ANNUAL REPORT
2017

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ZALANDO

zalando

LOCATION MAP OF EUROPE

ABOUT ZALANDO

Founded in 2008, Zalando is Europe's leading online platform for fashion, connecting customers, brands and partners. We bring head-to-toe fashion to more than 23 million active customers across 15 markets, offering clothing, footwear, accessories and from spring 2018, beauty. Almost 2,000 brands are currently offered by Zalando, from world famous names to local labels, as well as our own products. Our platform is a one-stop fashion shop for inspiration, innovation and interaction.

As Europe's most fashionable tech company, we work hard to find digital solutions for every aspect of the fashion journey: for our customers, partners and every valuable player in the Zalando story.

LOCATION MAP OF GERMANY

Segment Figures

		2017	2016
Earnings position segments			
Revenue DACH	IN EUR M	2,145.6	1,813.8
Adjusted EBIT DACH	IN EUR M	188.5	226.3
Adjusted EBIT DACH	IN % OF REVENUE	8.8	12.5
Revenue Rest of Europe	IN EUR M	1,973.6	1,570.2
Adjusted EBIT Rest of Europe	IN EUR M	21.6	–3.3
Adjusted EBIT Rest of Europe	IN % OF REVENUE	1.1	–0.2
Revenue Other	IN EUR M	369.9	255.1
Adjusted EBIT Other	IN EUR M	5.0	–6.7
Adjusted EBIT Other	IN % OF REVENUE	1.3	–2.6

ZALANDO AT A GLANCE

Key Figures

	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
Group key performance indicators			
Site visits (in millions)	2,563.5	1,991.6	28.7%
Mobile visit share (in %)	70.7	65.6	5.1pp
Active customers (in millions)	23.1	19.9	16.2%
Number of orders (in millions)	90.5	69.2	30.8%
Average orders per active customer	3.9	3.5	12.6%
Average basket size (in EUR)	64.5	66.6	–3.2%
Adjusted marketing cost ratio (as % of revenue)	7.9	10.3	–2.4pp
Adjusted fulfillment cost ratio (as % of revenue)	25.9	23.2	2.7pp
Results of operations			
Revenue (in EUR m)	4,489.0	3,639.0	23.4%
EBIT (in EUR m)	187.6	207.0	–9.4%
EBIT (as % of revenue)	4.2	5.7	–1.5pp
Adjusted EBIT (in EUR m)	215.1	216.3	–0.6%
Adjusted EBIT (as % of revenue)	4.8	5.9	–1.2pp
EBITDA (in EUR m)	246.4	255.3	–3.5%
EBITDA (as % of revenue)	5.5	7.0	–1.5pp
Adjusted EBITDA (in EUR m)	273.8	264.5	3.5%
Adjusted EBITDA (as % of revenue)	6.1	7.3	–1.2pp
Financial position			
Net working capital (in EUR m)	–62.4	–127.6	–51.1%
Equity ratio (as % of balance sheet total)	51.6	55.5	–3.8pp
Cash flow from operating activities (in EUR m)	193.7	275.8	–29.8%
Cash flow from investing activities (in EUR m)	–88.3	–277.1	–68.1%
Free cash flow (in EUR m)	–85.0	63.7	<–100.0%
Capex (in EUR m)	–243.9	–181.7	34.2%
Cash and cash equivalents (in EUR m)	1,065.5	972.6	9.6%
Other			
Employees (as of the reporting date)	15,091	11,998	25.8%
Basic earnings per share (in EUR)	0.42	0.49	–14.3%

pp = percentage points

Almost 45m
app installs

Almost 2,000
brands

954 Zalandos
volunteered

WE CELEBRATE YOUR PERSONAL EXPERIENCE.

Easy Navigation Menu

Further Information in the Report

Further Information on the Internet

For the Quick Reader

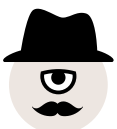
Further Information in the Online Magazine

hello_

Your Zalando X

Personalization is the next step in reimagining fashion. With that, as we celebrate our tenth anniversary this year, we're all about "Your Zalando X". You, the fashion lover, the browser, the seeker, the influencer.

"Your Zalando X" represents our journey towards more personalization and innovation this year, with the Roman numeral "X" marking the spot as we celebrate ten years of Zalando.



Online report:
annual-report.zalando.com

Stories 2017

Entering the Beauty Market

Zalando offers fashion in all its many facets – and from spring 2018, its range will be complemented by beauty products. Soon everyone will be able to find the beauty buys they need to underline their style. Individually, democratically, and personalized for them.

Zalando Opens Tech Hub in Lisbon

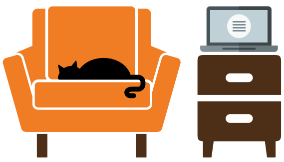
Sun, sea and cyber is all for the taking in one of Europe's leading tech hubs, Lisbon. Focusing on the digital experience in the Fashion Store, the new office will be the third of its kind internationally for Zalando.

Tailor-Made Experiences

We are working on new pilot projects to improve our delivery services and further adapt them to our customer's individual lifestyles. Our "My Parcel Now" and "Parcify" pilots are aimed at making deliveries and returns even more convenient, quicker and more flexible.

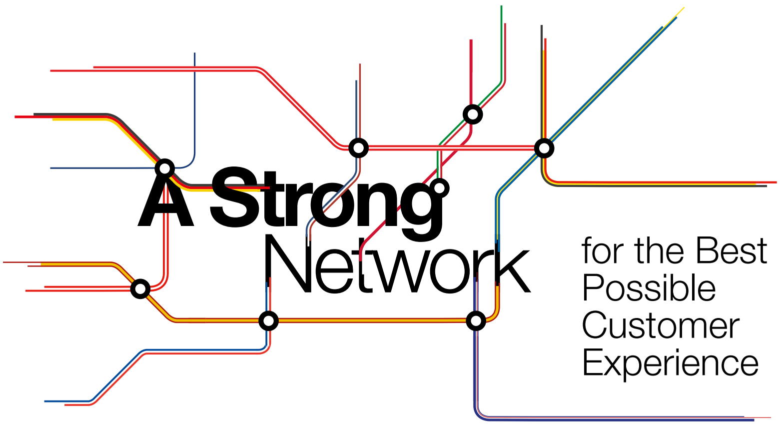
Making Sense of Sizing

Fashion is at the forefront of personal expression, and our job at Zalando is to make fashion as accessible, personal and relevant as possible for all our customers. Sizing is a huge part of personalization and one of the greatest challenges faced by retailers, especially when selling online. Comprised of experts, the Sizing Organization Team at Zalando understands that sizing is about more than "Does it fit?"



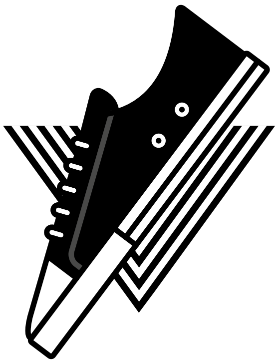
The Future of Work

How does a person's working environment affect them? And what conditions need to be in place to make work a satisfying and productive experience? Zalando's dynamic and innovative culture mean that flexibility and responding to individual needs play an important role in our workplace design.



A Strong Network for the Best Possible Customer Experience

Zalando has further worked on its logistics organization in the past year with the aim of becoming even quicker and getting even closer to the customer. Capacity ramp-up, automation and digitalization in its fulfillment centers are playing a key role in this process. One example is the bagsorter, a sorting system that went live at our fulfillment center in Mönchengladbach in 2017.



