27-Feb-2020

Zalando SE (ZAL.DE)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Dear, ladies and gentlemen, welcome to the Conference Call of Zalando SE regarding the publication of the Q4 Results 2019. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. [Operator Instructions]

May I now hand you over to Patrick Kofler, who will lead you through this conference. Please go ahead.

Patrick Kofler

Team Lead-Investor Relations, Zalando SE

Good morning, ladies and gentlemen, and welcome to our full year 2019 earnings call. The call today will be extended as we have joining our co-CEO Rubin Ritter as well to talk about our strategic initiatives and our achievements of 2019 and then followed by a speech by our CFO David Schröder, who will walk you through the financial and discuss with you the outlook for 2020. As always, this call is being recorded and webcast live on our Investor Relations website and a replay of the call will be available later today. Rubin, the floe is yours. Please go ahead.

Rubin Ritter

Co-Chief Executive Officer, Zalando SE

Yes, welcome and good morning also from my side, and thank you for joining our call this morning. One year ago, we met for our Capital Markets Day in Berlin and I think most of you had the opportunity to join and we talked about the next chapter of our growth journey and today, David and I are excited to give you an update on where we stand one year later. So at the heart of our presentation in the last year was our vision to become the starting point for fashion. So by that we mean the destination that all consumers naturally gravitate to for all of their fashion shopping needs. This ambition is based on the observation that we see customers choosing very few destinations when they are looking for service to buy our product to shop. For example, we see subscribers gravitating to Spotify whenever they want to listen to music. You see this trend becoming even stronger with the rise of apps over the last years.

I think it's true for most of us that we only download very few apps that we then use with a high frequency. And our goal is to be one of these few apps. And our goal is to be the one app that consumers use for all of their fashion needs. We have also last year talked about my favorite chart, which is the market opportunity that we have ahead of us. By now, I think you know that the fashion market is forecasted to grow to about €450 billion over the next five to 10 years, and we continue to see an ongoing shift towards online which we expect to be at about 25% online penetration compared to the 15% today.

As you know and as we have said in the past, our long-term ambition is to serve more than 5% of the overall European fashion markets which corresponds to about 20% market share in online fashion. I think this underlines once again how much growth in the way we have still ahead of us even without leaving Europe and in that context we have stated our goal to reach €20 billion GMV by 2023-2024. That aspiration is not without ambition, because it means what essentially double, triple the company compares to 2018. I think this growth outlook is not only exciting to me but to our entire team because it underlines that we are still very much at the beginning of our growth journey. Some of us call us a large company if we use the measure of a 12-year-old company. But I think we are really a small company, if you use the measure of the size of the opportunity that we are targeting.

Now over the last 12 months, I think we can really say that we have delivered on both our vision and our targets. So if we talk about our vision of being the starting point we have been able to grow visits by an astonishing 33% to 4.2 billion visits in 2019 which once again underlines that Zalando is the biggest shopping street for fashion in Europe.

I would like to emphasize that in absolute terms, we have grown more than one billion visits in just one year. I've just emphasized the strategic importance of the app business because the app helps us to build even deeper relationships with our customers and our app business has grown 56% year-over-year to about €4 billion in GMV, which is about 50% of our business. And I think this 50% shows that the app and for us being not an app only business, it's already an incredibly strong number. But I think it also leaves additional leeway for future growth.

If we look at our financial targets, David is going to give more detail later, but I would like to already point out the immense growth we have had on GMV growing 24% to €8.2 billion and also here with €1.6 billion in absolute growth in just one year. We have seen the highest absolute growth that we ever have been able to achieve in one single year.

Now on the coming pages, I would like to give you some backgrounds on the three strategic priorities that we have them and that we will be working on in order to continue to progress towards our vision and our goals. And we have also talked about all three in the last Capital Markets Day. And so they were not new to you.

Our first and most important priority is to continue to deepen our customer relationships with our existing customers. Our goal is to play an indispensable role in the lives of our customers. And for that purpose we continue to invest even more to make our strongest relationships even stronger. In this area, we measure our success by the health of our cohorts or the share of wallets and by the resulting customer lifetime value. Our second priority is to continue to grow our active customer base. We want to be relevant to a broad audience in Europe and already today we are serving 31 million active customers but Europe has about 400 million inhabitants. So it's pretty clear that also on this dimension we have a lot of leeway for growth. Our third priority is to transition towards a platform business model. We want our customers to enjoy endless choice and we want them to say if I cannot find an item on the Zolando it probably does not exist. If we want to get there we have to make sure that our brands take the steering wheels into their own hands and decide themselves which products to list when to list them and at what price and therefore have an incentive to build their own business on Zolando.

For us this means that we continue to focus primarily on building a highly scalable infrastructure of technology data and logistics that all brands can use to reach European consumers. Now these three priorities can be looked at as separate initiatives but of course the reality is that they are highly connected and highly interlinked. So if we manage to deepen our customer relationships it will increase our CLV which will make our active customer growth even more attractive. If we grow our active customer base more we will be able to attract more brand partners and convert them even more successfully into a platform business model. And if we manage to do the platform transition well we will strengthen our assortment which again will help us to deepen customer relationships.

Now on the following pages let's go through each one of these areas and talk about some examples and also some plans that we have for 2020. So starting with the first priority I think it is interesting to revisit the cohort analysis that we have shared with you already a number of times. So this chart maybe to start just again with the explanation what we chose is the total GMV per cohort per order here. The light grey bar that you see at the bottom shows the gross merchandise volume from these cohorts that we had acquired before 2014. So before the chart starts. Second on top of that you see the cohorts we have acquired in the years thereafter and you see the revenues cohorts we've acquired in the years thereafter and you see the revenues that they make over this time periods – GMV that they make over this time period, excuse me.

So from this chart, what can we say about the health of our customer base and of our cohorts. So the first thing we can say is that the first year churn continues to come down. So that is the churn of customers not shopping again in the first 12 months after they have shopped at Zalando for the first time. Actually we see that in the last four years, customer churn has come down by more than 6 percentage points. If you look at churn more closely, overall, I think the 6 percentage points improvement is actually quite massive improvement because typically you need to do a lot of work to even just to achieve a 1 percentage point change in churn. And I think the work we have been doing over the last years and increasing our NPS and building additional tools for retention and building a stronger proposition are really payout in this regard.

The second thing that we see is that the cohorts continue to grow over time. So after the cohorts have churn like some customers have churn out in the first 12 months after that GMV of this cohort starts to grow again and over the last years the cohorts have been growing by about 5% per year on average. The third thing that we see that for 2019 we would have grown our business even if we had not acquired a single new customer to the company. So if we just stay with our existing customers, business would have grown regardless of any churn. The fourth thing that we see is that every new cohort is bigger than the previous cohorts. So every new cohort that we acquire is bigger than the previous one. The only exception for that is 2016. And the last thing that continues to hold true is as we have shown on the Capital Markets Day, we continue to see that the customer segments with a higher spending continue to grow faster than the company overall, which also speaks to us to continue to deepen our customer relationships.

So I think this really underlines one thing – once again that we are creating a very healthy customer base and that we are succeeding in building customer relationships over time.

So what we want to do – what we want to do to drive deeper relationships also going forward. One of our most important initiatives is really Zalando Plus, as you know this program is targeted at customers that are willing to commit to Zalando by signing-up to the program and paying an annual fee and in return we give them the best service the fashion e-commerce has to offer, in terms of faster delivery, dedicated fashion advice and explicit assortment – exclusive assortment.

