Zalando SE – Annual General Meeting 2018

Agenda Item 6:

Resolution on the Approval of the Remuneration System for the Members of the Management Board (Say-on-Pay Vote)

Report on the proposed New Remuneration System for the Members of the Management Board

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Preamble

The current term of appointment and of the service contracts of all current members of the Management Board will expire as per the end of 30 November 2018. The Supervisory Board agreed in principle with all current members of the Management Board on their re-appointment for another 5-year term commencing on 1 December 2018 and the key terms of a new remuneration system applicable to such new term.

It is intended to implement the proposed new remuneration system following its presentation to the upcoming annual general meeting of the Company in connection with a statutory (advisory) say-on-pay vote.

The purpose of this report is to outline the proposed new remuneration system to which such say-on-pay vote (= agenda item 6 of the annual general meeting) shall relate.

A. Overview of the Basic Elements of the proposed New Remuneration System

Table Summary of Basic Elements of the proposed New Remuneration

	Proposed new Remuneration per Management Board member
Annual Base Salary	EUR 65,000
Long-Term Incentive	
Grant of options	one-off grant for entire new 5-year term
Number of options for entire 5-year term (with each option relating to one share)	1,750,000
Exercise price per option	current share price as per the grant date[1] plus 5% (illustrative exercise price: EUR 46.50[2])
Annualized fair value (at grant date)	EUR 4.25 million (illustrative)[3]
Performance criterion	average annual growth of business (CAGR) of 15% (with a step function with each 0.5ppt of CAGR below 15% resulting in a 10% pay-out reduction, the last step being (< 11.0% and ≥ 10.0%); below 10% CAGR pay-out is zero)[4]
Pension	not applicable

[1] The grant date will be the date of the execution of the new service agreements implementing the new remuneration system which is expected to occur in due course after the upcoming annual general meeting.

[2] Illustrative calculation of the exercise price as per the (future) grant date using the XETRA closing share price as per 29 March 2018 of EUR 44.28 instead of the actual (future) closing share price as per the grant date.

[3] Illustrative calculation of the fair value of the Options as per the (future) Grant Date using the XETRA closing share price as per 29 March 2018 of EUR 44.28 instead of the actual (future) share price as per the grant date.

[4] Please see p.6-7 for further details.

As is already the case under the existing remuneration system, the remuneration of the members of the Management Board under the new remuneration system will consist, besides customary fringe benefits, of two components only: an annual fixed base salary and a share-based variable long-term incentive. None of these remuneration components will include any discretionary benefits.

The Company will continue to not provide any company pension entitlements to the members of the Management Board.

Similar to the existing remuneration system, the vastly prevailing part of the remuneration under the new remuneration system will be allocated to the long-term incentive resulting in an entrepreneurial risk and return profile of the new remuneration system. As Zalando is still led by its founders and realizing the strategic ambitions continues to require an entrepreneurial type of leadership, such a remuneration system fits the needs of the Company also for the coming years.

The new long-term incentive will be linked to the development of the share price of the Company and the growth of the Company's business during the new 5-year term. As such, the long-term incentive structure includes a strong retention element as well as a clear pay-for-performance link. In addition, it creates strong alignment with shareholders' interests.

Each of the current three members of the Management Board will receive the same remuneration. The individual remuneration will therefore correspond, in relation to each component, to one third of the total remuneration granted to the Management Board as a group.

B. Non-Share-Based Remuneration (Fixed Base Salary and Fringe Benefits)

The annual fixed base salary is paid in monthly installments. For the new term, the annual fixed base salary will amount to EUR 65,000 gross per member of the Management Board, but will at least equal the statutory annual minimum salary required in the respective year for an exemption from statutory health insurance (*Versicherungspflichtgrenze*). This is a reduction compared to the current annual fixed base salary which amounts to EUR 200,000 gross per member of the Management Board.

In addition, the members of the Management Board will continue to be entitled to customary fringe benefits provided under the current remuneration system which include the private use of company cars, contributions towards health insurance and, as contribution for the use of private pension funds and insurance against unemployment, monthly gross amounts which correspond to the employer's maximum statutory contributions to pension and unemployment insurance for employees. Such fringe benefits, which in fiscal year 2017 amounted to an average of approximately EUR 13,000 gross per member of the Management Board, will apply unchanged.