Empowering Our Partners

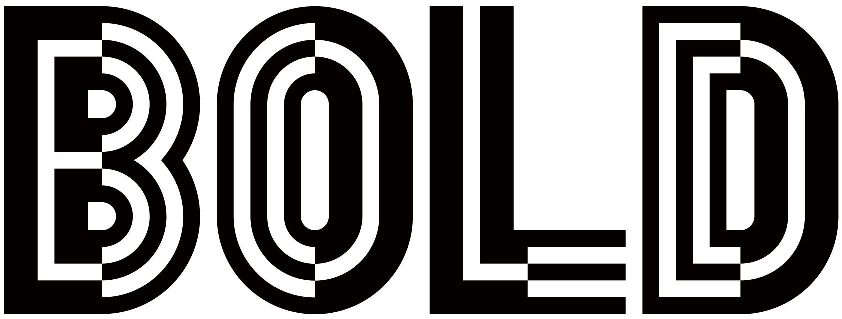
Being digital is not always easy. Zalando has developed cutting-edge digital capabilities over the last years. Now we are making these available to help our partners. This is Partner Solutions.

Breaking Down the Marketing Silos

The better we know our consumers, the more we can tailor our services to their needs. In partnership with Facebook, Zalando's advertising unit Zalando Media Solutions is taking new approaches to personalized marketing.

Bigger. Bolder. Bread & Butter.

The Festival of Style and Culture from September 1 – 3, 2017 at Arena Berlin offered a platform for brands to interact with their customers and ignite relationships with them. With its "BOLD" concept, the event showcased more than 40 international brands, nine fashion shows, as well as DJs, live acts, parties, exquisite street food and panels.

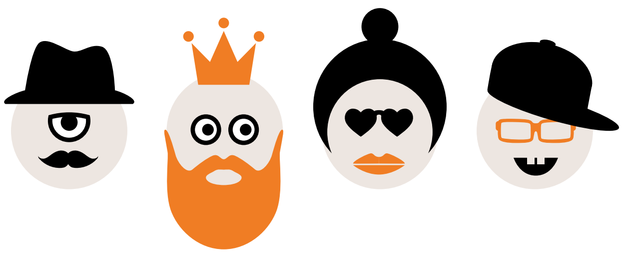


Next Steps to Help Brands Win Online

Zalando Fulfillment Solutions (ZFS) offers logistics services for partners in the Zalando Partner Program, taking over responsibility for the entire customer facing logistics chain for products that are sold within our online shop. Partners can choose the support components that fit their requirements best. In 2017, ZFS expanded its services for partners.

Zalando Gets Personal

The on-site personalization initiative is making the Zalando shopping experience even more individual, and will see a single Zalando online store transformed into many; each as unique as our more than 23 million active customers. The large-scale project requires intensive cooperation between Zalando's technology teams and the fashion division.



Have we piqued your interest? These and other stories can be found in full length at:
annual-report.zalando.com

Content

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2 Combined Management Report_

3 Consolidated Financial Statements_

4 Service_

Company_

1

Rubin Ritter **Robert Gentz** **David Schneider**

Dear Shareholders, Dear Friends,

Zalando keeps the pace high. Today we have built a business that reaches more than 23 million active customers. A business that provides jobs for more than 15,000 people. A business that has changed the fashion industry. We are incredibly proud of and thankful for what our team has achieved.

At the very core of our thinking is our customer. We offer the broadest assortment with almost unlimited choice, a high degree of fresh, in-season stock and the best possible experience along every single step of the way. We have introduced innovative delivery and return options and launched our fashion service, Zalando Plus.

For business partners, we kicked off Zalando Fulfillment Solutions, allowing them to leverage our logistics expertise and network, improving customer satisfaction and scaling their business internationally. Opening our infrastructure and expertise to third parties – and with this to a new set of customers – is one of the key ingredients of our platform strategy.

But on the brink of our 10th anniversary in the fall of 2018, we don't look back – but think about tomorrow.

Our purpose, to "Reimage fashion for the good of all," guides us and our team every day to bring our strategy to life. And we know that success is closely linked to building the best possible products and services for customers and business partners alike. Zalando will continue to move fast.

We believe the next leap is right ahead of us and encapsulates the personalization of experiences, enabling each customer to see their personal Zalando shop. It is a theme that will increasingly be part of our journey and we have dedicated this annual report "Your Zalando X" to underline our push towards more personalized experiences.

Over the past year we have paved the way for this next step, continuing our profitable growth with investments that focus on our customers, business partners and on building the underlying technology and logistics infrastructure. But what does the future hold for Zalando? In one word: growth.

We have chosen this path very early, and even today, at a much larger scale, we are certain it is the right way for us to maximize long-term value. The fashion industry is ripe with opportunities and we are willing to seize these to drive our business further.

We have our eyes firmly set on our goals: growing annually by 20–25% for the coming years, to double our business by 2020. We are convinced that further investments are necessary to expand our fashion ecosystem and increase the value we generate for all players connected to our platform. At the same time, we acknowledge that this increasingly depends on a policy framework that enables digital European companies to thrive, and we will play an active role in this debate.

Creating value for everyone involved also includes taking responsibility for the people and environment along our value chain. To live up to this responsibility, we took our sustainability strategy an important step forward: we defined impact visions and targets in our four pillars – people, fashion, environment and society. Using our unique mix of strengths in tech, fashion and operations we want to create sustainable business success and are determined to finding our role in contributing to a more transparent and sustainable fashion industry.

Our success as a company is deeply rooted in the excellence and drive of our entire team that works incredibly hard to move Zalando forward each day – thank you.

Berlin, February 26, 2018

Robert | David | Rubin

Robert Gentz | David Schneider | Rubin Ritter

WHAT'S NEXT?_

Stay Tuned: Our New Video Series Presents the Latest Events and Developments at Zalando.
zln.do/en-next

1.2 Corporate Responsibility

1.2.1 do.THINK Ahead

- Zalando's sustainability strategy is a key driver for our future business success
- This year we report transparently about past actions, but furthermore added for the first time strategic targets in people, fashion, environment and society
- With our do.STRATEGY we want to make a systemic contribution towards more sustainability in our industry – together with our customers, partners and employees

Letter from Rubin Ritter

GRI 102-14

"At Zalando, we work hard to find better ways to bring people and fashion together. At the same time, we also see great potential for technology to increase transparency in the fashion value chain to ultimately contribute to solving the complex social and environmental challenges that our industry is facing. As a start, we had to do our own homework in order to get the basics right. In 2017, we took the next step in our sustainability strategy and identified areas in which we will try to make a systemic contribution that goes beyond Zalando. We believe that our contribution is most effective if we combine our strengths in technology, fashion, and logistics and actively engage our customers, partners and employees. Our sustainability strategy not only contributes to changing the industry, but is also a key element for our future business success.