In 2019 we have gained even further evidence that Plus helps us to build even healthier customer relationships. So we see that Plus customers are happier than the average. So there NPS is four points higher, we see that Plus customers have a high engagement and higher frequency so they visit us 70% more than the average customer and we see that customers on Plus shop more, so actually they shop more than three times more than the average Zalando customer. So I think this underlines how powerful this tool is.

So also in 2020, we will continue to focus on improving the quality of the benefits that we offer and also continue the international rollout – of course we also wanted to continue to create more opportunities for customers to interact with us and create even more used cases where we can help our customers and this is why I'm really excited to announce the launch of a new category the pre-owned category. So currently you know the Zalando mainly for connecting consumers and brands for buying and selling new fashion, in the future we also want to be known for connecting buyers and sellers of pre-owned fashion. This is actually an initiative we have been testing since 2018, so we already have gained two years of experience and over that time period we have bought back more than 1 million pre-used items from our customer base and we feel it's now time to really go from testing into scaling. So what you can already do today in the Zalando Wardrobe app is that you can sell us used products from your wardrobe in a very convenient way. And in return for that you will receive the Zalando credit that you can redeem on our platform. Now the big new thing we're doing this year is that we will also allow you to discover a curated selection of pre-owned products on our main destinations so an Zalando. From that we see a number of opportunities and the first opportunity is that we think this can help us to deepen customer relationships because we do not only help you to fill your wardrobe but also to de-clutter your wardrobe. And we think the credits at the return will drive even additional frequency.

The second opportunity that we see is that we will complement our offer. So we will start to address the demand from young customers who are increasingly willing to shop pre-owned fashion. From our customer research, we know that there actually is a increasing number of young customers that states that they only want to buy they're only interested in buying pre-owned fashion.

And the third opportunity that we see is we need to bring our sustainability strategy that we have announced last year to life. And I think this is happening in exactly the way we would like to see it because this initiative is really an integral part of our business model and our customer proposition and this is how we think about sustainability should start to become a really integrated part of our business proposition.

Now let's turn to the second priority I talked about, which is active customer growth and here I think it make sense to look back the couple of years. So what has been the development over the last years. We really have seen marketing as a percent of sales coming down very significantly since the IPO from 13% at the time of IPO to 7% in 2018.

And as you know we have reinvested a good portion of [indiscernible] uptake into continuing to improve our proposition and as a result of that we have actually been able to improve customer KPIs and deepen customer relationships. So we saw NPS going up and then we saw as I explained churn coming down, share of wallet going up and as a result also CLV developing positively.

And this again has created an opportunity to actually think about if we should start a marketing again to make use of these improved customer KPIs. So in order to achieve this you'll remember that we executed a marketing change in 2018 where we reorganized our marketing and we upgraded to AI based tooling. We worked on developing strategies to select more to the effective content for performance marketing.

We introduced [indiscernible] and audience based testing and they did testing to have a more accurate measure of our ROI. And on that basis we have now increased our marketing spending quite substantially in 2019. So for the first time since the IPO which I think for the first time since we started the company marketing as percent of sales has been going up.

And as a result of that we have seen extremely strong active customer growth in 2019. We have actually added 4.6 million additional active customers to our customer base. That's 1.2 million more growth compared to last year or 36% more. And we have been able to achieve this with a reasonable payback period for the new customers. So I think this has been incredibly successful initiative. But of course marketing is more a tactical tool. Of course we want to continue to grow our active customers but just building a stronger and stronger proposition and that is what you will be also focused on in 2020 and in that context I'm excited to announce two more initiatives that we want to launch this year and the first one is to expand our Premium segment. Premium has been showing really strong growth over the past years, actually in 2019 has been growing with 35% and now we feel it's time to take the next step and to become also the starting point for our customers that are particularly interested in Premium and even Luxury brands. We are convinced this is a huge opportunity for us as a business. It is a large segment, about €40 billion market size in Europe. The segment is shifting online but even faster than regular fashion, so online CAGR over the last years has been 16%. Customer interest already on our destination is quite high. We have received 20 million searches for luxury brands that we do not yet carry. And in terms of order economics, I think its obvious how this category can help us to drive a higher average basket sizes and also counterbalance some of the effect that we have seen over the last years from fast fashion growing over-proportionately in our assortment.

So all in all, I think this is a great opportunity to address also new customer groups because we see really rising customer groups of young premium shoppers and I think Zalando is really well-positioned to also serve these customers. And the second initiative is around expanding and continuing to expand our logistics network by building a local spoke warehouse in Madrid. Spain is one of the biggest European fashion markets and we have seen strong growth momentum there recently, however, we think we are still lacking behind in terms of convenience proposition because we don't have a local warehouse and this is where we are confident that this spoke can really unlock customer growth in the Spanish markets. And we also think this is very much in line with our platform strategy where we have said that we want to build the pan-European infrastructure of technology, data, but also logistics which brands can use to reach European customers online.

Now with that, let's come to the third priority that I talked about, so the platform transition. This is something that we have been working on and talking about for several years. And as you know over time, we have continued to refine our approach. And then the last year, we put really a lot of emphasis on three connected initiatives that we talked a lot about during the Capital Markets Day. So let's briefly talk about the progress we have made. So the first initiative is of course the partner program itself, where we offer brands to be in the driver seat and to build their own business on our platform. The shelf partner program has grown from 10% to 15%. So the share has increased by about 50%. And of course if you look at the underlying item growth and GMV growth of the partner program, it is of course substantially higher. So the partner program GMV has been growing more than 80% a year-over-here. And I think this really puts us on the right trajectory towards our long-term aspiration of about 40% partner program share.

The second initiative is ZFS, as you know we offer our brands the service to use our logistics footprint, and this offers great economic advantages. We are often able to combine shipments, and therefore save on the delivery fees, and this is really also key to reduce any adverse impact that the partner program has on our unit economics. So here we have seen extremely strong progress. The items that we have shipped through ZFS have grown 240%, and we have gotten in the fourth quarter to 40% volume share of the partner program. And here we are really is significantly ahead of our rollout plan and on a great trajectory. On 2020, of course we want to continue and we are confident that this year we will see more than 50% of items being shipped via ZFS.

Now the third priority has been our media business, ZMS, here we offer our brands the opportunity to buy additional visibility and to acquire additional traffic on our platform and we believe that this will be a very meaningful margin contributor for us in the long-term. Also here we have seen, a extremely strong growth, revenues of ZMS grew almost 120%, and the ZMS revenues now account for roughly 1% of our GMV. So we are well on track to our long-term ambition of about 3% to 4% of GMV. When you look at the page, you get the bit the impression that ZFS is a bit leading and ZMS is lagging behind in terms of progress. And I just would like to point out that this is very much in line with what we communicated on the CMV.

And the reason is that ZMS for the brands is a more complex service to understand and to use. So it also takes more time to scale now if we look at this year, of course we want to continue to drive the platform transition at full speed. So let me just quickly talk about a few initiatives that we are working on, and the first one is really just to continue to internationalize the partner program. Many partners start with us in Germany because that is our biggest market and our home market, and the pilot program shared in the German market is actually at about 25%. And I think this is a great sign because in many ways Germany is also kind of the leading indicator to where KPIs and developments can go once we roll them out internationally. So we are working with partners to go really from the German pilot into a full international roll out. And I think this is a very clear an executable lever and the success we have had in the last year I think will help us to also accelerate this progress in this year. And also having ZFS growing in China will help us because it makes it operationally very easy for our brand partners to go international on the Partner Program. The second initiative is obviously to continue to work on integrating new partners and having them extend the range that they're off on our platform. We have currently about 500 brands enrolled on the Partner Program which is still I think small compared to the 2,500 brands we work with overall and small to the number of brands we put on board into this program. So we are working to make onboarding even faster and even easier. And of course also to scale our sales force that works especially with smaller local partners and make sure to convince them to also join the Partner Program.