Finally, the members of the Management Board will continue to be covered by the Company's insurance policies for directors and officers (D & O insurance) with adequate coverage and mandatory deductibles (*Selbstbehalt*) amounting to 10% of the covered damages, but at maximum 150% of the annual fixed base salary. The D & O insurance policies cover damages caused by breaches of duty on the part of the members of the Management Board in the performance of their tasks.

C. New Share-Based Long-Term Incentive

I. General Structure

The new long-term incentive ("**New LTI**") will consist of a one-off grant of options (each an "**Option**") to the members of the Management Board which are linked to both the development of the share price of the Company and the growth of the Company's business during the new 5-year term.

By virtue of this two-fold link, the New LTI aims to reward the creation of long-term shareholder value as reflected in the share price and the promotion of the continuous growth of the Company's business as the most relevant performance parameter under the Company's long-term strategy. Correspondingly, an unfavorable long-term development of the share price and/or the failure to achieve the targeted growth level will negatively impact, or even annul, the return under the New LTI.

Outstanding entitlements of the members of the Management Board under previous long-term incentive plans of the Company (SOP 2011 and SOP 2013), which are part of the remuneration for the previous and current term of appointment, remain unaffected by the implementation of the New LTI as only the latter is part of the remuneration for the new term of appointment. For details of the outstanding entitlements under the SOP 2011 and the SOP 2013 please refer to the remuneration report on page 66 et seq. of the annual report 2017.

The Options under the New LTI will not become exercisable before the end of the fourth year of the new 5-year term and, for part of the Options, only after the fifth year (the "**Waiting Period**").

Each Option has a uniform exercise price ("**Exercise Price**") and relates to one share in the Company. Accordingly, the relevant settlement value per Option will correspond to the amount by which the current share price at exercise exceeds the Exercise Price (the "**Settlement Value**"). This way, the New LTI is linked to the long-term development of the share price of the Company. The respective Settlement Value per Option will be subject to a pre-determined numerical cap.

In addition, the New LTI will provide for a performance criterion which measures the average annual growth of the Company's business during a performance period of four years and, for part of the Options, even of five years (the "**Performance Criterion**"). The number of Options which may be exercised depends on the extent to which the targeted growth rate under the Performance Criterion is met with the remaining Options to forfeit without compensation. Via the Performance Criterion, the New LTI is linked to the continuous growth of the Company's business in alignment with the Company's strategy.

Exercised Options may be settled, at the election of the Company, in shares of the Company or in cash.

In the case of a cash settlement, the Option holder is entitled to an amount in cash corresponding to the total Settlement Value of the exercised Options.

In the case of a settlement in shares, the total Settlement Value of the exercised Options will be translated, on the basis of the current share price at exercise, into an according number of shares to be delivered to the Option holders without them being required to pay the Exercise Price (net settlement). Fractions of shares will be settled in cash. For a settlement in shares, the Company may use new shares from a respective new contingent capital to be resolved by the general meeting of the Company and/or treasury shares to be acquired by the Company for this purpose.

II. Key Terms

Date of Grant, Exercise Price and Volume

There will be a one-off grant of Options under the New LTI for the entire new 5-year term.

The Option grant will be effected as per the date of the execution of the new service agreements by which the new remuneration system is implemented ("**Grant Date**"). Such implementation is intended to occur in due course after the presentation of the new remuneration system to the upcoming annual general meeting of the Company.

The Exercise Price per Option will equal the current share price of one share in the Company as per the Grant Date plus 5%, i.e. Options will be out of the money at grant.

Each of the three members of the Management Board will receive 1.75 million Options, each relating to one share in the Company. This will result in a total of 5.25 million Options to be granted under the New LTI to the Management Board as a group.

The fair value at grant of the Options will depend on the (future) share price as per the Grant Date. Based on an illustrative calculation, the Options to be granted under the New LTI translate into an annualized grant value for each member of the Management Board in the order of magnitude of EUR 4.25 million[1] per year for the new 5-year term.

Cap

The Settlement Value per Option (i.e. the amount by which the current share price at exercise exceeds the Exercise Price) will be capped at the higher of the following amounts:

(i) EUR 150.00 minus the Exercise Price; and
(ii) Two times the Exercise Price.