Over the past year we have made decisive progress in developing our sustainability strategy. We continue to do our homework in all areas. However, we feel that we have reached a point where we can go one step further and have defined additional strategic targets in four key areas:

- Employees: we want to provide a workplace for the future and impact the future of work. To get there, an innovative concept for personal and professional development is of paramount importance to us and our employees. Therefore, we invested further in our performance and growth culture to enable employees to continuously grow personally and professionally.

zln.do/en-workspace

- Fashion: we want to contribute to a more sustainable fashion industry. It is our ambition to become a leading online destination for sustainable fashion. In 2017, we focused on convenient and transparent ways for customers to navigate through our sustainable fashion selection. Our private labels further improved the social and environmental footprint of their products and teamed up with new partners and experts, e.g. in the Sustainable Apparel Coalition.

zln.do/zLabels

- Environment: we want to decouple our ecological footprint from our economic growth. To this end, we set targets in two focus areas: climate protection and sustainable packaging. We developed our first climate protection strategy and switched to 100% green energy in Germany, starting January 2018.
- Corporate citizenship: we want to find a suitable way for us to contribute to solving challenges we are facing as a society. We were proud to receive the German CSR[1] award 2017 for initiating cross-sectoral measures for refugee integration. Now we want to expand our efforts and intend to strategically invest 1% of our EBT in solutions for societal impact.

zln.do/en-neighborhood

At Zalando, we constantly learn and iterate. That is why we invite all stakeholders to give us feedback on our approach and the new visions and targets."

1) CSR stands for Corporate Social Responsibility.

About This Chapter

- In 2016, we reported for the first time in line with the G4-Guidelines of the Global Reporting Initiative (GRI). We continue using GRI in our report 2017
- This report has been prepared in accordance with the GRI Standards: Core option
- Readers will find references to the GRI Standards in the sidebar, while the full GRI Index can be found on page 228

GRI 102-51
GRI 102-52
GRI 102-54
GRI 102-55

Our do.STRATEGY

Reimagining the fashion industry and anchoring sustainability in our business model are exciting challenges for us. We are in the middle of a learning process and are approaching this task step by step. We started with the question of which sustainability issues are key for us and our stakeholders.[2] In the course of our initial materiality analysis, we defined 16 topics in five areas: employees, fashion, environment, society, and data protection.

GRI 102-46
GRI 102-47

zln.do/en-do-strategy

Our first major task consisted in creating transparency for ourselves about where we stand with regard to the relevant topics, how we can lay important foundations, and what paths we want to pursue. This groundwork will remain an essential element of our corporate responsibility (CR) activities in the future. As we are still a very young company, and one that is strongly growing, this has been and still is a challenge.

Throughout the whole company we have an action bias. We want to do more and talk less. This is also how we approach sustainability and therefore we called our CR strategy the do.STRATEGY. We used 2017 to define our ambitions for our systemic contributions within and outside of the company for four of our do.areas. The visions for our four do.areas, do.GROW – employees, do.KNOW – fashion, do.PROTECT – environment and do.CONNECT – society, all feed into our company purpose to "Reimagine fashion for the good of all." With the changing regulatory environment in data protection we decided to continue working on the foundation before talking about impact visions. Therefore, we continue to report this topic in the governance chapter of this annual report.

Further Information
Corporate Governance p. 52

Our do.STRATEGY → 01

Purpose	do.areas	Impact visions
Reimagine fashion for the good of all	do.GROW	Provide a workplace for the future and impact the future of work.
	do.KNOW	Contribute to a more sustainable fashion industry.
	do.PROTECT	Decouple our environmental footprint from our economic growth.
	do.CONNECT	Reimagine how corporates contribute to societal challenges.

2) More information on how we identified our key topics can be found in the 2016 annual report on p. 22.

Each vision is broken down into strategic outcomes and specific targets that we want to achieve between 2018 and 2020. At the beginning of each chapter, we summarize the corresponding outcomes and targets that we will work on in order to get closer to our systemic impact visions.

Our Non-Financial Report 2017

Our Corporate Responsibility chapter includes our combined non-financial report for ZALANDO SE and the Zalando group in accordance with Section 289b (1) and (3) and Section 315b (1) and (3) HGB (German Commercial Code). Relevant information of the non-financial report can be identified by the indent of the paragraph and the black line next to the text. All information including relevant key performance indicators (KPIs) are provided jointly for ZALANDO SE and the Zalando group, as in our CR strategy and the related activities we do not distinguish between Zalando group and ZALANDO SE, and definitions and data collection processes do not allow for a separate presentation of KPIs for ZALANDO SE. Due to the different approach of the GRI Standards and the German implementation of the CSR Directive on Non-Financial Reporting (CSR-RUG) regarding materiality requirements, we do not apply any frameworks for our non-financial report 2017.

The information on our business model can be found in section 2.1.1 Business Model of our Combined Management Report. The definition of material topics for our non-financial report is based on the materiality analysis we conducted in 2014 and 2015. The 16 topics that we identified were analyzed according to business relevance and impact – positive as well as negative – of our business model on the corresponding topics. As a result we identified five topics to be material according to the CSR-RUG. The topics are: working conditions in Zalando Logistics, human rights in our supply chain, climate protection, community engagement and anti-corruption. Relevant information on the first four topics can be found in this CR chapter, while information on anti-corruption is provided in section 1.4.2 Corporate Governance in the Corporate Governance Report.

Further Information
Business Model p. 79

Our integrated risk and compliance function called Governance, Risk and Compliance (GRC) monitors risks that might impact our business performance in bi-annual risk workshops. The risks also include social and environmental risks and the results of the net risks with a high probability and high impact are summarized in section 2.4.4 in the risk and opportunity report. As a preparation for our non-financial report, the CR and GRC functions jointly analyzed these risks as well as potential further risks that emanate from our business, our business relationships, our products and services on the five material topics identified. As a result there are currently no net risks assessed with a high probability and high impact. The reason for this conclusion is that potential negative impacts are managed by the corresponding teams with strong measures and due diligence processes in place.

Further Information
Risk and Opportunity Report p. 107

GRI 102-11

How We Manage Sustainability

The responsibilities and processes in the area of sustainability at Zalando are clearly regulated. Strategic responsibility for CR within Zalando lies with the Management Board, supported by the General Counsel. The CR Team reports to the General Counsel and collaborates closely with decentralized counterparts throughout Zalando to implement sustainability-related initiatives. Furthermore, the team drives the implementation of the sustainability strategy, and identifies potential for optimization. At the same time, many teams and employees as proactive experts in their respective fields initiate measures that shape our business activity in a sustainable manner.

GRI 102-18

How We Engage Our Stakeholders

To drive sustainability in fashion and online retail, we actively engage our stakeholders and rely on the dialogue with our partners. We want to learn about their expectations and ideas and involve them in our commitment as closely, but also as flexibly as possible. Which stakeholders we exchange ideas with depends on their expertise and relevance for Zalando as well as their influence. This agile interaction allows us to respond to specific situations without having to define formal processes or formats for stakeholder engagement. This is part of our corporate culture and has proven its worth in practice.

GRI 102-40
GRI 102-42
GRI 102-43
GRI 102-44

The focus of our commitment in 2017 was primarily multi-stakeholder initiatives that advocated, at an international level, more sustainability in the fashion industry's supply chain. While we are more proactive in pursuing topics with high priority, we are generally open to anyone who wants to get in contact and engage in exchanges with us.

