94% of Europeans will join Zalando is what Jim is now going to tell us a little bit more about.

Jim Freeman

Senior Vice President-Engineering, Zalando SE

Thanks, Robert. So, now we want to look at how do we take this opportunity we've been talking about all day long and really unlock that, What are the areas of focus we need, and how do we make this happen, becoming the starting point of fashion for our customers?

So if we're going to look at a couple of different areas where we believe we need to really continue to elevate the experience, make this happen, And we start by imagining what would our customers say if we did make it happen and what key areas would they focus on.

And first, we imagine them thinking of our assortment. And that assortment becoming so strong that they would say, if it's not on Zalando, it does not exist. Next, we think they would consider our digital experience. And here, we imagine they would say Zalando knows me and inspires me. Next, we think they would consider the convenience that we offer. And here, we imagine they would say, Zalando was so convenient, why would I go elsewhere? And lastly, we imagine they would say, no matter what my fashion need, Zalando's my one-stop shop.

So let's look at these different areas in a bit more detail. When it comes to assortment, there are three critical dimensions we consider: How complete is the offer, how fresh is the offer and how desirable is it. We have a team that's been working hard on scaling our assortment and looking for more and more ways for brands to offer their assortment through our platform. And this is really paying off.

You can see in Q4 of 2018, we scaled to over 500,000 articles available to our customers; a significant improvement over where we were in the past, 2.4x over the last four years. But it's not just about the size of the assortment, it's also about how fresh is the assortment. And here, our teams have worked super hard to remove friction from the onboarding process and we're now adding 1,500 articles every single day for our customers, a 3x improvement over where we were four years ago. And as you'll learn in the next presentation from Dave and the team, it's also of course about the desirability of the assortment. In 2018, we added for example Massimo Dutti which is a popular brand in my household.

When we ask ourselves, are we there yet. And the answer is clearly no, not yet. We've developed the capabilities in house to look at the incrementality of our assortment and understand the areas of opportunity that we have, and we see significant areas of opportunity.

Not only that, we hear directly from customers every single day. We received 200,000 size-related requests from customers who have found something they would love to purchase on Zalando that's not currently in stock or available through partner program. So, we see huge upside in continuing our journey of improving assortment with the ultimate aspiration that five years from now, customers will be able to say if it's not on Zalando, it does not exist, online or offline.

Next, let's consider the digital experience. And today I want to focus you on two complications. The first complication is relevance. If you scale a sort significantly, it becomes increasingly difficult to find the relevant items for one customer. Four years ago, we began really scaling our engineering talent and, in particular, our data science talent. And they have taken on this relevance challenge. And in the last several years, in particular, we've been building the operational systems and infrastructure required to make more and more portions of the Zalando experience highly relevant for our customers.

And this is paying off. As you can see, engagement in our app has significantly scaled over time. Now, we're at 69 minutes on average per customer per month from 16 just four years ago. And the demonstration on the right of this slide illustrates how two different customers are receiving very different content based on their behaviors and their interests. And there are more and more areas of the experience that will benefit from this relevance engine in the coming months.

The second complication of course is fit. This is a significant challenge for the whole industry, but obviously, a special challenge in online. The perfect experience would be one where every single item fits you perfectly. Of course, we're not there yet, but we're also making progress.

We have a simple size recommendation product today that shows customers when something runs large or small. This is currently covering 86% of our wholesale assortment and driving a 4% reduction in size-related returns for those products versus products that do not have that.

The next innovation we're going to offer our customers is precise size predictions for them, taking exactly their size for a particular article. This is currently available in certain markets and in certain categories. We're innovating on this, iterating on this and scaling this. They're just two of the complications we're tackling in the digital experience area, but two that are very, very important to our customers.

Now, let's look at convenience. Convenience is a moving target, was delightful before becomes a basic expectation. The way we focus our efforts is looking at how can we create the best convenience for fashion, and so fashion-specific problems. And I'd also like here to talk about two examples. First is our pay later offering. The pay later allows the customer to make the final purchase decision in their own home after they receive the articles. And this is a great experience for our customers and one that drive significant NPS as you can see here. And it's one that we're currently scaling to reach a 65% share of our customers.

The next example of course is the returns process. Returns are part of fashion. And here, our goal is to make it as seamless as possible for our customers and again you can get the super high satisfaction that we're able to achieve based on all the fashion-specific adaptations we've made in this area. So, we'll continue to invest in new forms of convenience for our customers with the ultimate goal of customers saying why would I shop anywhere else, it's so convenient on Zalando.

Now, we've talked about elevating assortment, the digital experience and convenience, all crucial areas to our strategy. But given our ambition to be the starting point for fashion, we also need to take a step back and reflect that not every fashion journey is the same, not every moment is the same. One day a customer may need very fast delivery, but the next day, maybe they need style advice for a special occasion, and maybe yet another day, the customer is looking for an exciting deal instead.

Obviously, we've been investing over the years and exploring many of these different situations and what the offering can be from Zalando. But what I want to share today is when we evaluate the success of these investments, we look at them in two different ways, what is the direct impact and also what's the indirect impact in terms of other customer behavior changes that we see associated with these.

And as our data shows, customers who turn to Zolando for more of their fashion needs spend significantly more, but it's important to point out that's not just through the new touch point that they've adopted, it's also across everything.