Accordingly, an increase of the share price to above EUR 150.00 or three times the Exercise Price, respectively, will not result in any further increase of the return under the New LTI.

Vesting Scheme

The Options will vest in 20 equal tranches on a quarterly basis over the new 5-year term.

As a rule, in all cases of pre-mature termination of the office as member of the Management Board, Options of the applicable member of the Management Board which have not yet vested on the date of such termination will cease to vest and be forfeited without compensation. In certain situations of termination qualifying as so-

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[1] Illustrative calculation of the fair value of the Options as per the (future) Grant Date using the XETRA closing share price as per 29 March 2018 of EUR 44.28 instead of the actual (future) share price as per the Grant Date.

called bad leaver events, even vested and unexercised Options of the applicable member of the Management Board will be forfeited without compensation.

However, by way of an exception from the foregoing, if a member of the Management Board member is revoked from office by the Company without good cause for termination within the meaning of Section 626 of the German Civil Code (*BGB*), such member of the Management Board retains, in addition to the Options which have vested until such termination, also those Options which would have vested during a period of two years thereafter.

Waiting Period

For Options which are vested until the end of the fourth year of the new 5-year term (i.e. for 80% of all Options), the Waiting Period expires after the fourth year of the new 5-year term.

For the remaining Options (i.e. for 20% of all Options), the Waiting Period expires at the end of the fifth year of the new 5-year term.

Performance Criterion and Performance Period

The Performance Criterion relates to the compound average growth rate (CAGR) of the Company's business during the relevant performance period.

As relevant parameter for the growth of the Company's business the Company's consolidated revenues are used.

However, should the share from the Company's so-called Partner Program[2] increase to a 14% share in consolidated revenues, adjusted for the "grossed up Partner Program merchandise volume"[3] (i.e., not including Partner Program commission only as in revenue, but treating the Partner Program as wholesale, thus grossed up to show 100% of the Partner Program merchandise volume), then these adjusted consolidated revenues shall be used as the relevant parameter for the growth of the Company's business for the full relevant performance period.

> *Explanatory Note on Partner Program and Partner Program merchandise volume:*
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> *Within the Partner Program, Zalando offers its brand partners (suppliers) an alternative way of cooperation versus a straight sale (through which Zalando becomes legal owner of the inventory). Under the Partner Program, the brand partners continue to own the inventory and as such retain control over pricing and assortment. A higher Partner Program share improves the customer proposition through more assortment. Such model is preferred by many brands as they keep more control, while also allowing Zalando to scale in an efficient, capital-light way. Due to these benefits, the Partner Program is a further important way of cooperation between Zalando and the brand partners and as such considered a key value driver for Zalando in the years to come.*

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2 Please refer to page 80 et seq. and, specifically, page 84 of the annual report 2017 as well as the explanatory note below for a description of the Partner Program.

3 Please refer to the explanatory note below for a definition of Partner Program merchandise volume.

The Partner Program merchandise volume covers the full transactional volume of sales under the Partner Program and is defined as the total amount spent by customers for such merchandise sales (excluding taxes).

Under the Partner Program, Zalando receives a percentage commission for any sale, which is shown in revenue. However, only a certain percentage of the total Partner Program merchandise volume is shown as part of Zalando's revenues. As such, as the Partner Program grows, revenue is not fully reflecting the growth of the Zalando trading platform any more.

The key basis for calculation of the Performance Criterion are consolidated revenues which are IFRS based and disclosed on an ongoing basis. The Company currently provides certain key data around the Partner Program (percentage scale, assumptions regarding commission level) to the public, such that market participants can estimate the adjusted consolidated revenues mentioned above. As the Partner Program progresses to gain in relative size, the Company will consider to disclose further information.

For Options with a four-year Waiting Period, a four-year performance period applies and the respective CAGR is calculated for the last twelve months as per the end of Q3 2019 through the last last-twelve months as per the end of Q3 2022 as relevant performance period.

For Options with a five-year Waiting Period, a five-year performance period applies and the respective CAGR is calculated for the last twelve months as per the end of Q3 2019 through the last last-twelve months as per the end of Q3 2023 as relevant performance period.