GRI 102-12
GRI 102-13

zln.do/en-CR-Contact

Stakeholder Engagement

→ 02

zalando

- Examples of forms of involvement
- Examples of issues addressed by stakeholders

Society
- Dialogue with NGOs like PETA
- Individual meetings and press conferences with media representatives
- Zalando's responsibility e.g. regarding animal welfare, as a neighbor or as an employer

Customers
- Customer service
- Social media
- Customer satisfaction surveys
- Market research
- Availability and delivery of products
- Product quality
- New store locations and markets
- Sustainability of products

Employees
- Internal exchange formats
- zBeat – our internal pulse check
- Works councils
- Zalando Employee Participation (ZEP)
- Speak-up culture
- Employee satisfaction
- Equal opportunities
- Remuneration and benefits
- Development opportunities
- Volunteering programs

Industry
- Memberships
- Individual meetings with partner brands
- Conferences
- New memberships this year focus on human rights and sustainable products e.g. Sustainable Apparel Coalition, Better Cotton Initiative, Leather Working Group

Political leaders
- Individual meetings with political representatives, advocacy groups and non-governmental organizations
- Conferences
- Think tanks
- Zalando as an employer and job creator
- Data protection and processing
- Infrastructure
- European single market

Shareholders
- Annual general meeting
- Annual report
- Individual meetings
- Zalando strategy and performance
- Environmental, Social and Governance (ESG) questions

Suppliers
- Conferences and dialogue forums
- Daily interactions
- Sourcing strategy
- Suggestions to improve cooperation and daily interactions

1.2.2 do.GROW

do.GROW → 03

Impact vision	Aspired outcome	Targets	Timing
Provide a workplace for the future and impact the future of work	**Zalando has built a state of the art development and growth culture**	Enable continuous growth and development for each employee by building a real-time feedback and performance culture.	2020
		Help employees to kickstart their leadership career and provide comprehensive support to first time leaders.	2019
	Being a magnet: Zalando has continued its successful growth story and established an attractive and innovative work environment	Provide fair working conditions and continuously improve standards in all fulfillment centers independent of location, start-date or size of fulfillment center.	2020
		Successfully reduce attrition rate by 30% compared to 2017.	2020
		Increase representation of women in leadership positions to 25% on first and 30% on second level below management board.	2022
		Create an attractive and healthy work environment that fosters collaboration and entrepreneurial spirit.	2019

This Is Zalando – Open and Ambitious

Zalando unites talents from more than 100 countries. With great passion and a strong business sense, our constantly growing team has created Europe's leading online fashion platform in just a few years. In this dynamic environment, our more than 15,000 employees transform challenges into opportunities every day. Our employees continually develop new services and products in order to reimagine fashion – exceeding our customers' expectations. We want to create a work atmosphere in which employees are fulfilled and can leave their personal mark. To this end, we want to create an environment that fosters collaboration and entrepreneurial spirit. This means providing access to all relevant information and, at the same time, the freedom to impact Zalando's success story with own ideas and passions. This environment offers employees great opportunities for development. We support this personal and professional growth by building a strong feedback culture that enables development and learning opportunities on a daily basis.

As a company, we value diversity and focus on creating an open and honest atmosphere in which each individual feels encouraged to actively put forward opinions and suggestions – irrespective of tenure, age, or position in the company. We also recognize our responsibility as an employer to protect the health of all Zalandos and to provide a work environment that caters to the current and future needs of our employees' work-life balance. Attracting talent is an essential factor in the success of our growth strategy. That is why we want to design an attractive and innovative work environment together with our Zalandos.

Zalando in Numbers*

→ 04

Zalando keeps growing

GRI 102-7
GRI 102-8
GRI 401-1

15,091 employees 2017

Total number employee exits
3,443
turnover rate: **25%**
female: **43%**
male: **57%**
above average age: **29%**
below average age: **72%**

11,997 employees 2016

Total number employee exits
2,670
turnover rate: **25%**
female: **44%**
male: **56%**
above average age: **30%**
below average age: **70%**

New hires

45% (44%) female

55% (56%) male

68% (70%) **below average age**

5,997 (4,583)

32% (30%) **above average age**

Target to reduce attrition by 30% until 2020 compared to 2017
–30%

Average age

37
Average age (36)

without logistics
32
(32)

Employees on parental leave

363
female: **58%**
male: **42%**
2016

451
female: **53%**
male: **47%**
2017

Employment types

13,576 (11,107) **full-time**
male: **7,555** (6,158)
female: **6,021** (4,949)
total share: **92%** (93%)

1,171 (890) **part-time**
male: **291** (242)
female: **880** (648)
total share: **8%** (7%)

Employment contracts

9,853 (8,035) **permanent contracts**
male: **5,263** (4,254)
female: **4,590** (3,781)
total share: **67%** (67%)

4,894 (3,962) **temporary contracts**
male: **2,583** (2,146)
female: **2,311** (1,816)
total share: **33%** (33%)

Employees by classification

2,042 Commercial
1,476 2016

9,289 Operations
7,193 2016

1,974 Technology
1,653 2016

1,442 Other
1,675 2016

*) The figures from the previous fiscal year are shown in parentheses. All numbers – except the total number of employees – do not include Anatwine Ltd., Ifansho Portugal Unipessoal Lda., KICKZ Never Not Ballin' GmbH, zLabels Trading Ltd., zLabels Trading Southern Europe S.L.U.

Prospects for Everyone

GRI 103-1/-2/-3 MA
Training and Education
GRI 404-2

Zalando is constantly growing and we want our employees to personally and professionally grow with us. Our philosophy is that development should not be limited to current positions within Zalando. We want to prepare our employees for the jobs of the future and impact the future of work.

Turning Feedback into Development

zln.do/en-workspace

We believe that the future of work will demand an essential characteristic from people: the ability to learn and continuously develop. We want to prepare Zalandos for this, and therefore we fundamentally changed the way we develop employees in 2017. The aim of this change is to support employees in the dynamic Zalando environment so that they can use the experiences they gain and the challenges they face every day to stimulate a continuous learning process. The new development approach is summarized in a company-wide program called ZONAR and harnesses the power of appreciative and constructive multi-sourced feedback and self-reflection.

With ZONAR we want to ignite a feedback culture among Zalandos and kicked-off the process with an extensive set of feedback trainings. Still, we are well aware that giving constructive feedback has to be constantly practiced. In 2017, eligible Zalandos shared and received almost 54,000 written feedbacks that served as input for individual employee development talks. Additionally, employees could choose whether they wanted to provide or request a short in-the-moment feedback, for example, after an important presentation, or a more comprehensive round of feedback.

To further support employees in their development, we launched a career framework that provides greater transparency on professional and personal development opportunities and the support employees can receive in the process. The career framework provides Zalandos with information on job families, a grouping of roles with similar skill sets over departments, and the relevant abilities that are expected from colleagues in these positions. Each job family is additionally broken down into career stages and impact tracks that go beyond traditional general management career paths and empower employees to provide business impact through business development and expertise. Whatever development path employees choose, we encourage them to use the information and options that we provide and to be proactive in driving their own careers.

In the development talks, managers and employees agreed on targeted development goals and actions. Our employees are encouraged to take the lead and to define their personal development targets. Leaders act as coaches throughout the conversation; a role for which they receive special training in advance. Development talks were further bolstered by our development catalogue. This catalogue promoted development areas and corresponding actions which included skill building on the job, joint learning, and self-study options using digital and offline sources such as videos, articles, and books. In line with our philosophy of continuous development, we wanted to raise awareness among employees for learning opportunities that go beyond classroom sessions and can be integrated into daily work.