We believe there's significant leverage in the capabilities and experiences we've developed in integrating them deeper and offering them to more customers. So, we see ourselves as increasingly relevant to the many different fashion moments our customers have. And that's our focus on becoming the one-stop shop for our customers.

And with that, I'd like to turn it over to Robert to talk more about how we're deepening our relationships with our customers.

Robert Gentz

Co-Chief Executive Officer, Zalando SE

Thanks. Thank you, Jim. So, as you saw, we are working very hard now on these arguments for being a starting point and you will see us both grow – thank you. You will see us both grow in numbers of active customers and as well in the standing.

Yet in some areas of investing into our proposition, we will face choices. So, choices such as if we're limited in the availability of assortment, so whom should we actually show this to? We have a certain share of orders that we can deliver same day. So, to whom should we actually deliver these orders first? And when being faced with choices like these, being the starting point for those customers that are most committed to us is the better route for us. So, we'd rather have 25 million customers that spend 100% of their wallet with us than having 250 million customers that spend 10% of their wallet with us.

Going forward, we will prioritize being a starting point for our most committed customers over being just another fashion destination for many. This is the most sustainable and as well the more financially attractive path to take. And I'll show you why.

So, as you see, we – like already, our deepest customer relationships are the ones that are the fastest growing. So, on average, we have grown our active customer base by 15% over the last five years. But if we only look at the customers that spend more than €500 with us, actually we have managed to grow this customer group at the top of the CAGR, at more than 30%.

These customers, they shop everything with us. They shop from head to toe, from basics to fashion pieces. And the great thing about them is they're proportionately more profitable. So, they yield several times much more profit contribution per year as an average Zalando customer. So, this type of very deep customer relationship is a relationship that we're very focused on.

So actually, in 2008, we started off with a very simple marketing message. The simple marketing message was great selection, free delivery, free returns.

And with such a simple marketing message, we started to educate the population around understanding fashion e-commerce as a way to have this changing room experience from offline at home. And so, with that, we built it towards the mainstream, so to make it natural part of people's lives. So – and Zalando really at the forefront of this mainstream.

So, now, in the next decade, we are building on top of this but tailor the experiences going forward. So, we still have a main entrance at Zalando, but we're rolling out the red carpet. So, the red carpet to our most committed customers.

And with this red carpet, we invested into those customers even more which are already the most committed to us. We'll give them an experience where Zalando is not anymore one of many choices, but it's like the only choice that people are very happy with, with spending 100% of their fashion spending with us. Or to put it differently, we are now adding to the general transaction mindset of Zalando as one of the more subscription mindset for our most committed customers.

And one key lever to deepen this customer relationship is through our successfully launched membership program, Zalando Plus, and Zalando Plus exactly builds on this mutual commitments. So, in Zalando Plus, customers commit to us by subscribing to an annual fee of €15. We commit to them by providing them the red carpet, the best that fashion e-commerce has to offer. Faster delivery, fashion advice, return pick-ups and many things more to come.

And like today, Plus is available in most parts of Germany and we already see like very positive impacts. So, we see that – we increase our share of wallet with these customers. In fact, they spend two to three times more than the average customer already. So, the customer satisfaction increased as well quite a lot, and the result of signing up to the Plus program we see as well an increase in cost and lifetime value.

So, that's why we're so fascinated over Plus and this is why we [indiscernible] (02:05:21) rolling out further two countries to follow in 2019. And as we scale Plus, we'll decide then which more benefits we add to Plus and which more countries we add to Plus.

So ultimately, with the benefits that we're adding to Plus, we aim it really going to this deep relationships and to provide the customers with no reason to use any other fashion destination out there to get ultimately to this 100% of fashion wallets that we want to have.

To sum it up, we have 17 European markets that we're in and there is about 450 million people, so everybody needs fashion. Nobody is running around naked. Every – and every one spends [indiscernible] (02:06:05) about like €1,000 per year on fashion offline and online. And as I said earlier, we have 6% of the European population which is already on Zalando, so 94% to go. 25%, they spend about €250, so about 25% average of fashion. So, you will see us grow in two dimensions.

We're adding more and more customers to Zalando, but actually delivering on these statements. What is not on Zalando doesn't exist. Zalando knows me so well, knows my sizes, knows my style and knows what I want that I'm actually still surprised. Zalando is always the better choice. If I have many choices, always a better choice. And with Zalando, I have – with one-stop shop, it covers everything on fashion. So, adding more customers

But when being faced with choices, you will see us as well grow on the other dimension in terms of our share of wallet. By applying a subscription mindset, by rolling out the red carpets to our most committed customers, and really growing as one to this direction. And we won't stop until like every single European is on Zalando and spends 100% of their share of wallet with us. So, that's [indiscernible] (02:07:17) and this is where we are on.

With that, thank you very much. And we'd like to go to Q&A.

QUESTION AND ANSWER SECTION

David Schneider
Co-Chief Executive Officer, Zalando SE

A

Okay. Robert, thanks then. Usual set up, Magnus, will we start again or – so we'll start here, okay.

Q

All right. Yeah, thank you very much. [ph] Charlie (02:07:41) from Exane again. Can you talk about what proportion of your German customers and/or what portion of that spend now you're – is coming through Zalando Plus?

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

We'll, we've – so, we just last year tested out this program. So – and we see very positive results. So, it's still like – it's not huge yet, but we plan to make it huge I think with that.

Q

Less than 10%? Was that...