The third initiative we are driving is the ZFS off-price integration. I think that's actually interesting initiative to understand how different parts of the business really come together to create value. So we are now offering a direct integration between ZFS and off-price which gives partners that put their inventory for the Partner Program into our warehouse to sell any leftover items on our off-price channels and therefore we further increase their stock flexibility and limit their inventory risk and at the same time we create a business opportunity for Zalando off-price specifically for Zalando launch to have access to attractive merchandise.

The fourth initiative I would like to mention is really to build the next generation of our tooling. So in the platform world obviously the tooling we offer our brand partners is key and we want to make sure our platform is more accessible by making it easier to onboard and integrate and that the platform is more understandable by offering the analytics tools that allow the brands to really understand the drivers of the trading outcome and then also to make it actionable by making it easier for them to influence the outcome, for example through ZMS. And we would like to integrate all of this into one integrated tooling suite that makes it even easier for partners to be successful on our platform because on our platform the brand success also will be our success.

Now, in summary I think from my perspective 2019 has been a year where we really have shown that we have a clear direction and that we have made great progress towards both our strategy, but also in terms of our operational excellence and also our financial success and I really would like to thank the entire team at Zalando for the great work that has come in to making this year a big success. And for the next years we want to continue to execute on our ambitious plan and we think the plan is the right plan, make sense and that is our path for success and we want to continue to execute on the priorities I've outlined of building deeper customer relationships, driving active customer growth and driving the platform transition. So, we continue to be excited about this opportunity to both the starting point for fashion and to also build a European digital success story and with that I would like to hand over to David for the finance section.

David Schröder

Chief Financial Officer, Zalando SE

Thank you, Rubin, for this strategic update on our progress towards becoming the starting point for fashion and for sharing our priorities going forward. Let's now look 2019. We are particularly pleased to report that we were able to combine significant progress on our strategic agenda as Rubin outlined with strong financial results which I'm going to comment on. You can see some of the highlights summary on this page. Let me elaborate more on the details of our financial performance on the next few slides.

First, I would like to dive deeper into our top-line performance. Group top-line growth was strong with GMV growing by almost 24% to €8.2 billion in 2019. I would like to emphasize that we were able to accelerate our growth versus last year by 2.6 percentage points driven by healthy demand across all markets and fueled by the attractiveness of our platform business for brands in particular. The partner program showed a very strong performance in 2019 especially in Q4 when partner program share reached 15% of fashion storeGMV. This also explains to a large degree the gap of around 3 percentage points between GMV and revenue growth of around 20%.

At the same time our B2B services Zalando Fulfillment Solutions and Zalando Marketing Services contributed strongly to grow revenue in 2019 already. Let's now look at the different segments. Our core segment fashion store saw 20% revenue growth in 2019. We are happy with the strong performance of our core sales channel overall. This is also true for the two regions, the DACH region and rest of Europe. DACH exhibited even higher growth than last year. So the growth is up plus 1 percentage point year-over-year and rest of Europe continued to significantly outperform DACH by 6.9 percentage points. Our offprice segment recorded 33% revenue growth in 2019 and this development was mainly driven by strong performance in Germany and our younger market additions in Poland and the latest addition in Q4 of last year Czech Republic.

In our other segments we saw revenues decreased by 43% in 2019. This shouldn't come as a surprise to you we've talked about it in recent earnings calls before and it had to do with the fact that our private label activities have been significantly downsized in Q1 2019 and are now no longer reported in the other segment. But I'm rather proud of the fashion store segment. Excluding that levels would have resulted in a pro forma revenue of €118 million in 2018 and a growth of our business of around 60% in 2019. The main drivers of this growth are Zalando marketing services and our personal style advice service Zalon. Looking closer at Q4 in particular we see a similarly strong development across segments and We see a similarly strong development across segments. And more than 24% GMV growth overall despite a very strong prior year baseline of more than 25% growth. Record breaking Cyber Week results significantly contributed to our success in that quarter.

So let's talk a bit more about Cyber Week. Cyber Week 2019 was another huge success for Zalando, especially in the light of an outstanding partner program performance. We were able to prove that we can leverage our entire platform ecosystem at scale to provide millions of customers with very attractive offers rather than an extended period of massive demand. I think it's fair to say that, thanks to our partners Cyber Week is much bigger than it would have been without them.

Let me highlight some of our key achievements. We acquired a record breaking number of around 840,000 new customers. Cyber Week [indiscernible] increased by 32% compared to 2018 and partner program share of GMV averaged 20% actually it peaked at more than 50% on the day after Black Friday. While this combination of strong demand and attractive offers led to exceptional levels of traffic orders and shipments, our technology and logistics infrastructure performed at very high levels throughout the event and we were even able to increase customer satisfaction as a mirror by net promoter score by plus five points year-over-year. This brings me to our key customer KPIs for the fourth quarter.

Since Rubin already mentioned that we are progressing very well on our customer dimensions, I will keep it short at this point. In Q4, we saw all KPIs trending in the right direction on top of strong increases and active customers, orders per active customer and GMV per active customer, average basket size very much stabilized at around minus 1% year-over-year following a steep decline of more than minus 5% in 2018. This can be largely attributed to the success of our continued order economics focus, in particular the rollout of our customer segmentation approach and the introduction of minimum order values across different markets.

Let's now take a closer look at our profitability. We ended the year at the very top of our initial adjusted EBIT guidance of €175 million to €225 million that resulted in a relative increase of 30% and an absolute increase of €52 million of our adjusted EBIT. Despite continued growth and platform investments.

I will elaborate more on the different drivers on the next slide. Before we do that though, let's take a look at the profitability of our core Fashion Store business first. The Fashion Store adjusted EBIT improved off in absolute terms and in relative terms mainly driven by the [indiscernible] region and that we were able to improve our full year margin by 2 percentage points and our Q4 margin by 0.5 percentage points as gross margin, fulfillment costs and admin cost improvements more than compensated for ongoing investments in customer proposition and acquisition.

In rest of Europe our margin for the full year remains around breakeven as we made deliberate over proportional investments into local customer experience improvements and customer acquisition efforts to drive future growth and market share gains, particularly in Q4. As a result active customers grew [indiscernible] overall at the rate of more than 20% year-over-year and we added close to 1 million active customers in rest of Europe during Q4 alone. This represented almost two-thirds of the total active customer growth in that quarter.

Obviously this came at the cost of a temporary margin decline in Q4. We are convinced that these investments and the resulting strong growth in active customers will pay off in terms of strong and profitable growth in the future.

Let me now give you some more color on the main effects that led to the positive development of profitability both in absolute and relative terms this year. For 2019 overall gross margin showed a recovery from last year's debt level mainly due to a more normalized seasonal trading pattern at a buying conditions and lower allowances for the effective returns.

In contrast Q4 development was slightly negative due to higher price investments and special partnered program incentives during Cyber Week which allowed us to drive customer satisfaction and platform transition alike and also to capture additional growth opportunities particularly in the rest of Europe Our fulfillment cost ratio improved year-over-year as a result of a higher level of utilization, and therefore also higher efficiency across our logistics network as well as a result of improved RA economics. The Q4 development was in line with full year development. Q4 results clearly show that our fulfillment network works cost efficiently if fully utilized.