As we are continuously learning, we collected a lot of feedback from employees all over the company and in all hierarchies on ZONAR, the tools we used and the support that was provided. This feedback will help us to improve the program and cater to the needs of our employees and the organization. In the long-run, ZONAR will further professionalize our people development with the help of data. We want to use data for a more coherent understanding of the goals and actions that Zalandos are pursuing. This leads to more data-driven decisions on strategic investments in people development.

Knowledge Transfer from Learning Communities

We invest in an unconventional organizational structure for people development: experts in distinct learning communities develop concepts that are tailored to the knowledge, learning and work environment of the corresponding functions. For example our Tech Academy offers specific training on coding languages, while our Training Teams in Zalando Logistics focus, for example, on tailored leadership development for staff in our fulfillment centers. Our central People Development Team strengthens the relationship between the different learning communities and provides assistance and support to enhance the learning experience. Further, they test innovative learning formats, e.g. virtual reality to foster team communication or using the learning potential of volunteering. The latter provides employees with the opportunity to help social initiatives pro bono with their expertise and thus reinforce or further develop their own expertise and presentation or coaching skills.

zln.do/en-volunteering

Further, we continued offering employees the pilot program for learning how to code, even if this skill is not required in their current role. With our coding as a foreign language program, we want to prepare employees for the jobs of the future. In 2017, we adapted the program to pilot a learning environment in which non-tech Zalandos and refugees learn Java Script together. To enhance the experience of learning with and from each other, the pilot further included workshops on the Arabic language and Syrian culture in which Zalandos could learn from refugees and enhance their intercultural skills.

Leaders with a Special Role

Leaders play a vital role in ensuring that a learning culture and constructive development conversations are fostered at a team level. We are committed to giving employees the opportunity to take on leadership responsibility and to support new as well as experienced leaders. In 2017, we launched programs dedicated to this idea, such as the ZONAR Leaders Series, a series of workshops that prepare managers for a wide variety of situations in performance reviews, e.g. tough talks and feedback labs. Moreover, we have introduced additional leadership programs, including Be a zLeader for first time leads and Core of Coaching to help enhance leaders’ abilities to coach employees.

Our Culture – Open and Honest

An open feedback culture is a prerequisite for a successful company. We use our recurring online survey zBeat (five surveys during 2017) to see how satisfied employees are and how they gauge certain issues such as our feedback culture at the time in question. The results from the business units are published for all to see, so that managers and teams can discuss them with each other. The participation rate for the surveys is approximately 50% on average.

Our interactive intranet zLive allows us to share information within the whole company or relevant groups promptly and in real time. All employees can send updates, for example to their team or their network. The functionalities are similar to those of a social network and promote a company-wide conversation in which everyone with access to the Zalando network can participate.

Direct exchanges between the Management Board and the employees are very important for us. There are three formats for this: the All-Hands meeting, the zTalk, and the recently introduced Ask-Us-Anything format. The All-Hands meeting is used by our Management Board to inform all Zalandos about strategic topics and company-wide projects. In our zTalk, the Management Board and/or guest speakers provide inspiration and talk about relevant trends in our industry. Our new Ask-Us-Anything format allows all of our employees to discuss current issues and topics with the Zalando management. All-Hands and zTalks are held once every quarter. All the formats can be streamed live in all our locations and are also accessible online afterwards. At the end of each meeting, employees have the opportunity to ask the speakers questions – live or online. Another format, zInsights, offers each team the opportunity, as needed, to inform all Zalandos about projects and initiatives that are relevant for large parts of the company.

GRI 103-1/-2/-3 MA
Labor/Management Relations

We also encourage exchanges between local leadership and employees in our Zalando Logistics. In weekly consultations hours, employees have the opportunity to share their opinions, questions, and ideas. In addition, we have our Logistics News, an informative print magazine that we publish every two months, in particular for the employees at our fulfillment centers. The magazine covers both general news about Zalando and Zalando Logistics as well as specific issues related to the particular location.

Promoting Inclusion and Diversity

The diversity of people, lifestyles, opinions, and attitudes are crucial drivers of innovation and success. That is why inclusion and diversity are firmly embedded in the corporate culture at Zalando. For us, inclusion describes a culture in which we can all collaborate, develop our unique talents, and achieve excellence together. We believe that an inclusive culture is the most effective way for us to increase diversity within the company and benefit from it.

GRI 103-1/-2/-3 MA
Diversity and Equal Opportunity

We are continuing to raise awareness about the importance of inclusion and diversity when onboarding new employees. Further, teams have the opportunity to access tools designed to strengthen their own inclusive culture and to exchange experiences and articles on zLive. Zalandos who want to get involved as inclusion and diversity champions are given the opportunity to do this in our network for diversity called Diversity Guild, which was originally limited to our technology teams, but is now active throughout the company. We additionally celebrate special occasions and participate in external events that emphasize various dimensions of diversity, such as the German Diversity Day, International Women's Day, and Christopher Street Day. Furthermore, we started to invite guest speakers to share their insights with employees, e.g. in one of our zInsights.

GRI 102-12

In 2017, we took part in an increasing number of conferences and events in the tech community on the topic of gender equality and LGBT[3] and drafted our job advertisements to be gender-neutral. We are additionally revising our hiring process with the aim of increasing the diversity of candidates and thus of the company itself.

Employee surveys in 2017 show that our efforts have a positive impact: 73% of employees have the impression that different perspectives and experiences are valued in their team. 81% believe that they can be themselves at work and feel accepted.

3) LGBT stands for "lesbian, gay, bisexual and transgender."

Zalando is a highly international employer. We unite people from 131 countries, and approximately 43% of our employees are non-German citizens. To create a welcoming culture for international colleagues, we provide them with support during the local registration process, with translations of important documents such as health and safety training, and offer mentoring programs, to name but a few.

Diversity is also a high priority in Zalando Logistics. At each location, trainings are provided to strengthen intercultural skills, and events are organized to raise awareness of similarities and differences between cultures, languages, and journeys through life. Moreover, our locations are involved in local and nationwide initiatives. Our fulfillment center in Erfurt, for example, has signed the Charta der Vielfalt (Diversity Charter), while the one in Brieselang is an active member in the initiative Tolerantes Brandenburg.