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

That's right.

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

Yeah. We shared so many KPIs with our customers.

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Hi. It's Simon Irwin. A couple, Firstly, just thinking about returns. You talked about the improvements to [ph] efficiently cut that 4% (02:08:29). Can you break down the cost of returns? I mean what percentage is due to fit? What percentage is due to other things, increased choice, et cetera. So, kind of what part of the problem are you addressing here?

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

You want mine?

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

No, it's okay. First, let's keep in mind that I'm a bit newer to the team, so, I'm going to invite anyone who needs to correct me if I get something wrong. About a third of our – a bit more than the third of our returns are size related today. Of course, we're constantly improving the instrumentation around size-related returns, meaning getting better, higher quality data about the actual reasons why customers return but this is what our current data shows. And of course here, we're working super hard to give customers that size advise that I mentioned before, so that they themselves using all the data collected across all returns at Zalando can understand that something runs small or large, but also the more purchases they make in certain categories, the better we can predict their personal size as well. So, these are two areas we're currently invested on. But we also have much longer-term initiatives as well that we're not ready to talk about today, but are more experimental in nature.

So, the way we approach it is we have many different time horizons we're looking at in terms of innovation starting with the things we shared today, which are currently operational but also further reaching ideas as well.

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay. And if I can ask a follow-up on assortment. How many SKUs can you get into a single DC?

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

So...

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

How many SKUS can you get into a single DC?

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

Yes, I'm definitely going to defer that to someone else.

Q

So, single DC...

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay, the answer...

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

First of all, I think they're all very different sizes. So...

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay, but if I...

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

Yeah.

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Let's just breakdown the [indiscernible] (02:10:25).

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

I got to take it?

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Right.

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

That was between 10 million and 12 million items, then it depends on really how many SKUs you can store into that in terms of the...

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

In terms of range out of your €0.5 million.

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

So, we shared earlier in the main presentation that our current footprint of 11 warehouse, we can deliver up to €12 billion GMV .

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Right.

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

And so...

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

So, I'm going to note that – the point I'm trying to get to is as you widen the range, they're presumably not all in the same DC and presumably the kind of basket economics and stock going down quite fast, if somebody in Sweden orders to two elements of that basket from the GMV and [indiscernible] (02:11:04) and the next one is kind of somewhere in Italy. So, how do you kind of square away the increasing range if you can't make it more immediately available to your customers?

Jim Freeman
Senior Vice President-Engineering, Zalando SE

A

We definitely have people who can address this question. He's sitting down in the audience.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

Let's listen. I can...

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

A

[indiscernible] (02:11:25) give you an idea. So, in the end, you have certain – we have our main warehouse – big warehouses in Germany and Poland at the moment. We have small one in Italy. The other one in France and then the one up in Stockholm. If you are a Swedish customer, we're trying to replicate what we pretend – what we forecast that the Swedish customer will order.

If he orders beyond that, then there is a certain one specific warehouse out of – currently, it's Poland where you're going to get [indiscernible] (02:11:59). So, it's roughly split. We forecast it on a very regular basis to split that out, so it's not that the case that you sent something from Italy into Spain. It's more that you have already kind of a set-up where you say okay, we're just moving upwards and one is moving downwards.

Robert Gentz
Co-Chief Executive Officer, Zalando SE

A

Okay. So, now, I get what is up. So, I think like first of all, it's a machine learning question of how to put these items before hand, what we do with forecasting. The second question is like should we actually have to take this, like how much like [indiscernible] (02:12:32). And by offering that or starting to offer like minimal order values, we will be as well able like to as what pay on this selection proposition but still not hurting our economics going forward.

Simon Irwin
Analyst, Credit Suisse Securities (Europe) Ltd.
Q

Thank you.

Jürgen Kolb
Analyst, Kepler Cheuvreux SA (Germany)
Q

Thanks. Jürgen from Kepler Cheuvreux. Two questions. First of all, Robert, you talked about the assortment that you're – that you want to have. Apparently, you're not yet there 100% that you have all the assortment ready, so that everybody and every customer has all the opportunities where you still see white spots, where you would like to have a deeper, wider assortment available.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE
A

Can we hold that question for the next section following? Great. Second question.

Jürgen Kolb
Analyst, Kepler Cheuvreux SA (Germany)
Q

Then, switching to you maybe. With your background from Amazon and being at Zalando now for some time and obviously you give a little insight that you're working on this size questions. In terms of technology, where do you see more work to be done at Zalando? What's your core areas of digging deeper into advancements?

Jim Freeman
Senior Vice President-Engineering, Zalando SE
A

Yeah. I think the good news is that actually a lot of the core work has been done and has been a priority for a long time. So, again, it started four years ago but the dramatic scaling of our engineering and data science practices, and this group has been very busy building really the infrastructure that we need as a company to work on these really difficult challenges. And I think when a company scales as fast as Zalando does, I think this is normal that you need to go through an infrastructural investment cycle, and I think we're coming out of that cycle to where more and more impact for customers will be visible in the experience.

So, I'm pretty optimistic about where we are right now. But of course, we're continuing to improve this infrastructure and hiring more talent to scale. So, I think because the areas of opportunity, in particular, probably are all in the machine-learning area. And here, I think one big opportunity we have is to imagine different data we might receive through our ordinary processes so that we can feed the machine-learning models with much richer data sets.