In 2019, our marketing cost ratio increased year-over-year as we ramp up our customer acquisition and engagement investments supported by our new ROI-based marketing approach. The Q4 development was in line with the full year development and also in line with what we communicated during our Q3 earnings call. Last but not least, admin costs improved significantly as a result of increasing economies of scale, continuous process improvements, and ongoing cost efficiency measures, both on a yearly and on a quarterly level. These cost developments all together resulted in a 30% increase in adjusted EBIT in 2019. Let me also note that the switch to the new IFRS 16 accounting standard acted as a slight tailwind for profits contributing around €7 million to our full year result.

Before we move on, let me briefly use this opportunity to comment on the development of our net income as well. You probably have noticed that net income and earnings per share almost doubled year-over-year, equally driven by a notably higher EBIT as well as significantly reduced effective tax rate, which came down from 52% in 2018 to 31% in 2019. The tax rate decline resulted from the recognition of unrecognized tax loss carry forwards in all foreign subsidiaries. Higher income tax differences between subsidiaries and the group, and the full tax deductibility of our most recent stock-based compensation programs. Going forward, we expect a tax rate of about 32% to 34%, with continued positive effects on net income and cash flow.

To conclude our section on 2019 financials, let us now also take a look at the development of our cash flow.

Net working capital continue to be negative and even further improved year-over-year with a higher increase in payables plus 42% or plus €409 million and then inventories and receivables, net working capital continues to show a favorable trend. The overproportional increase in payables can be attributed to proponed delivery of inventory to drive availability for our customers, higher marketing spending and strong growth in our partner program.

With regards to CapEx, we were almost spot-on spending €307 million versus the €300 million we had guided towards as all key logistics and technology projects progressed as planned. Overall, our free cash flow in 2019 increased by €56 million from minus €40 million in the prior-year period. Free cash flow is mainly positive due to IFRS 16 adoption, which led to shift between operating and financing cash flow. As a result, our cash balance at the end of Q4 amounted to €977 million, roughly €20 million below last year's level.

Let's now turn to the outlook as the last section of our presentation. Before we focus on 2020, let me reiterate that we continue to primarily focus on capturing incredible growth opportunity ahead of us. Please think of Rubin's favorite slide. Aiming to grow several times faster than the overall European fashion and online fashion markets, we confirm our mid-term target of growing to €20 billion in GMV by 2023-2024, corresponding to around 5% market share of the European fashion market. In line with our strategy to become the starting point for fashion, the key building blocks of this journey remain the deepening of our customer relationships through continued improvement of our customer experience; second, the growth of our active customer base to our I-based investments in customer acquisition; and third, the transition to a platform business model and further scaling the partner program and our partner facing services. We therefore confirm the mid-term guidance we issued at our CMD last year for the coming years. We continue to target a growth of – a GMV growth of 20% to 25% per year, which is two times to three times faster than the European online fashion market is expected to grow. We furthermore expect an adjusted EBIT margin of 2% to 4% during the transition period between 2019 and 2021, driven by continued investments in our growth and a successful platform transition.

After 2021, we expect margins to increase as our platform transition progresses. And last we continue to expect negative cash flows during the transition period driven by continued investments in logistics and technology to enable this growth, which would result in CapEx of 4% to 5% of revenue, thereafter increasing profitability will reside in stronger cash generation. With our strong 2019 performance, we successfully managed the first year of this transitional phase and you can see that we delivered at that higher end of our target growth and profitability corridors. So we are very happy about that performance.

In the coming years, we will remain focused on driving a successful platform transition to enable our starting point strategy and to lay the foundation for future strong and profitable growth. During this transition phase, we will continue to carefully manage the short-term trade-off between growth and profitability with the clear objective to maximize company value in the long-term. Let me therefore shed some more light on how to reconcile our margin profile during the transition period to our long-term target margin rate, since actually this has been one of the most popular question we got in our earnings calls this year and also on our road shows. While we remain committed to our 2% to 4% margin target for the transition period in order to maintain our strong growth trajectory and to unlock the full value of the platform business model. This margin target assumes continued EBIT investments especially on two dimensions. The first dimensions – the first dimension is our EBIT investments in to deepening customer relationships and growing our active customer base, amount roughly 3 percentage points in EBIT margin and come in mainly forms. First they are related to additional investments into brand and performance marketing as well as targeted price investments during retail events to drive strong growth of our customer base and to drive the market penetration across Europe. If we would simply cut our marketing investments by one third today we would already save almost €200 million a year which is equivalent to 3 percentage points in usage.

The second sector or the second area of investment is that we are obviously seeing over proportional and front loaded investments into our technology overhead as well as the teams that are building our new experiences especially our new premium membership program Zalando Plus, our personal style advice salon, our new pre-owned fashion category that we announced today. Also our local commerce proposition connected retail and third we are obviously also continuing our front loaded investments into scaling our European logistic network. As you've heard today we plan to open new local wells in Spain and we are also continuing to introduce exciting proprietary last mile delivery services particularly for Plus. As you would expect from these types of investments a typically result in additional temporary ramp-up costs which then are reflected in our margin in this transition phase. Let's talk about the second bit package of investments and these are really related to our transition to our platform business model and they account for roughly 2 percentage points in EBIT margin platform investments come in the form of additional costs that are mainly cost and negative tradeoffs between our existing wholesale business and the fast scaling partner program during the transition period. Let me provide you with some examples. I think we've talked before and you've also asked us about the address or the economics detect of the partner program in the short-term which result from shipping items of the same order in multiple shipments and which over time as you know we expect to mitigate any increasing adoption of Zalando Fulfillment Solutions. The second example potentially temporary overstock challenges, whenever partner programs gauge much faster than expected, given that our partner program is not 100% incremental and that wholesale budgets are not fully flexible in the very short term. And there's a further example, I would like to talk about the overall proportional and front loaded overhead investments also and the teams that are building the whole partner experience. So the partner program Zalando Fulfillment Solutions and also our team running Zalando Marketing Services, since those are clearly necessary to enable a successful platform transition.

If we were to adjust for these deliberate long-term investments of some 5 percentage points EBIT margin or around €350 million per year during the transition period, our pro forma margin would already amount to 7% to 9%. At the same time we are convinced that these significant investments help us drive company values since then help us to grow two to three times faster than the online fashion market. For the European market for example, Euromonitor currently forecast a growth of 9% in 2020. This would imply that our growth investments are generating in a tough market relative growth of 6% to 11% on absolute growth opportunity of an additional €550 million a year. Considering our revenue multiples, this investment clearly yields an attractive return in terms of a higher company value.

If we look even further beyond the transitional period and consider a long-term target date, where we can reap the full benefits of our platform. We continue to target a margin range of 10% to 14%. The additional margin improvement is mainly driven by growing the program share and the resulting benefits from increasing high margin commission and service revenues, especially advertising income from ZMS in order to capture the significant growth opportunity ahead of us, and also reap the margin opportunities We therefore continue to invest in order to maximize the long term value of our company. With this in mind let us now turn to our concrete outlook for this year.

Let me specify how our midterm guidance will materialize in 2020. For growth, we expect to grow GMV by 20% to 25% and to add around 1.6 to 2 billion additional GMV which would make it the biggest absolute growth we've ever achieved driven by continued customer acquisition and the deepening of existing customer relationships. As communicated before, we expect revenue growth to trail GMV growth as a consequence of our progressing transition to platform and an increasing partner program share resulting in revenue growth of 15% to 20% in 2020. Gap between GMV and revenue will most likely be smaller than in 2019 due to a stronger adoption of our partner-facing platform services a Zalando Fulfillment Solutions and Zalando Marketing Services.