GRI 102-12
GRI 102-13

Women in Leadership

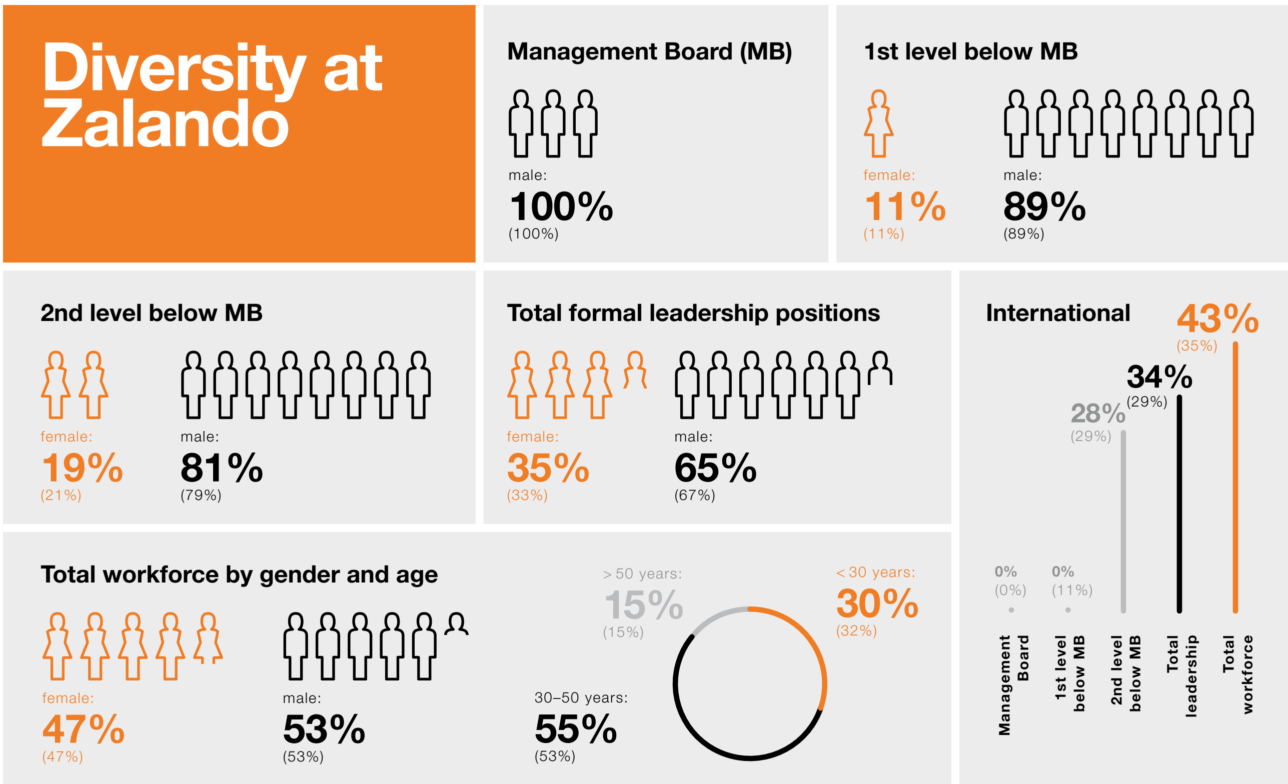
We are dedicated to increasing female representation in leadership positions and therefore set a target for 2022: we are striving to increase the percentage of female managers at the first level below the Management Board (SVPs) to 25% (currently 11%) and at the second level below the Management Board (VPs) to 30% (currently: 19%).

GRI 405-1

Further Information
Corporate Governance Report
p. 52
zln.do/en-supervisory-board

Employees by Gender and International Background*

→ 05



*) The figures from the previous fiscal year are shown in parentheses. Numbers displayed do not include Anatwine Ltd., Ifansho Portugal Unipessoal Lda., KICKZ Never Not Ballin' GmbH, zLabels Trading Ltd., zLabels Trading Southern Europe S.L.U.

Family Friendliness

In order to be an attractive employer for parents, we offer flexible working hours and job location solutions as well as childcare facilities. With our mom-and-dad shift in our fulfillment centers, we have established a family-friendly shift system that was designed in collaboration with our employees and has been very well received by them. At the same time, an ever-increasing number of our employees are making use of their right to parental leave.

Further Information
Zalando Keeps Growing p. 17

Zero Tolerance for Discrimination

GRI 103-1/-2/-3 MA
Non-Discrimination
GRI 102-16
GRI 406-1

zln.do/en-ethics

We do not tolerate breaches of the principles of our corporate culture and discrimination of any kind. Our Code of Ethics and guidelines for the implementation of the German Equal Treatment Act (AGG – Allgemeines Gleichbehandlungsgesetz) form the basis of fair and respectful interactions. If Zalando employees feel discriminated against, they have several options for putting forward their concerns:

- Our Compliance function by using the Ask and Tell process (which can also be done anonymously)
- Their contact person in P&O, our Human Resources Department
- Social workers in the fulfillment centers and our customer care
- Works councils or other employee participation bodies such as ZEP (Zalando Employee Participation)

All cases are taken seriously and processed in accordance with legal requirements.

Attractive and Fair Employment Conditions

Our Remuneration Model

GRI 103-1/-2/-3 MA
Employment

Fair compensation that is in line with market standards is an integral element of good employment conditions for us. We continuously review our pay system to ensure that it is attractive and motivating. Employees receive a remuneration mix comprising a fixed salary at market level, special bonuses for outstanding performance, and a broad range of attractive benefits. The remuneration for our leaders consists of a monthly salary as well as long-term oriented share options granted on an annual basis. This is intended to further reinforce the entrepreneurial spirit of our leadership and to foster a sense of ownership.

GRI 401-2

As benefits, we offer discounts in our shop, free and subsidized employee stock ownership plans, life insurance, contributions to public transport tickets, as well as free fruit and soft drinks at work. Furthermore, employees benefit from health programs including sports activities, massages and workshops, e.g. on mental health. The health programs differ between our locations.

The remuneration for each individual position at Zalando is regularly compared to market levels and adjusted based on the individual skills, experience and performance of the employee. Clearly defined criteria and processes for remuneration decisions ensure objectivity and internal fairness. With this approach we strive to avoid, for example, pay gaps between men and women. To provide our employees with as much transparency as possible, we inform them of the individual pay level in comparison with our salary bands in the course of the annual performance and feedback review.

Salaries at Zalando Logistics are based on the general conditions of the collective bargaining agreements in the logistics industry. Especially in Zalando Logistics, temporary staff contributes to our success every day. Fairness and respect for them are established elements of our corporate culture. We clearly state in our social standards that temporary workers shall receive the same hourly wage as our permanent employees.

Social Standards in Zalando Logistics

Approximately 62% and thus a significant part of Zalando's employees works in our operations. With a high level of commitment, these employees ensure that more than 23m active Zalando customers in 15 European markets experience convenient and reliable service every day. A large part of our logistics is covered by our own fulfillment centers. To show our appreciation of this contribution, we strive to continuously improve the working conditions at all Zalando Logistics locations and those of our partners and therefore set this as one of our main targets in our do.GROW area. Our expectations in this regard are summarized in our social standards, which are applied both in our own fulfillment centers and in those operated by our partners in the Fashion Store logistics network. These standards are based on our Code of Ethics and Code of Conduct and include topics such as equal opportunities, remuneration, working hours and freedom of association. As part of the continuous improvement process of working conditions, we updated the social standards in 2017.

GRI 102-16

zln.do/en-CR-Contact

In our own Fashion Store fulfillment centers the implementation of our social standards is reviewed twice a year in the form of an unannounced audit by an independent external institution, DEKRA. The average result of the audits in summer 2017 at our sites in Brieselang, Erfurt, Lahr and Mönchengladbach was 1.41 (on a scale of 1 = very good to 4 = not sufficient). We thus monitor compliance with our social standards and derive measures to improve working conditions. The auditing process was furthermore checked by our internal audit function in 2017.

Employees as well as temporary staff at our own fulfillment centers have the opportunity to address all concerns to social workers and to receive counseling during their working hours – also in private matters.

We value co-determination and are in continuous dialogue with our employees. In order to stay on top of the strong competition for employees and potential applicants, we have to meet high standards and continuously work on further improvements – in general and at each location. That is why we strive to provide good working conditions and fair compensation models that we develop in a joint effort with our employees. Several works councils have already been established and actively engage at the corresponding locations.