For example, I mentioned briefly earlier improving the quality of the return data. This is just one of probably 100 examples that we have where we imagined ingesting more data, different data slightly higher quality data to drive these machine-learning models and get a lot of leverage through these optimizations that we're doing with machine-learning.

Rubin Ritter
Co-Chief Executive Officer, Zalando SE

Four, five, six, seven. No further questions? Well, I also have no questions from the Web, so we're going to conclude this session. Thank you, Robert. Thank you, Jim, for giving an insight. And well, I think that's applause. Thanks for making it.

So I need to egress the session a little bit. One organizational thing I want to tell you, we have organized two passes, one to [indiscernible] (02:16:00) Airport directly after the event starting at around 3:30, that's a first come first serve basis. Once the bus is full, it goes away. But we can also are able to arrange taxis for you.

But now coming back to what we started. So, we have just heard the proposition of how we try to interact with our customers. But why do customers come up to our website, because we have the brands. And in the next session, welcome Moritz and David on stage. We're going to make a deep dive into our assortment. And Moritz and David will also tell you how we're going to interact with our partners going forward. Moritz, David, the floors is yours.

David Schneider

Co-Chief Executive Officer, Zalando SE

So, ready for the last session. It's been quite a day. Now for – now, we actually we turn it a bit around. We discuss so much about the starting point for fashion. We discuss our platform. So, what we're going to do now is rather look at it from a bit different perspective, when you look at it from a partner perspective, what does that strategy actually mean?

And we pulled out sentences like if it's not on Zalando, it doesn't exist today. And so, this is quite high ambition level that if you look at it from an assortment point of view, that sounds a bit crazy at the first moment. And to be clear also, it does not mean for us that we have to carry every fashion item ever produced. But it means for us that we have to have anything that is relevant for a specific customer. So, anything she usually seeks for. But either way, it's quite – it's a tough nut for the assortment because how does that translate? We need all relevant brands. Then, from those relevant brands, we need actually full range access, like all the best styles.

Then, of all those styles, we have to have like a perfect availability, try to be never be sold out. And in addition to that assortment access, we also want to create great experiences for our customers. So, we actually need a lot of content, exciting content, great experiences.

So, if you look at last year, we've done quite some progress along all those dimensions. If you look at relevant brands, we added interesting stuff like Massimo Dutti. Yeah. So, one of the last Intidex brands, still to miss.

We've added interesting premium brands like See by Chloé, Diane von Fürstenberg Extra. And beauty, we mentioned it earlier today that has also opened up actually quite new interesting players for us here. You have very international players like Estée Lauder coming to the platform.

Yeah. In terms of range, take sneakers as an example. We are – sneakers, it's always one of those most pronounced sections where you need the very latest and the very best styles available, yeah? And that is something where we collaborate very closely with brands, yeah?. We've worked, for example, with Nike quite closely to improve our sneaker experience. And this year, this Nike MK2 (sic) [M2K] (02:19:40), that's one example that has proven not our own just fashionability but with also – was also quite a commercial success.

On the availability layer, I think we also mentioned that before, the Partner Program here actually unfolds its power. You can actually see how well that adds to our availability. Those €190 million, that is just backfilled, yeah? So, again, what we mean by that, it's articles we have bought and would sold out on them. So, the partners ship it directly. So, that would have been customers, they – we would have lost them or they would have been unhappy because their size was not available.

And then also in terms of engaging content, yeah, we've increased quite a bit like this content layer. We – any given week actually run around 1,000 competitors in 17 different markets. And we also have like a lot of exciting stories around it.

So, when we do all that, we have to also remind ourselves that getting this full access in the fashion industry is actually super hard. If we want to have all relevant brands, and I'm actually answering the question we recently had, of course, there's brands that never sell to other retailers or also don't like to sell through external partners, vertically integrated partners on example. I mean, the Zaras and Inditex and – yeah, the Inditex overall as an example, premium brands that are very careful about where they sell and what the adjacencies are.

Range access, also not an easy game. Sneakers, for example, to continue that. You have brands, they love to see the customers camping outside some store in [indiscernible] (02:21:39). So they care a lot about like how they 're actually positioned, their articles.

Availability, also in fashion, has its very own characteristics. You have – we have to place – somebody has to place buying bets. You have long order cycles. You have to manage inventory with size runs, and that's expressed by like, I feel like 260,000 size requests we get per day. Then also in terms of content, the more we move into the personalized world, I imagine we have to [indiscernible] (02:22:13) like fresh exciting content for 26 million customers.

So building this flawless offer for customers, it is very hard. And while I emphasize that it's hard, actually, that's why it's also one of our main differentiators. We have built up better access than anyone else, and we have built very strong partnerships. So I think there, we're actually quite ahead, and there's also a reason for it. Because to put it in very simple words, like why brands place their bets on us, we provide a combination of reach, of great business opportunities, and a place where they can actually protect or even build on their brand equity.

And I mean reach, I think today, we said a lot of numbers. So, I mean, again, like the 3 billion visits we have, I mean that's enormous for partners, 26 million active customers across 17 markets. And not only that access to consumers, it's also the insight that generates. I mean, this is like insights, that data, the brands wouldn't get hold of that anywhere else, and can use that actively to actually improve their product.