For profitability, we expect an adjusted EBIT of €225 million to €275 million which at the midpoint would imply a 10% growth in adjusted EBIT despite continued investment into customer acquisition, customer experience improvements as well as the platform transition effectively laying the foundation of strong growth and market share gains in the future. Please also note that this EBIT guidance is in behalf of previously communicated range for the transition period.

At the same time, we will obviously maintain our focus on driving efficiency gains as well as on increasing the profit contribution from high margin platform services. Talking about cash flow we continue to expect slightly negative net working capital and CapEx of €330 million to fund our investments into logistics and technology which are among the key enablers of our platform. As a percentage of revenue CapEx would thereby continue to decline driven by logistics network optimization and platform benefits. Please note that this 2020 outlook is subject to a potential negative impact from supplier demand side disruptions caused by the coronavirus. Let me also make clear that we have not seen any immaterial impact so far. Looking forward; however obviously parts of our product supply could become delayed or even canceled which would temporarily negatively affect our ability to drive and satisfied customer demand. In addition, as spread of the virus across Europe could have temporary negative effects on customer demand. The situation is evolving. We are preparing for all kinds of scenarios and we are in close contact with our suppliers as well as logistics partners and we will provide more information during our Q1 earnings call in May.

Before we go into Q&A. Let me briefly comment on current trading for Q1. Overall, the year has started according to plan and we've seen a strong end of season sale period of the fall winter season. However two short-term effects I would like to mention and also briefly explain. Firstly, we see gross profits negatively affected by the exceptional Partner program performance in Q4 which exceeded by far our expectations and temporarily cost higher than planned wholesale overstock which we successfully sold off during our fall winter end of season sale.

Secondly, we see an industry-wide delayed season start into the spring summer season when compared to last year. Since we remain focused on long-term value creation, we continue to invest through cycle into driving a market growth. Both developments have been fully considered in our full year outlook for 2020. They're going to lead to a lower profitability in the first quarter compared to Q1 of 2019. We are now fully focused on ensuring a good start to the spring summer season and getting a head start into our full year targets. Looking further ahead we believe that on the back of our strong performance in 2019 and based on the outlook for 2020 we just presented to you. We are well on track to reach the goals we've laid out for the coming years at our Capital Markets Day last year. To summarize the goal is to become the starting point profession, we want to second to continue to capture market share and to show strong growth at solid profitability, while we execute on our platform strategy and invest into attractive opportunities for long-term value creation.

That concludes our presentation. Let's now go into Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you very much. Then we will now begin our question-and-answer session. [Operator Instructions] And the first question we've received is from Aneesha Sherman of Bernstein. Please go ahead. Your line is now open.

Q

Hi, good morning. My question is about the luxury platform. There have been some reports last month that Amazon is building a luxury platform in the US and Europe, which sounds very similar to what you've outlined today. Would you say that this is a defensive move on your part to gain traction with those premium brand partnerships and premium customers ahead of Amazon? And do you think Zalando can gain more traction in this segment than Amazon and why? And then my second question is, what is your weighted average commission rate today on Partner Program? And do you expect to move into luxury to provide some upside in the take rate for the next couple of years? Thank you.

A

Sure. Let me maybe comment on the first question, and then David can speak on the second question. So, expanding and doubling down on our premium category really I think is a very logical step if we look at the success we have had in the last years. I mentioned that in 2019 the premium category grew 35% and its already at a very significant scale. So we just see a lot of tailwind. We also see a lot of interest from brands to join our platform that are more at the higher end of the Premium segment and also some brand from the Luxury segment. So I think this is where it is a logical step for us to move into this direction. Also we see if you look at Premium and Luxury overall that I think the traditional customer segments that have been active in shopping these products is probably more declining, whereas the segment of younger customers that also start to purchase these products is really emerging and this is exactly the audience that Zalando is targeting and that Zalando is popular in. So I think this is a logical step for us.

I think when we compare it to Amazon I think all the differentiators that we also see in fashion apply, but I think they apply in an even more pronounced way because particularly for customers that are spending very high price points for very unique items, obviously to them, the whole fashion experience is even more important. And this is as you know where we really differentiate from Amazon. So I would expect our advantage in the fashion space what Amazon to be even more pronounced for Premium and Luxury.

Right and let me take your question on the commission rates. I think as we already explained during our Q3 earnings call we recently adjusted our commission rate table. It ranges from 5% at the very low end for low price high return rate categories all the way to 25% for high price full return rate categories. And I think it's safe to assume that our average commission rate is around the midpoint of that range. As you already pointed out in your own question, however, this is only part of the total take rate we get from partners. So what you can actually put on top is the take rate we get from them adopting Zalando Fulfillment Solutions and also Zalando Marketing Services. And as Rubin has outlined in the presentation we gave earlier, we actually see a stronger and stronger adoption of these services which will allow us to increase the take rate over time.

Operator: Thank you. Then we go to the next question that is from Tushar Jain of Goldman Sachs. Your line is now open. Please go ahead.

Tushar Jain
Analyst, Goldman Sachs International

Q

I was just wondering if you can elaborate, is there a possibility of you going into a loss in 2020 given the incremental step in the investments and when do you see sort of a margin reflecting in Rest of Europe segment. And second, just a clarification, the pre-owned initiative that you are doing, it is a marketplace business model or inventory owned for you and what is the sort of long-term margin you are expecting in that particular segment. Thank you.

A

So if I've understood you correctly because I think you were muted at the beginning of the question. I think you were asking around the outlook for Rest of Europe and how we see the margin evolving.

Tushar Jain
Analyst, Goldman Sachs International

Q

Yes.

A

If we tried to explain during the presentation, I think we are really focused to drive growth in DACH and in Rest of Europe, also in 2020 just like in 2019. it's also clear that Rest of Europe in a way is at an earlier part of the growth trajectory given that we enter those markets typically later than we played in that. And also given that the online market in at least some of those countries is far less developed and therefore we actually see it as a great opportunity to develop the market and also to continue to have a leading position in many of those markets. In terms of how we steer, I think just like 2018 and in 2019, we put our main focus on growth, but we do that within reason. So our goal is to keep that segment at least breakeven just like you've seen us do in the previous years and actually to maximize growth on top of that. Yes and let me maybe comment on your question on the pre-owned margin potential. So I think in general you know when we are launching something like this, I think it's too early to you know start right away with talking about the target margin, I think that's not how we approach it, I think we come really from what is the customer need and how can we best serve it. I think the main effect though in terms of economic attractiveness will be – not so much coming from the profitability of the segment itself but really from the effects it has on our overall relationship with the customer and then as I explained earlier and in this we also spend a lot of time talking about at the Capital Markets Day. The priority is really to deepen the relationships with our best customers and that means we want to create more opportunities for them to interact with Zalando and therefore to become more and more sort of indispensable in terms of how they think about the role we play in their fashion lives and we think very specifically this business model can create more traffic because we create additional use cases for customers to visit our app.

These things specifically and we see already that crediting these customers with Zalando credits for the products we buy from them also makes them visit us again and makes them buy again on Zalando and I think it's just a emerging and pretty substantial customer needs that is coming up with a whole movement also around sustainability, we just see young customers really sort of you know emphasizing that they want to see pre-owned items and that some of them even only choose to buy pre-owned items and if we want to be the starting point for fashion that's something that we need to serve and I think it will therefore increase our share of wallet and long term also CAV and of course that's one of the biggest underlying value drivers that we have.