European online retail is expected to see continued strong growth. The online European retail industry is projected to grow at a CAGR 7%[4] in the next 4 years, while Zalando aims to outperform the online fashion market by the factor 2x.

The percentage of vested Options which can be exercised depends on the extent to which the Performance Criterion has been met. 100% of the vested Options can be exercised if a targeted CAGR of at least 15% has been achieved during the relevant performance period. Otherwise, and for each additional 0.5%-point shortfall of such targeted CAGR of 15%, a 10%-point reduction to the relevant percentage of vested Options which can be exercised is applied as follows:

CAGR	**Exercisable Options (in % of total number of vested Options)**
CAGR ≥ 15.0%	100%
< 15.0% and ≥ 14.5%	90%
< 14.5% and ≥ 14.0%	80%
etc.	
< 11.5% and ≥ 11.0%	20%

[4] Only 4-Year CAGR (2018-2022) available; Source: Euromonitor, fixed exchanges rates. Data for Europe (excluding Russia) includes apparel and footwear, bags / luggage, jewellery and watches. All figures incl. of sales tax.

CAGR	Exercisable Options (in % of total number of vested Options)
< 11.0% and ≥ 10.0%	10%
< 10.0%	0%

Exercise Period

Vested Options may be exercised, to the extent the Performance Criterion has been met, any time after the expiry of the relevant Waiting Period until the end of the 8th year after commencement of the new term (i.e. until 30 November 2026) subject to certain black-out periods and potential statutory restrictions.

Dividend Payments

If the Company distributes dividends to its shareholders, the holders of Options are entitled to a proportionate payment in relation to their vested and unexercised Options.

Change-of-Control

In the event of an acquisition of control of the Company within the meaning of the German Takeover Code (*Wertpapiererwerbs- und Übernahmegesetz*) in connection with a voluntary takeover offer, or resulting in a mandatory takeover offer, under the German Takeover Code, the Option holders will be entitled to demand from the Company that all vested Options are cancelled against compensation in cash with such compensation to be calculated based on the consideration per share paid by the respective bidder under such take-over offer. The Company, in turn, is entitled to demand from the Option holder that all Options are cancelled with (i) vested Options being cancelled against compensation in cash (which is again calculated based on the consideration per share paid under the takeover offer) and (ii) not-yet vested Options being replaced by an economically equivalent new program.

However, there will not be an accelerated vesting of Options or a termination right as a result of such change-of-control.

D. Procedure and Main Considerations

The Supervisory Board has set up a Remuneration Committee consisting of four members, all of which are considered independent within the meaning of the German Corporate Governance Code. The Remuneration Committee reviewed the Management Board's performance and in 2017 started discussions on the design and introduction of a new remuneration system for the Management Board, which were concluded in the first quarter 2018. In this process, it was supported by independent external advisors.

The total remuneration under the new remuneration system is set to be appropriate to the tasks and performance of each of the three members of the Management Board who act as co-CEOs. The criteria used to determine the appropriate level of remuneration are driven by each member's responsibilities and individual contribution, as well as the Company's economic situation, performance and future development. The industry context, as well as the internal remuneration structure, are also considered.

In preparing the proposed remuneration package of the members of the Management Board for the new 5-year term, the Supervisory Board and its Remuneration Committee considered various relevant perspectives:

- Company's perspective (internal):
  - Zalando's strategic (growth) ambitions
  - Required leadership capabilities and competencies
  - Internal pay relativities and alignment of incentive structures
- Labor market perspective (external):
  - German cross industry market, including more or less similar sized (M)DAX companies amongst various industries[5]
  - International sector specific market, including more or less similar sized technology driven companies located in Europe and US[6]
- Relevant principles from the German Corporate Governance Code

These perspectives have been incorporated in the proposed remuneration package to the extent appropriate and reasonable. This can be summarized as follows:

- Zalando's strategic ambitions are translated into the performance criterion applicable under the new long-term incentive. Moreover, the entrepreneurial spirit to realize these ambitions is reflected in the extreme focus on the long-term incentive within the total remuneration package. This is appropriate for Zalando, which is still a founder-led company;

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[5] Please refer to the Annex for the companies used for benchmarking purposes.
[6] Please refer to the Annex for the companies used for benchmarking purposes.