And business opportunities. We provide the brands, actually, tools and services that allow them to actively invest into growth themselves. And we also make sure that they can actually earn money with it. So we offer – we know every brand. Some are hesitant to invest into digital, that's not a secret anymore, but there's only very few alternatives. And Moritz will actually tell you a little bit about that in a minute. So, actually, we are, I think, the partner. We are the best alternative, actually, if they want to grow digitally.

And then third on dimension, the brand. Yes, we focus on fashion. We've created that environment. We wanted to create like exciting experiences for consumers. And in addition, we also provide the brand, actually, the tools to manage that themselves to drive their brand, to drive their content, regard it a bit like having like a flagship store within our system.

You might say, those components, you can also get them somewhere else. You might have big marketplace models to give you a lot of reach. But I can assure you, they do not give you this brand place where the brands actually feel comfortable and where they actively invest in brand equity. So there, they try to work it out or limit as far as possible to, whatever, old season stuff or late end season stuff, but they don't use it as brand building.

Then you have retailers. They might get the brand perspective actually right or even better because, of course, you have some that are very opinionated and very sharp. But again, those, they don't really have the reach and plus, also, they don't give brands actually those capabilities. They actually need to drive their digital strategy. So, it might be an add-on, but they do not become part of that strategy.

So, very honestly, we believe that this combination in Europe, we're actually the only – the best place for those brands to be. We have – the only one who can actually combine all these important dimensions. And you see it like how complementary that works to brands. I mean, we have all those skill sets, building the reach, having data, the technology, the operations behind. And the brands, they can actually fully concentrate on what they do best. And I think in that context, we've built up very strong and trusted partnerships.

So, now, with the good brands, they care about all these things I just said. The very best brands, they actually care about even something more because they actually strive to go direct to consumer. And to hear this quote from Nike actually summarize it quite well, the closer we are to market, the stronger the demand signal and the better the assortment.

The great brands actually know that they have to play a different game online. And they have to be in control of their brand and they have to get closer to the consumer. And so, the most obvious pick, of course, is building own e-comm. But we'll actually tell you in a minute that this is very limited, what they can do in there, and here, also want to emphasize that a direct to consumer strategy from the brand is actually very much in line exactly with our platform strategy.

And because we actively build all those tools and capabilities necessary that enable and empower the brands. Now, we don't want to be like a dealer retail model or some kind of intermediary. Rather, we aim to become a significant part of the brand's digital strategy.

And now, I can actually hand over to Moritz who can tell you a bit more how that works out for brands.

Moritz Hahn

Senior Vice President of Supply and Demand, Zalando SE

Sure. Yeah. David said brands really like going direct. What they like in particular is their own e-comm store. They have big fans of their own e-comm store for two reasons. Number one, this helps them to outbalance the shrinking business in offline. And second, as David explained, this own e-commerce gives them the chance to have a direct access or have a direct relationship with their customers. So, they love it. And I think you know better than I do that they have also communicated a lot on their own e-comm strategies, right. That's a big thing for brands.

However, there's a problem. There's a problem. You see from the growth rates, growth is slowing down. In the past, they had healthy or huge growth rates, and now, their own e-comm growth is coming down. And we expect that this is going down even further. And there are mainly two reasons. Number one, for brands, it's very difficult to acquire new customers in the same speed as they did in the past. Why is this the case? [ph] Rents (02:28:58) are really used to doing now, Google Marketing, and the Google search terms, they are not coming additional search terms to Google, and the Google search terms in terms of the number or the volume is not growing.

The number of people who have searched for a dress or searched for a skirt or searched for a sport shoe is not growing anymore. So, there's a limit to how much the e-comm business of a brand or the brand store of a business can grow on their own.

The second big piece is the retention. If you think about a single brand, for example, like Levi's jeans or a shoe like a Nike shoe, there's only so much reason to come back on a regular basis, right. How often does someone on a weekly basis or every week buy a jeans, right? The engagement, the shopping frequency is a big challenge for the brand owned e-comm.

Now, let us zoom a little bit into the new customer acquisition, one of the first problems the brand own e-comm has. When you talk to brands, they are now all into the mood social media is the way out. So I explained, actually, Google is limited. The number of people looking for dresses, I said, is stagnating. Now, social media is the new thing, right? We, on the other hand, also invest heavily in social media, and what we have figured out is when we show an ad, for example, for a Timberland boot to customers on Facebook or Instagram, in 19 out of 20 cases, in 19 out of 20 cases, customers buy something else than Timberland, right? And this is, in return, the beauty of having a multi-brand store because this drives your conversion rate to a completely different level than in a mono brand or single brand environment, right? And you can see this from our figures, we have changed our – the way we do performance marketing last year heavily. We do now machine learning and automated a lot of processes, but the core of the success of the social media team here at Zalando is coming from the multi-brand environment, which drives the conversion rate to a much different level than you have on a single or mono-brand environment.

If you just look at the figures, in 2018, we spent almost €19 million, right? 2017, 2018, like this. And inside 2018, it's also trending like this. So, Q4 was the record ever we had on social media spending, which, in return, makes it difficult for multi-brand use cases to compete with us on social media. So, that was the new customer acquisition challenge for a brand's own e-comm.