Operator: Thank you. The next question is from Rocco Strauss of Arete Research. Your line is now open, please go ahead.

Rocco Strauss

Analyst, Arete Research Services LLP

Q

Yes good morning and thanks for taking my questions. I guess a follow-up on Aneesha's question with many luxury brands aiming to remain in control of a pricing is Partner Program. Actually the key [indiscernible] here to get those brands on board potentially in contrast to Amazon likely the offering a margin, why a shouldn't stronger growth in the premium segment rather add to a longer term margin expectations given the higher commission rates and higher basket sizes or is that already priced in the like 10% to 13% EBIT target margin? And secondly with 50% of GMV driven by InApp I guess that kind of further – like would use the dependency of Zalando on search engines. So I guess the question is two-folds here. With stepping into Beauty, high ticket -- high ticket premium segment items and movies, et cetera should we expect to see basket sizes actually rising from here on again? And the second part of that question is was Instagram pushing into shopping via check out especially is there a risk of the app exposure to drop or do you rather see Instagram still as a continuous customer acquisition tool? Thank you.

A

Sure. So let me maybe comment on your first and the third question and then David will comment on your second question on basket sizes. So in luxury and premium I think it is -- it can be both just in – and the rest of our assortments to really work with the brands through wholesale but also through the Partner Program and obviously by having these different tools in the toolbox, we want to make sure that we find the right way to collaborate with all of the brands because obviously they also have different preferences in terms of how big that trading abilities are, how much liquids they want to take and we are prepared to work in different homes with them. Obviously in premium and also luxury, the pricing piece is important. So that makes the Partner Program very attractive so that makes the partner program very attractive in the segment. On the other hand, I think that brands also know that we have no not the track record of being the drivers of discounting and going for no highly discounted sales. But really we want to help the brands to create a on price destination where customers come not primarily for the discount but really for the quality of product and service. And in terms of long term profitability, yes, I think premier luxury has high attractiveness because baskets are high and that also has a positive impact on profitability. But I think for us that doesn't mean that we change our long term model, but obviously this can be one of the tools to really increase the profitability potential of the company over time.

Maybe quickly on your third question, so the app has really higher strategic focus for us specifically because we think that can create really this destination that creates a habit for customers and that creates a very high repeat rates. And when we look at the underlying KPIs of the app, you already mentioned that makes up about 50% of our business. I mentioned it is growing with 56% year-over-year so there's a lot of future potential but also underlying that we see that customers that use the app are visiting our site more than 2 times as much as the average customer and that's customers that use the app have significantly more product views than the average customer and that NPS actually is more than 10 points higher than for the average customer. So everything we see in the app that is really driving customer activity and I think that also speaks to the defensiveness of that position because obviously those customers come directly to Zalando and also significantly lower acquisition cost in terms of driving daily and weekly traffic to the app. Instagram of course is also a credible destination, but of course much more on the inspirational side and much less on the commerce side. And I think it also remains to be seen if they really can build a destination that can be both like all the inspiration but then also the place where I shop. I think those are really ultimately two very different customer use cases. So we are very confident that with building a strong app destination ourselves, we are building a defensible position but we are also operating with social networks to really be part of those experiments and also be part of offering our brands the service to access social commerce.

And then close with the answer to your basket size question, of course you're right to point out that a higher share of premium items directionally leads to a higher basket but at the same time I think we also talked today about pre-owned fashioned items, we talk about beauty items which typically have a lower than average item value and therefore in the mix we actually expect that the basket size will remain pretty stable going forward. We are not expecting the type of decline we've seen in the past. Actually I think it's going to be stable and the main driver to drive GMD for customers is going to be frequency and obviously the frequency is going to be largely influenced by many of the things Ruben just mentioned so the app is a key frequency driver, plus is the key frequency driver, pre-owned will be a key frequency driver and therefore we have a good range of drivers to increase the cost of customer all and that's really our main goal to have an even deeper customer relationship and to have a higher CLV not just a higher basket size.

Operator: Thank you. The next question is from Charlie [indiscernible] of Exane BNP Paribas. Your line is now open. Please go ahead.

Q

Good morning. Thank you for taking my questions. I have just two. The first one just relates to the profitability of the DACH and the rest of the Europe segments within the fashion store. I know you don't give a full P&L breakdown anymore but I wonder if you give some insight. Is it still the case that most of the difference actually rates to the gross margins as was the case when you use [indiscernible] And then my second question relates to KICKZ. I see that you have some assets held for sale. I wondered whether you could just clarify you're selling the entire KICKZ business. And if so what was the profit contribution in the last financial year and is that in or excluded from adjusted EBIT? Thank you.

A

All right. So let me take your first question and then Rubin will shed some more light on KICKZ. With regard to the profitability I mean maybe before we talk about that let's also recognize that rest of Europe actually outgrows by 6 percentage to 7 percentage points. So obviously that requires some investment but we also get a good return on that investment. If we then look at the profit margin difference between those two countries it is primarily driven by two factors, one is a lower gross margin and the second one is higher marketing investments because we are trying to acquire customers much faster than in the DACH region. So as I mentioned two thirds of all new customers acquired in Q4 actually were customers in rest of Europe and that I think is directly linked to a higher marketing investment in [indiscernible] of sales in this region. Then on the second question relating to KICKZ so we have – we have sold the entire business and we have not made any adjustments in the EBIT for 2019 or 2020.

Operator: Thank you. And then we go to the next question It is from Andrew Ross of Barclays. Please go ahead. Your line is now open.

Q

Hi good morning. Just wanted to ask about advertising and a couple of bits of that. So first it's obviously now a few months since you introduced sponsored ads. Can you give us a sense as to how customer engagement is trending with those sponsored ads maybe any thoughts you can share in terms of how likely [indiscernible] click on them, how behavior is changing. And then you've given your 34% target of GMV in the long term. What kind of potential GMV from [indiscernible] do you think could be achievable in 2023 2024. So we can have a sense as to how meaningful it might be by then. Thanks.

A

Yeah so I'm happy to take both of these questions. As you rightly point out I think the key growth driver for them in last year has primarily been our successful product listing ads don't forget we also offer branding opportunities for brands and I think long term we also see a high potential in these types of performance and we also see rising interest of brands and these types of wallets especially during times like the season start or where they want to present new collections or feature specific product launches. If we look at our core product right now those are the product listing ads we definitely see a significant uptick compared to the prior year so I think if we compare where we were in terms of share of impressions a year ago and where we are now more than doubled. And I think that really shows you that we do not only see interest from brands but we also see – see this influencing and also going well with the consumer experience. This is obviously key for us because on the one hand you could think about obviously leveraging that even more and scaling it even faster at the same time we're very mindful that in the end most important thing is relevancy for customers and that's why we think it's great that we can show that we can do all hand-in-hand have great engagement on the customer side and at the same time grow our advertising business. And this is something we also expect to continue to do going forward. As you know long term we have a target of 3% to 4% of GMV for our advertising business. This is not the target for 2023, 2024, I think it's fair to assume that will be quite a bit along the journey already and for sure will be much higher than the 1% to see for 2019.

Operator: Thank you. The next question is from Rebecca McClellan of Santander. Your line is now open. Please go ahead.

Q

Yes. Good morning. And just – this is with your comment about the first quarter 2020 and the inventory mark down in wholesale. Have you anticipated to managing that filtration going forward balancing the growth program and how is that inventory mix et cetera?