GRI 402-1

Providing a Healthy and Safe Work Environment

We want to offer our employees a safe and healthy work environment. That is why we aim at completely preventing accidents (Vision Zero) and minimizing the risk of occupational illnesses. Our health and safety management concentrates on both the physical and the mental health of our employees.

GRI 103-1/-2/-3 MA Occupational Health and Safety

We have established clear and reliable structures within Zalando and Zalando Logistics that offer tailored solutions for corresponding work environments. Depending on the risks that have been identified, the Zalando companies are reviewed every one to six months by internal and external auditors, who base their work on the OHSAS standards. Appropriate measures are derived from this process, the effectiveness of which is reviewed in the course of follow-up inspections.

Health and Safety Indicators*

→ 01

GRI 403-2

	2017	2016
Absentee rate Zalando Logistics	10.6%	11.2%
Absentee rate Zalando excluding Zalando Logistics	4.6%	5.3%
Work-related fatalities	0	0

*) Numbers displayed do not include Anatwine Ltd., Ifansho Portugal Unipessoal Lda., KICKZ Never Not Ballin' GmbH, zLabels Trading Ltd., zLabels Trading Southern Europe S.L.U.

In order to prevent accidents in our office buildings, there are online tutorials, training courses for fire safety assistants and first aid helpers, while protective equipment is provided along with supporting information on zLive. Furthermore, we offer our employees health-promoting activities on a regular and voluntary basis, including preventive occupational health care. In 2017, employees could participate in an extensive range of sports programs, massages, vaccinations and consultations on ergonomics at the workplace. The program also included workshops on mindfulness, meditation and Qi Gong.

zln.do/en-health

In our fulfillment centers, all health and safety issues are resolved in close consultation with the employee representatives. There are occupational health and safety committees following up on the needs of our employees. The focus of optimization measures is placed on ergonomic work at height-adjustable tables and the implementation of shift schedules designed to prevent monotonous movement patterns. Employees can also have free vaccinations and benefit from regular sports activities. We work closely together with our in-house doctors on all measures.

1.2.3 do.KNOW

do.KNOW

→ 06

Impact vision	Aspired outcome	Targets	Timing
Contribute to a more sustainable fashion industry	**Zalando is a leading online destination for sustainable fashion**	Grow the selection of sustainable fashion in our Fashion Store.	2020
		Improve navigation and visibility of sustainbale fashion in Fashion Store.	2018
		Use our unique position as a tech and a fashion company to increase transparency in the fashion value chain.	2020
	Our private labels have improved their social and environmental footprint	Source 25% of private label products from factories in our Factory Improvement Program.	2018
		Reduce carbon, water and waste footprint of our suppliers by 10% to meet European Clothing Action Plan targets.	2019
		Eliminate critical heavy metals.	2020

We want to leverage our unique position as a fashion and tech company with an enormous outreach to contribute to a more sustainable fashion industry. For us, this implies providing customers with a great choice of sustainable and fashionable items and at the same time a convenient and transparent shopping experience. In our own supply chain, we are aware of the responsibility we have towards people and the environment and are committed to improving the social and environmental footprint of private label products.

zln.do/en-assortment

Our Supply Chain

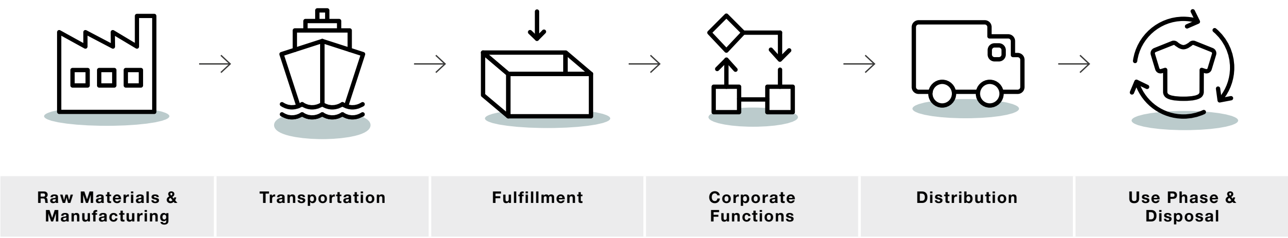
GRI 102-9

Our supply chain can be broken down into six phases. In the first two phases, third-party brands and our private labels produce items that are transported to our fulfillment centers. In the fulfillment centers, products are stored and prepared as soon as customers place an order. Our internal corporate functions – such as technology, marketing, and customer service – ensure that customers have a convenient shopping experience. Distribution partners subsequently deliver the products to our customers. The last stage of the supply chain is the use phase and ultimately the disposal of products.

zln.do/en-supply-chain

Our Supply Chain

→ 07



Supply chains for producing fashion are very complex and span across the globe – our supply chain is no exception. This entails challenges and risks, especially in terms of human rights, working conditions, and environmental protection. That is why we strive to improve the social and environmental impact of the products on our platform. In our approach, we distinguish between third-party brands and our private labels. The work involving our private labels represents a significant part of Zalando's commitment to improvements in the supply chain, as our impact is stronger at this point. This will be reflected in the following subchapters on sustainable products, animal welfare, human rights and product safety.

The Supply Chain of Our Private Labels

GRI 102-4
GRI 102-9
GRI 102-10

Our private label brands such as mint&berry, Pier One and Zign are managed by the Zalando subsidiary zLabels. zLabels has 17 private label brands, which source products from 24 different countries. The main sourcing countries are China (46%), Turkey (10%), India (10%), Bangladesh (8%), Spain (4%), Portugal (4%), Vietnam (3%), Romania (2%), Cambodia (2%) and Bulgaria (2%). Due to the size and variety of our assortment, zLabels does not own any supply base or factories, but rather collaborates with sourcing partners and agents with years of technical expertise in their respective product areas. We currently cooperate with 272 sourcing partners and 450 factories[4], a small decrease in comparison to 2016. Consolidating our sourcing partner base and strengthening relationships with strategic partners helps us to maintain better oversight over the supply chain and to work closely with partners on an individual basis.

Gaining transparency throughout the supply chain is an important focus for us, and in 2017 we began a mapping exercise for tier 2 processes in order to trace and track our sourcing partners along this tier.

4) Status December 29, 2017

Our Commitment to Sustainable Fashion

It is our ambition to become a leading online destination for sustainable fashion. More and more customers are interested in ethical, animal- and environmentally friendly clothing. That is why we want to use our expertise in technology and fashion to provide customers with an attractive offering as well as the necessary transparency for an informed buying decision. Today's market for sustainable fashion is still fragmented and difficult to navigate for customers in terms of easily accessible and understandable product information. Certificates such as GRS (Global Recycling Standard) are intended to help, but are largely still unknown among customers and, because there are so many, can easily cause confusion. We want to improve this situation for our customers with product transparency and simple online navigation.

zln.do/en-sustainability

> Sustainability is becoming an important new driver of consumers' purchasing decisions.
> The State of Fashion, McKinsey 2017
> 31% of all customers in Germany purchased sustainable fashion in 2016.
> Dr. Grieger & Cie Marktforschung

We are exploring new ways to highlight information on certified products that we offer online, and our customers have responded positively to these efforts so far. Our on-site personalization initiative in the online shop simplifies the search for labels such as Fairtrade or Organic Cotton. In addition, we are testing customer communication on sustainability topics such as sustainable jeans products through a separate microsite.

www.zalando.co.uk/
sustainable-fashion/

In 2016, we launched the sustainable flag in the children's category in the German Fashion Store, and expanded it to all markets and categories in 2017. We continue to refer to certificates such as Fairtrade and the Global Organic Textile Standard (GOTS) in order to fulfill the highest and externally audited standards. At the same time, we know that many innovative brands are implementing high sustainability requirements in their products and supply chains without having these certified by an external organization. We are working on ways to highlight their commitment towards customers. In this process we are collaborating with brand partners and experts from the industry.