The other topic I also mentioned was the retention piece. They are also like, talking from our site, brands buy on Zalando, 13 different – customers buy on Zalando, 13 different brands, right? And now, imagine a customer who needs to download 13 different apps, right, to engage with each of these 13 brands. This is most likely not going to happen, right? The whole move into app moves into this multi-brand environment situation. You have the app fatigue, I think something you have probably heard. People do not download several apps. And if they download apps, they only use a few. So, the multi-brand use case gears the whole industry to one fashion app. And that makes it much easier to then engage with the customer on a regular basis.

Now, I showed you two big examples or two examples why it's difficult for brands to succeed – or their e-comms to succeed in the future. Now, our answer to this is that as much as you like going direct to customers and as much as you like your own e-comm, you can like Zalando.

So, what we want to do is we want to replicate all the positives or all the dimensions brand like at their own e-comm at Zalando. That's the whole thinking. Our thinking is that we allow brands as much as possible, direct access, okay?

We have two different business model. We have the Partner Program business model, which is the most direct business model. And Partner Program brands own the store, and they do the merchandising and pricing on their own. So, it's the most direct business model we can offer to brands. And on top of this, so that they feel it's very similar to their own e-comm, we add a lot of customer insights. So, we have a merchant portal where they can interact and learn, and cut and slice and dice the customer data as much as legally possible, right? But it becomes very similar to their brand-owned e-comm.

The second business model we have is the wholesale business model. It's still the most dominant business model. Nevertheless, it also can have some direct features. It's different to the Partner Program model, but nevertheless, it can also have some direct features. We have here, the retail portal, where we allow brands also to engage with their customers, upload own article data, trigger, for example, reorders. There's also a lot of direct components in there.

Now, let's talk about – a little bit more in detail about the most direct business model we can offer, our Partner Program model. I think what we learned over the last years is that actually, the success of Partner Program heavily depends on ZFS. ZFS is one of the enabling functions of Partner Program. So we think about Zalando in two business models, and then we have enabling features, ZFS, ZMS, and so on. ZFS is probably the most important to unleash the platform dynamics as we want to.

So, therefore, let me dive quickly into ZFS. ZFS is the magic to the whole platform for two reasons. Like, first of all, from a customer perspective, if you think about our average order, a customer has three to four items in her basket. All right? And if you think now the extreme that all those items will be fulfilled by different partners, she would have to carry four boxes home, right? She would have four boxes to carry from different partners because they would all send different boxes to her. And then she would be at home, and then maybe she would keep three or two items out of the four, and then she would have to carry back two parcels to the post, right?

And that's not really customer-friendly. That's not what she wants, right? She wants one parcel and shop it all in one go also in a physical dimension. And therefore, we figured out that ZFS does the trick. ZFS combines the convenience of our wholesale model with the beauty of the direct to consumer dimension and own e-commerce. So, ZFS, very good from a customer perspective.

The second and that's also an important point for the platform, ZFS unleashes profits, right? If you can stay with me in this example with the four different parcels of customers who had ordered four different items, these four different boxes, they would all need to pay for carrier costs, right? The DHL here in Germany would have to come four times to her door, which makes it very costly for all of us. The profit pool in such a situation goes down massively.

So, to put it in reverse, ZFS decreases the shipment cost by 50%, right? By 50% because on average, we have one partner article in our basket, and now, we combine them together, and instead of paying DHL two times, we pay DHL in this German example one-time. Right? That's the whole – the magic.

What it does to the whole platform is since it's now much more attractive for brands to work with us in the Partner Program, they upload massively more SKUs, right? I just have here an example with you, a brand before ZFS, a brand after ZFS. It's three times more SKUs than before. It just comes from the fact that it's economically attractive for them to actually now, with ZFS, to upload more SKUs.

Now, I said that this ZFS is actually the basis for the whole platform dynamics. Let me hand over back to David, who can now show you how it all comes together. Thank you.

David Schneider

Co-Chief Executive Officer, Zalando SE

Yes. Thank you, Moritz. Moritz perfectly explained how that works out for brands. And I have to say like whenever we go talk to brands, it's actually not a real – it's not a hard sell because actually, it makes a lot of sense for them. And it has a lot of benefits for the brands, and that's what we also see then reflected in the numbers.

I mean, we do see that all those platforms services are picking up a lot, and the brands, they're getting more and more active. The more they understand actually, the more they invest into it. So, I think we are in a very good track. And when you heard the numbers before the Partner Program has picked up, we're now – it's already 10% of the GMV. And you also heard our plans that this will increase quite heavily over the next years.

ZFS is super interesting. Moritz explained all the benefits, and we also see that the brands are really signing up for that very heavily. And also, if you look not only like the current share of 25% of our Partner Program, the items, obviously, the pipeline, I mean such as those brands like Mango, Adidas, Inditex brands, I mean, there's a lot of movement also if you look at this year, what will happen.

And ZMS, I think that's the interesting part, the better we get on the Partner Program and then with ZFS enabling that, the more we unlock actually profit potential for brands they can reinvest into growth. And that's where ZMS comes in and where we also have like many positive examples, and a good growth engine for us, those examples like Under Armour, where we enable brands actually to target audiences they wouldn't be able to get to otherwise.

And to make it a bit more tangible, we can maybe briefly discuss a concrete example because I think Mango is an interesting and also a representative case of what we all discussed because they care a lot about going direct to consumer. They're vertically oriented. They have a strong brand. They also care a lot about their own e-comm. So when we launched with them, we launched in Partner Program and they shipped from Spain. So, it wasn't the ideal situation. But then, also, when they saw the potential, they also started investing more and more into their own capability. Finally, they did an ownership from Spain. They started shipping from Germany. So we got better into customer experience. We grew wider in the assortment, rolled it out further. It worked well in Germany, so we started internationalizing and rolled out several countries.