A

Yeah. Great question. And maybe this is also an opportunity to provide you with some more context and also remind you of the things that have happened over the course of last year. But you might remember that when we were in our Q3 earnings call, we talked about the fact that during Q3, revenue growth of [indiscernible] growth is not only because of the baseline effect from the prior year but also because of the fact that we saw partners engaging less into end of season sales events at the end of the spring summer season. And as you know, it's our clear goal to be successful with our platform transition to make sure that they are engaged throughout the year and also contribute and have to offer our customers great deals in periods like Cyber Week or end of season sale. However, coming from this Q3 experience, we obviously wanted to make sure that we have the right of our customers and also have all the inventory we need to ensure sustained fast-paced growth, and therefore we actually decided deliberately to increase our inventory position in wholesale to have a great offer for the most important period of the year.

What then happened was obviously a great, in a way also unexpected because we saw our partners finally engaging much more than they ever had before into providing great offers to our customers, during [indiscernible] week, during Christmas sales, and now also during end of season sales in January and February this year. And this is something that we also drove very deliberately with the certainly two measures. One measure was, what we call price-based margin selection, it essentially creates the type of competition, you would expect from a large e-commerce platform because what it does during sales period in particular is that the merchant who offers the best price on a given product is able to list that product and sell it to consumers. And this obviously help many partners, especially also retailers to put great offers out towards consumers. The second thing we did is we provided partners with a special incentive on their commission rates because we obviously know that giving high discounts to consumers and then paying 25% commission in some cases might be tough. So therefore, we gave them a special incentive of a lower commission which obviously was tied to a certain growth assumption which then also materialized. So I think overall we are very happy with what we saw in Q4. And the short-term impact that related to this is obviously that we were slightly overstocked and then sold our inventory in January. I think long-term we actually think it's a great thing because long-term it means that we can count on partners to actually present a great offer and to drive our growth. In short-term we'll obviously continue to manage our inventory position closely and also make sure that we are prudent in our overall inventory management approach.

Operator: Thank you. The next question is from David Holmes of Bank of America. Please go ahead. Your line is now open.

Q

Good morning, guys. Thanks for taking the question. I just wondered if you could go into a little bit detail on the trajectory of the margin driver, so the [indiscernible]

A

Yeah. So I think the – since the overall margin is rather flat, I think the story is also rather simple, we expect a slight improvements in our gross margin and in our admin cost line, driven by scale effects, driven by also an increasing share of our platform business and driven by our continued focus on efficiency and we see a slightly higher marketing costs and slightly higher fulfillment costs driven by our efforts to acquire more customers and keep growth at a very high level and also driven by our continued investments and customer experience particularly for that customers.

Operator: Thank you. The next question is from Adam Cochrane of Citi. Your line is now open. Please go ahead.

Q

Good morning. First of all congratulations on the – on pre-owned [indiscernible] I think that's a very, very good initiative in terms of the right thing to do and the benefiting the consumers. So two questions, really when you've given your guidance previously of the 10% to 13% margin you split it down into the wholesale and the partner program with wholesale of 6% to 8% partner program of 20% 25% as a target margin would you able to say where you are today on that same basis. So we can try and forecast those two bits in a slightly different way to the way that you report at the moment, looking forward so we can reconcile that guidance and then secondly can you remind us you had no issues so far in Italy from the sounds of things, whereabouts is your warehouse or warehouses in Italy compared to the affected area and what proportion of your sales in Italy do you think would be in the north of Italy please? Thanks.

A

Right on Your first question. I'm afraid I won't be able to provide much more color. So I think we obviously have that split in mind when we talk about the overall target margin and we still target 6% to 8% margin for wholesale and 20% to 25% margin in partner program. But I can tell you however is that, if you look at all the components of our partner facing business or partner programs ZMS and ZFS that combined margin is already higher than the margin we have in wholesale today.

So it's no longer margin dilutive as it used to be in the very early days of the program but we are obviously also not yet at the level of 20% to 25% and I think we talked earlier on the call about how we – how we will be able to increase take rate over time to get there and on Italy yes it's right as I said overall there's no impact on the business yet related to the coronavirus in Italy in particular, our logistics sites are situated in the north, one in [indiscernible] that's the main one we use right now and future one in Verona which is supposed to go live over the course of this year and also to ramp up over the course of this year but it's not contributing major volume at the moment, all sites neither in the red or yellow zones as identified by the Italian government so they are not affected by the current cases in Italy And even if they were the network over there only represents around 5% to 6% of our overall outrun capacity, and we would be easily able to compensate any loss with the rest of our network. I think that's also the big advantage of having such an extensive network, it's I know more than 10 sites, they are in more than five different countries, and therefore I think we are, I think it's fair to say that we are very resilient when certain cases are up in different countries.

Operator: Thank you. The next question is from Jürgen Kolb of Kepler Cheuvreux. Please go ahead. Your line is now open.

Q

Very good. Thank you, guys and two questions on my side. First again, coming back to the Wardrobe app and the idea here, and I'm sure it will create some additional costs for you. How does that work in terms of when customers shift back or sell their merchandise for credit, do you have to clean the merchandise or what additional costs or services do you have to do in order for the merchandise to be resalable again?

And secondly on ZAYN, I think you put out a new -- notes – note recently saying that ZAYN will become a more sustainable brand. Does that mean that also the share of your private label will increase again, or will it more stabilize on these current levels, but ZAYN will become really the more sustainability share of your business? Thank you.

A

Yeah. Let me take those two questions. So, on the pre-owned category, the way that it works is that customers generally essentially take pictures of the products they want to sell us. And on that basis, we estimate the price and of course we also assess if we think they are resalable and then customers send these items in, where sort of ideally they can even use Zalando return parcels to just put them on top. So, in those cases no extra cost is incurred and then of course our team takes a look at these items and in the vast majority of the cases, we can then actually sell those items either in an offline location, so we have actually launched the store here in Berlin, where we sell secondhand products, and it's extremely successful. So the more that it's in, I think it's very thankful to us to bringing some additional traffic and customers. But then the idea is to really also sell it under the Zalando main destination. And of course that will be a highly curated approach. So we will not flat the platform with pre-owned items, but we will really curate the offer that we put on Zalando, so that it's really adding value to the customers. So obviously we are very much at the beginning of this and there will be many things that we can figure out and improve. But I think really this mechanism of having customers also think of us when they de-clutter the wardrobe. And then I think they're very happy to be paid in Zalando credits and that allows us also to really account for this additional frequency we can expect from that. So I think this is more of that has many, many interesting angles on how we can create value. I think it has also many dimensions where you can see that probably Zalando is really in the best position to offer this type of service. And obviously also too many things to figure out, and many things to improve over time. So we think it's really interesting and we are looking forward to customer feedback. Actually the feedback on the Zalando Wardrobe app is really positive. So if you want to take a look at it in the App Store, the reviews are really great. On your second question with respect to ZIGN. So you're right that we have turned that into a sustainable label and we are working on this really with the goal to also learn more about what does it mean to produce a more sustainable fashion to not only ask our brand partners to do it but to also do it ourselves and learn about it. And I wouldn't expect that it dramatically change just the private label share. But I think it can be a really interesting product for customers and it can also be a really good learning opportunity for ourselves.

Operator: Thank you. The next question is from Anne Critchlow of Société Générale. Please go ahead. Your line is now open.

Anne Critchlow
Analyst, Société Générale SA (UK)

Q

Hello. Two questions from me please. First of all just coming back on your comment that you expect improved gross margins for 2020; I'm also thinking about the successful Cyber Week and off price suggesting the customers really like discounts. So, how confident can we be that the gross margin should go up in 2020? And then secondly on off price, would you be able to tell us what proportion of sales relate to wholesale inventory, what proportion to partner program and what proportion to products that are important especially to the off price business? Thank you.