- Realizing the strategic ambitions requires a specific type of talent and leadership. Therefore, one of the design objectives of the new package has been retaining and incentivizing our high-quality Management Board members. In this perspective, the Supervisory Board believes it is appropriate to assess the labor market perspective more broadly than only the German market. In line with the specific characteristics of Zalando, an international group of technology-driven and consumer-focused companies has been used in addition to reflect the relevant labor market dynamics. The proposed remuneration package qualifies at the upper end of the defined German cross industry peer group (at Total Direct Compensation level), while it positions slightly below the 25^{th} percentile of the international sector specific peer group, thereby indicating a balanced outcome;
- When comparing the total remuneration package for the three current members of Management Board (taking into account the long-term incentive value by means of the annualized fair value at the date of grant) to the average remuneration of senior management and also to the average remuneration of professional staff, the internal pay ratio has decreased over the last year since the remuneration package for the Management Board members has not changed during that period (while average remuneration at lower levels increased). With the proposed package, the internal pay ratio will decrease a little further. Also, the continued use of a share-based long-term incentive for the Management Board is aligned with the compensation structure of other senior leadership positions within Zalando which are also structured to contain a significant share of share-based long-term incentives;
- The new remuneration system will comply, and the process of its development has been performed in compliance, with all recommendations of the German Corporate Governance Code dealing with Management Board remuneration.

Furthermore, the Company decided to disclose, in this report and also in future remuneration reports, all components of the new remuneration system of the Management Board on an individualized basis, irrespective of the exemption from individualized disclosure applicable for the last time to the Company's annual financial and consolidated financial statements 2018 pursuant to a resolution of the Company's general meeting dated 11 July 2014.

E. Other Notes

For purposes of the implementation of the new remuneration system, a new service contract will be concluded with each of the members of the Management Board. The new service contracts will each have a fixed 5-year term commencing on 1 December 2018 and expiring as per the end of 30 November 2023, corresponding to the proposed new 5-year term of appointment.

If a member of the Management Board is revoked from office by the Company without good cause for such termination within the meaning of Section 626 of the German Civil Code (*BGB*), the new service contracts are intended to provide for a right of the

Company to unilaterally terminate, against severance payment, also the respective service contract with statutory notice period. The severance payment will equal, in line with the relevant recommendation of the German Corporate Governance Code, the annual fixed base salary for two years, but at maximum for the remaining contract term. Similarly, the respective vesting scheme for the Options under the New LTI, will in such case provide for a continued vesting for up to further two years (see C.II. above).

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DISCLAIMER:

PLEASE NOTE THAT THE PROPOSED NEW REMUNERATION SYSTEM IS NOT YET IMPLEMENTED AND ONLY KEY TERMS HAVE BEEN AGREED WITH THE MEMBERS OF THE MANAGEMENT BOARD. THE COMPANY AND ITS SUPERVISORY BOARD MAY THEREFORE STILL DECIDE TO CHANGE OR AMEND THE PROPOSED NEW REMUNERATION SYSTEM.

Appendix

The table below provides an overview of the reference markets that have been used for benchmarking purposes. For the German cross industry reference market, a selection of (M)DAX companies was made based on comparability in terms of size. For the international sector specific reference market, a selection of European and U.S. companies was made based on comparability in terms of size and comparability in terms of (technology-driven) operations and/ or business model.

German cross industry	*International sector specific (technology-driven)*
AXEL SPRINGER	AMADEUS IT GROUP
DEUTSCHE BÖRSE	ASOS
DÜRR GROUP	CIMPRESS
FRAPORT	CNOVA
FUCHS PETROLUB	CRITEO
GEA GROUP	EBAY
HUGO BOSS	EXPEDIA
INFINEON TECHNOLOGIES	HSN
K+S	KLARNA BANK
KION GROUP	LIBERTY INTERACTIVE
KRONES	NETFLIX
MTU AERO ENGINES	OCADO GROUP
PROSIEBENSAT.1 MEDIA	PRICELINE GROUP
RTL GROUP	UNITED INTERNET
STADA ARZNEIMITTEL	WAYFAIR
SYMRISE	YAHOO!
	YOOX NET-A-PORTER GROUP