Then we went further and said, okay, let's jointly invest into marketing and we did joint campaigns. Even like last year, we did a joint TV campaign. We worked out exclusive connections with them they don't even show like in their own stores. And that went even that far now that they recently – they launched in Spain with us, which is their total home turf. Yeah, but – and where they worry most about like their own e-comm, but I think that's an interesting case where we see an old brand that actually understands those tools and really knows how to leverage them, how well along that also goes with their own ambitions.

And our goal is very clearly, like we say for Mango, it's not that we want to be one partner. Rather, we want to be a significant part of their digital strategy or [indiscernible] (02:41:59) want to be their digital strategy. We want to be the partner actually that helps them to be successful. And there, I think we also closed the loop to building that starting point, because we very strongly believe by building those complementary capabilities, our platform services by doing stuff that just really makes sense for brands to invest in. So the brands, if they love it, then we know the customer will love it because the experience gets actually better and better. And the more time and money the brands invest, the better the customer experience, the more reason the customers have to actually use Zalando as their starting point. So, that's somehow what we see – how we see our platform at work.

With that, now we can also go to Q&A.

QUESTION AND ANSWER SECTION

Patrick Kofler
Team Lead-Investor Relations, Zalando SE
A

Wonderful. Thanks, David. Thanks, Moritz. So regarding my conversation I had with some of you during the lunch break, there are some questions around that, but I didn't forget Jürgen. So, you have the microphone [indiscernible] (02:43:06). So please, take your postponed question to Moritz and...

Jürgen Kolb
Analyst, Kepler Cheuvreux SA (Germany)
Q

Just to follow up what I was asking earlier on, where do you see still some white spots in terms of product assortment that you would like to increase, i.e., being specifically in sports or any specific price category even as well?

David Schneider
Co-Chief Executive Officer, Zalando SE
A

So I'd say number one, of course, we have some big verticals that are still out there in Europe. Number two, for me, premium brands, premium is actually super successful for us. And we're growing very strongly, so I think our proposition is actually getting better and better. So, there's definitely brands to add. I mean, the third, definitely have in rather specialist areas, for example, specialists in certain spot areas. And also to add a specialist, beauty, I mean, we just launched it. That is also, of course, something where we can still improve like they offer quite a bit.

And I think on all dimension, I think what's interesting like we think we're moving closer and closer, like the vertical from everything we described here very actively support this direct to consumer strategy, which should be relevant for them. Premium, the better we get in personalization and being able to send out targeted messages. I think there, we're also working very close collaboration with them to do that. And then on the specialist area, it's the same story.

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Another question? Magnus.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)
Q

Magnus Råman, Handelsbanken. Perhaps I can ask a little bit outside of this brand question. But can you provide an update on the project to connect stores, physical stores? Perhaps share some numbers of how many countries you're at right now, how many stores or retailers are signed up as of now.

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Yeah. Yeah, sure. I think this is a very interesting – really interesting future project because we mentioned those, call it, complications in fashion that we have so much decentralized inventory sitting around everywhere. And the majority of the inventory actually lies in physical stores. So, actually, we believe like in the future, there's huge potential if we're able to unleash that, and then in the long run, even be smart about it and connect local inventory to local consumers, like superfast delivery or even creating like different experiences.

So, this whole thing is [audio gap] (02:45:55) we started connecting first brands to – for example, with Adidas, we had pilot cases where we connected stores. We also connected shoe networks, for example, to connect midsize shoe retailers. So, by now, we have couple of hundreds of stores that are already integrated and that are shipping. And I think here, it's more about now, we have to post optimized processes with data quality and be like the processes to actually handle those volumes. We had those example where you know that there's a source actually, [indiscernible] (02:46:36) suddenly, you have like a lot of parcels there now that they don't even get out anymore. So, I think there's like many interesting things we can figure out still.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)
Q

Because if you speak to leading store-based brands, they just guide this as the main potential for them to deliver out of stores...

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Yeah.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)
Q

...feeder stores, and have really rapid delivery goes out in geographical peripheral locations. What would be the main reasons for you to be that partner for retailers not to do that themselves proprietarily?

David Schneider
Co-Chief Executive Officer, Zalando SE
A

I mean, A, actually, the more they do it themselves, the better for us because actually whatever they connect with their own e-commerce, it's actually easier for us to integrate it as well. So, the number one. Number two, I mean, the same reasoning we had before, I think in their own e-comm, it is limited. And, I mean, we unlocked them actually quite some additional potential. I mean, if we connect those stores, I mean we already have proof points like how much volume it can actually generate additionally. And brands actually, they have a very strong incentive. If they work very closely with us and they have to go digital, they actually have a very strong interest in incentivizing their stores to be part of that equation and not actually undermine what the stores are doing.

So I think in all sense, from a store manager point of view, from a brand point of view, and from our point of view, from a customer point of view, I think it makes sense. Like I said, just mean there's also – that said, there's also I mean some hurdles we have to ,overcome like when it comes to order economics processes, of course, there's still a lot we have to develop further.

Magnus Råman
Analyst, Svenska Handelsbanken AB (Broker)
Q

Thanks.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE
A

Tushar, yeah.