A

Yeah. So I'm happy to take those two questions. I think on the gross margin we are confident that we will see a slight improvement over the course of the year. I think what makes us confident is that we definitely see scale effects that are buying conditions for example and that we obviously also see an increasing effect from the platform transition. What we expect to obtain obviously is that we also want to play a successful Cyber Week in 2020 so this won't come as a surprise and it is fully part of our outlook. Relating to your off price question, I think it's important to understand that off price is actually not a platform business as such, so 100% of the sales that we do there are is on inventory it is – also true and I think we try to explain it earlier that now we've built a connection between Zalando Fulfillment solutions and off-price leveraging the full power of the platform for our partners and partners do that however, they effectively sell their left over inventory to off-price and then it becomes also wholesale business for off-price as a result.

Operator: Thank you. The next question is from Michelle Wilson of Berenberg. your line is now open, please go ahead.

Michelle Wilson
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Hi good morning two for me please. First of all just on the customers acquired over cyber weeks I think it's 20% of your growth in customers. I guess they were incentivized through price investment and marketing. How do you get comfortable that those cohorts will show similar economics to the rest of the customer cohort and then secondly just a clarification point on the commission rates that you mentioned earlier that you talked about 5% to 25% range and is that gross commission or was that commission net of any volume rebates and if it nets can you give us an indication of a quantification of volume rebates that you're paying out and where they're recorded on the P&L.

A

So let me start with the first question and then David can take the second question. So on the customers acquired during cyber week of course we have a lot of data from the previous cyber weeks and whenever we plan you know the next cyber week in our activities around discounting and then of course also customer acquisition, we take that data into account and the Cyber Week is no exclusion from the rule that we take, I think very rational decisions when it comes to customer acquisition and that we look at lifetime value and how it costs on to the customer acquisition cost and we actually have seen in the last years but also the cohort of customers, we have acquired during cyber week have shown KPIs in the following years that are very similar to other cohorts. So even though they are acquired obviously at the data where discounts play a big role and you can make a great bargain that doesn't mean that they are significantly worse customers than the ones that we acquire on other dates. So, I think that actually also has a reason for us to really lean on Cyber Week and use it as a customer acquisition opportunity because we have seen it has added value to the customer base also in the past.

A

And then let me take your question on commission rates, the values I mentioned so the range 5% to 25% those are gross commission rates. They are all booked in our cost of sales and in the end influence our gross profit. And what is not reflected in those rates is special discounts for events like Cyber Week. But what I can say is that outside of Cyber Week is discounts are very, very small. And so they don't materially impact the net commercial rates that we get.

Operator: The next question is from Simon Irwin of Credit Suisse. Please go ahead. Your line is now open.

Q

Good morning all. Just one quick question; can you give us an update on the percentage of volumes that these days that are going through one day, two day and longer delivery?

A

Yeah. So, as you know obviously a key part of our proposition to offer a better convenience to our customers across Europe that's also why for example we are now setting up a new warehouse in Spain to take down our delivery time for three to five days to one to three days for example. What I cannot disclose is kind of percentiles per day. But I can tell you is that a double-digit share of our parcels overall and more than 30% of our volume in Germany is delivered next day or even same day to our customers.

Operator: Thank you. The next question is from [indiscernible] of MainFirst Bank. Please go ahead. Your line is now open.

Q

Yes. Thanks for taking my questions. Three if I may.

Firstly, on the partner program fee restructuring, can you elaborate a little bit on how that work without any negative repercussions in terms of partner losses, how that's been taken on? Secondly, your Dutch supplier post-analysis said they've seen a slowdown in fashion growth since the beginning of the second half of last year saying the market was more mature. Is that something you also see in Dutch market or on other markets? And lastly, if you can, can you comment on the competitive landscape whether they're any guys you see more often than you thought you would or less often than you thought it would about you says they grew 60%, they seem to be up and coming. So anything you can share there. Thank you.

A

Yes, I think overall we're very happy with how the rollout of our new commission table went given that some partners that actually meant significant increases in some cases because the upper end of the range was extended to 25% whereas before I think most of them had in more around the midpoint of that range. And actually we only have a very small single-digit number of partners that did not accept the new commission table. And all the big partners actually representing close to 99% of our partner program GMV are on the new commission table as we speak and that obviously points to a very successful all out of this new cable. And I think the more important thing is really sets us up for future growth since now brands have an incentive to list all price points and all categories at Zalando because they work in the same way and are economically feasible. And then on your question relating to the Netherlands, as you know we don't really disclose individual market data, but I definitely cannot confirm an overall a slowdown of the fashion market because as you can see from our growth rates that we reported today and also that we project going forward, we feel very confident that we can grow and we also see in many cases especially in those lesser developed markets, not Netherlands but some others in Europe that we can even have to accelerate the market growth.

And then maybe let me make a comment on your last question on competition. So clearly there is competition in the market, and when you are operating online we always had a competitor, the competitors only a mouse click away. So and also when you look at our long-term aspiration, we say we want to serve more than 5% of the total fashion market, and more than 20% of the online fashion market. So also there you see also in the future obviously there will be competition. However, I think when we look at 2019 I think we have shown once again in a very strong way how massively we grow, also compared to competitors. So you mentioned about Zue, and I think the $1.6 billion addition in GMV, that should be about 2 times about Zue added in just one year. I think it's also roughly one half of ASOS added in just one year. So I think these numbers really speak for themselves.

Operator: Thank you, Dan. We now take our last question, it is from Olivia Townsend of UBS. Please go ahead. Your line is now open.

Q

Hi, I have two questions. Firstly at the Q3 result, you said that the ZFS share at the end of the quarter was just over 40%. Could you just update us with what the ZFS share at the end of Q4 was, as well as the whole quarter. My second question is, could you just give us an update on how many of your warehouses are still in ramp up, and how many has been ramped up to full operation, and then how many more would reach full operation in FY 2021. Thank you.

A

All right. So if we look at ZFS, I think the share at the end of Q4 is still around 40% and there's a specific reason for that. Obviously in preparation for Q4 we made sure that we on board all partners to ZFS ahead of Q4. And then we don't do major supply chain changes at peak times. I think that's also appreciated by our partners but also by our internal teams. What it also shows though is that even with those huge volumes during peak we still delivered tons of ZFS items and if you look at the absolute number actually that increased because we obviously also had many more shipments in Q4 than in Q3.

Now your second question on the ramp up of our warehouses. I think if you – if you look at all the warehouses that we've had for a while, so Erfurt, Mönchengladbach, Paris, Szczecin and Milan they are all fully ramped up. Szczecin actually reached full capacity during Q4 and also contributed to a great high performance. Currently we are still seeing major ramp ups across three warehouses. So one is Lodz in the east of Poland. And one is Verona in the north of Italy and we are also still ramping up our capacities in Stockholm so in Sweden. And as you know over time we are now also start ramping up Madrid. And with we are also very much looking forward to taking online our new hub in Rotterdam, so once the construction has finished. That will happen in 2021.

Operator: Thank you very much. As we have no further questions I would like to hand back to Patrick Kofler for some closing remarks.

Patrick Kofler

Team Lead-Investor Relations, Zalando SE

Thank you. Ladies and gentlemen for joining today's call. We hope you learned a lot. And we are open for any questions you may have in the course of the day or the next days and happy to see you in the next weeks. Thank you. Byebye.

Operator: Ladies and Gentleman thank you for your attendance.

This call has been concluded. You may disconnect.