Tushar Jain
Analyst, Goldman Sachs International
Q

Yeah. Tushar from Goldman Sachs. Just in terms of ZFS, the third party brand inventory, do you keep the inventory within Germany or do you send that inventory to your satellite hubs as well? And also, the order fulfillment in Italy or France or in Nordics?

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE
A

So, the ZFS logic works very similar to wholesale from an inbound perspective. So, we are splitting the shipments upfront in order to optimize our warehouse.

David Schneider
Co-Chief Executive Officer, Zalando SE
A

A quick comment on internationalization, ZFS. I think that was also part of the question, right, or...

Tushar Jain
Analyst, Goldman Sachs International
Q

Yeah, exactly. I mean...

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Switzerland, for example...

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE
A

Switzerland is now – it's going live.

Tushar Jain
Analyst, Goldman Sachs International
Q

So, we will be asking Mango to send parcels to Germany or you will be asking Mango to send parcels – the whole inventory to all your warehouses?

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE
A

So, we cover the Mango in the same way as we would cover Mango in a wholesale business, right, we would store it in different locations in order to be as fast as possible to the customer.

David Schneider
Co-Chief Executive Officer, Zalando SE
A

Actually, to add to that, Switzerland, for example, is also an interesting sample. Like many brands don't even have the capabilities to deliver like conveniently to Swiss customers. So, open up those capabilities that they can actually do that through us, that's actually another one of those examples where we actually have a stronger network and a stronger infrastructure in some sense.

Tushar Jain
Analyst, Goldman Sachs International

Q

And in terms of how many days do you keep the inventory before you give it back to Mango, for example?

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE

A

How many days we keep the inventory? We have similar targets for the inventory as we have for wholesale like we have turnover targets, stock turnover targets. And then if we're below those targets, then there is a conversation happening. That's standard

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Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Other questions? Yes, Caroline?

Caroline Gulliver
Managing Director - European Retail Equity Research, Jefferies International

Q

Hi. It's Caroline Gulliver from Jefferies. Could you share a bit more color on the data that you're giving back to your partner brands? In particular, are you giving them data on what their customers – the other brands that they're looking at?

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE

A

I think the most exciting part of brands is actually to learn what their major competitors do. So we cannot like, for legal reasons, I think I said this, we cannot like share individual customer data. What we can do is we can benchmark. And actually, Zalando has a massive, I don't know, insight center for them because they have no other way to benchmark themselves against their major competitors.

And so, therefore, they are really interested in getting this kind of data, and that's what we do, right? So we try to ask them for a peer group. We define with them, a peer group together or their major competitors, and then we benchmark their success and their – whatever metric you're interested in, there are always measures to this peer group.

Caroline Gulliver
Managing Director - European Retail Equity Research, Jefferies International

Q

And how are you effectively pricing that knowledge that you're giving them? Is it just coming through in gross margin terms or – I mean, it's also huge more powerful information that you can give on. How are you – how do you think about that economically?

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE

A

So economically we, first of all, think like from a customer perspective, so we think the more that brands know, the better they can serve our customers, right? That's our – like that's the first way. I think in the long term, there could be potentials maybe to monetize it even further, but for the time being, our main focus is to create the best customer experience.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

Other questions here? We go almost the last row. Can I help you?

Michael Benedict
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you. Michael Benedict from Berenberg. Are you able to let us know the commission rate you receive for the Partner Program both with Zalando Fulfillment Solutions and without it?

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE

A

Sorry. The last part of the question...

Michael Benedict
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

With ZFS and without.

Moritz Hahn
Senior Vice President of Supply and Demand, Zalando SE

A

Yeah. So I think we shared it here that ZFS massively improves the profitability, which improves the profit pool for Zalando and for the partner. And therefore, when we introduced ZFS, we also had the conversation about the commission rates, that's what we do.

Michael Benedict
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

And in a previous session, you said that you expected to be free cash flow negative in 2021. Is the implication that you expect to be positive from 2022 onwards?

David Schneider
Co-Chief Executive Officer, Zalando SE

A

So, that's obviously [indiscernible] (02:52:49) partner question. Obviously, we have to ask Rubin back to the stage, I guess, for stuff like that.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

A

He was back [indiscernible] (02:53:00) now. Other questions in the room here? If that is not the case, we are well ahead of time. All questions answered.

Patrick Kofler
Team Lead-Investor Relations, Zalando SE

So, thank you very much for your attention. One more thing before I got to hand back for the closing words to David. We currently have a beautiful weather outside here in Berlin. We are assuming no weather conditions for the remainder of the year. But if I'm looking on to my weather app, I think there will, at some day during 2019, be still rain. So if you go out afterwards and pick up your backs and your other stuff and jackets, there's also a small umbrella for you for rainy days in 2019. It's a little gift and you can take it, and thanks for that.

With that said, David?

David Schneider

Co-Chief Executive Officer, Zalando SE

Yeah, don't worry. No big closing words, nothing. So, just from our end also, many thanks for coming all the way here. Hope it was an interesting and very insightful day for us. We can say like if we – standing here like our new campus just having turned 10 with this vision of building this starting point, we are very excited about the next few years. And so happy to see you, well, next time.

Patrick Kofler

Team Lead-Investor Relations, Zalando SE

Thank you. Bye-bye.

[Additions in square brackets at the start of the transcript denote the requests which came directly from Zalando]