Sustainable Products at Our Private Labels

We have a responsibility to improve the clothes that we make. To this end, we are making strides towards growing our offer of sustainable products. In 2016, we began developing our first sustainable products as part of our re:imagine collection, which we launched in January 2017. It included 48 styles across five different brands, certified with GOTS and GRS. We continued to offer the re:imagine collection throughout 2017, and our organic cotton range for babies, STUPS Organic, will be fully GOTS certified for the upcoming spring/summer 2018 season.

This year we also took some sizeable steps forward to scale up our sustainability efforts across the entire zLabels brand portfolio. We joined the Sustainable Apparel Coalition (SAC) and submitted our first results to the SAC's Higg Index to benchmark our performance against other leading brands. Minimizing water and waste is one of our focus areas in our supply chain, and by using the Higg Index we will be able to measure the sustainability performance of our partners and their factories. We are actively engaging with our sourcing partners to increase the number of tier 1 factories using the Higg Index.

GRI 103-1/-2/-3 MA Water
GRI 103-1/-2/-3 MA Supplier Environmental Assessment
GRI 102-13

Collaborating closely with the rest of the industry is important to us as we are constantly exploring better solutions to common challenges. In 2017, we travelled to the University of Santiago de Compostela to receive advice on a range of topics and are actively using open-source tools such as the SAC's Materials Sustainability Index and data from Nike's Making app to make more informed decisions.

We signed up to the European Clothing Action Plan (E-CAP) to reduce the environmental impact of our products and have set ourselves a minimum target of 10% in carbon, water and waste savings by 2019 by switching to more sustainable fabrics such as organic cotton, TENCEL®/Lyocell and recycled polyester. We are working closely with our Design and Sourcing Teams to change our buying habits from conventional materials to more environmentally-friendly alternatives and are investing in training delivered by external experts on topics such as recycled materials, wet processing and trims.

GRI 102-12
GRI 103-1/-2/-3 MA Materials

To continue our journey of sourcing more sustainable fabrics, we became members of the Better Cotton Initiative, which exists to make global cotton production better for the people who produce it, better for the environment it grows in and better for the sector's future.

GRI 102-13

While leather offers some important benefits in terms of product quality and lifespan, we are aware that the production process is associated with many complex social and environmental issues. In 2017, we began investigating our leather supply chain past tier 1 and became members of the Leather Working Group, which rates tanneries under its Gold, Silver and Bronze system. We have now identified five strategic tanneries/sourcing partners that we will work with over the coming years to improve environmental standards and the lives of the many people supported by the leather industry.

Committing to Animal Welfare

Zalando is committed to animal welfare and the conservation of biodiversity. Our ethical sourcing standards are based on Directive 98/58/EC concerning the protection of animals kept for farming purposes and the standards of the World Organisation for Animal Health (OIE). Zalando does not sell any products that originate from endangered species listed in international conventions. We allow only products from farming animals that have been bred for meat production. Further, we condemn any form of cruelty to animals and do not sell any type of rabbit wool such as angora. Zalando stopped selling articles made of fur in 2012 and has been a member of the Fur Free Retailer initiative since 2016. This organization informs consumers about how retailers deal with fur products and supports retailers who undertake not to sell fur.

GRI 102-2
GRI 102-12
GRI 102-13
GRI 102-16

Animal Welfare at Our Private Labels

We expect even higher standards for our private labels, and in 2017 we started to implement the Responsible Down Standard (RDS) across all our private brands. We also know that vegan products are important to our customers, and for autumn/winter 2017 we launched 27 additional vegan shoe styles under our Even&Odd label, which we intend to expand significantly over the next few seasons. We were very proud that one of our shoes was selected as the winner of PETA's Vegan Fashion Award and are collaborating closely with PETA on the roll-out of our vegan strategy to other brands.

GRI 102-16

Protecting Human Rights in Our Supply Chain

Our Code of Conduct sets the minimum standards that we expect all our business partners and their subcontractors to comply with, such as minimum wage, freedom of association and the absence of forced labor, child labor, and discrimination. It is based on the principles of the Universal Declaration of Human Rights (UDHR) and the Conventions of the International Labor Organization (ILO). We continuously review the minimum standards we set forth with our Code of Conduct and update it on a regular basis. The latest update took place in 2017.

Audit Program of Our Private Labels

GRI 103-1/-2/-3 MA
– Freedom of Association and Collective Bargaining
– Child Labor
– Forced or Compulsory Labor
– Human Rights Assessment
– Supplier Social Assessment
GRI 308-1
GRI 407-1
GRI 408-1
GRI 409-1
GRI 412-1
GRI 414-1

Checking that our sourcing partners comply with our Code of Conduct and treat the workers in our supply chain ethically and fairly is a crucial part of our work at zLabels. In 2017, we reviewed and relaunched our audit program with changes to create a more robust program. The new program was communicated to our sourcing partners in December 2016, and the changes were implemented in March 2017. We limited the number of auditing companies and reduced the types of audits we accept. We remain committed to reducing audit fatigue and working together with the industry to find a common solution. We are also collaborating with other brands through the Social and Labor Convergence Project.

Our Ethical Trade Team evaluates all audits received against our internal non-compliance matrix. The matrix is based on the standards set forth in our Code of Conduct as well as local legal requirements. The findings on non-compliances are clustered into minor, major and critical, a rating is given to the factory, and a Corrective Action Plan (CAP) is sent.

In order to address specific country risks, we developed a country risk categorization based on international indicators as well as audit findings. This risk categorization allows us to focus our work on areas where the greatest improvements need to be made. This year we added additional requirements for factories from twelve different countries, and we also launched additional policies to protect migrant and homeworkers.

As part of our onboarding process, all new sourcing partners must sign our Code of Conduct, and the corresponding factory must meet all ethical requirements before orders can be placed. As part of the updates to our audit program, we now require an audit that has been conducted within the past twelve months to set up a new factory. If critical findings are observed, we do not begin the relationship without evidence that the existing findings have been remediated. In the past year, we rejected the onboarding of 52 factories due to ethical trade concerns.

For our existing factories, we request new audits every twelve months to monitor and reassess factory conditions. In 2017, we evaluated 506 audit reports for new and existing factories. If a critical instance of non-compliance is found at an existing factory, we require evidence of improvement to continue our business relationship.

The addition of a new Ethical Trade Team based in Hong Kong has enabled us to develop closer relationships with our partners at source. Our Ethical Trade Team visited 68 factories in 2017. Our team based in Hong Kong also works closely with our partners and their factories to develop customized improvement plans based on the challenges faced by individual factories.

We believe internal training is key to establishing good practice across the business. To ensure Sourcing and Product Teams are aware of the impact of buying decisions on our supply chain, we rolled out a new ethical trade e-learning. It is mandatory for all zLabels employees to complete the e-learning and in addition, specific training on sustainability and ethical trade topics were also offered throughout the year.

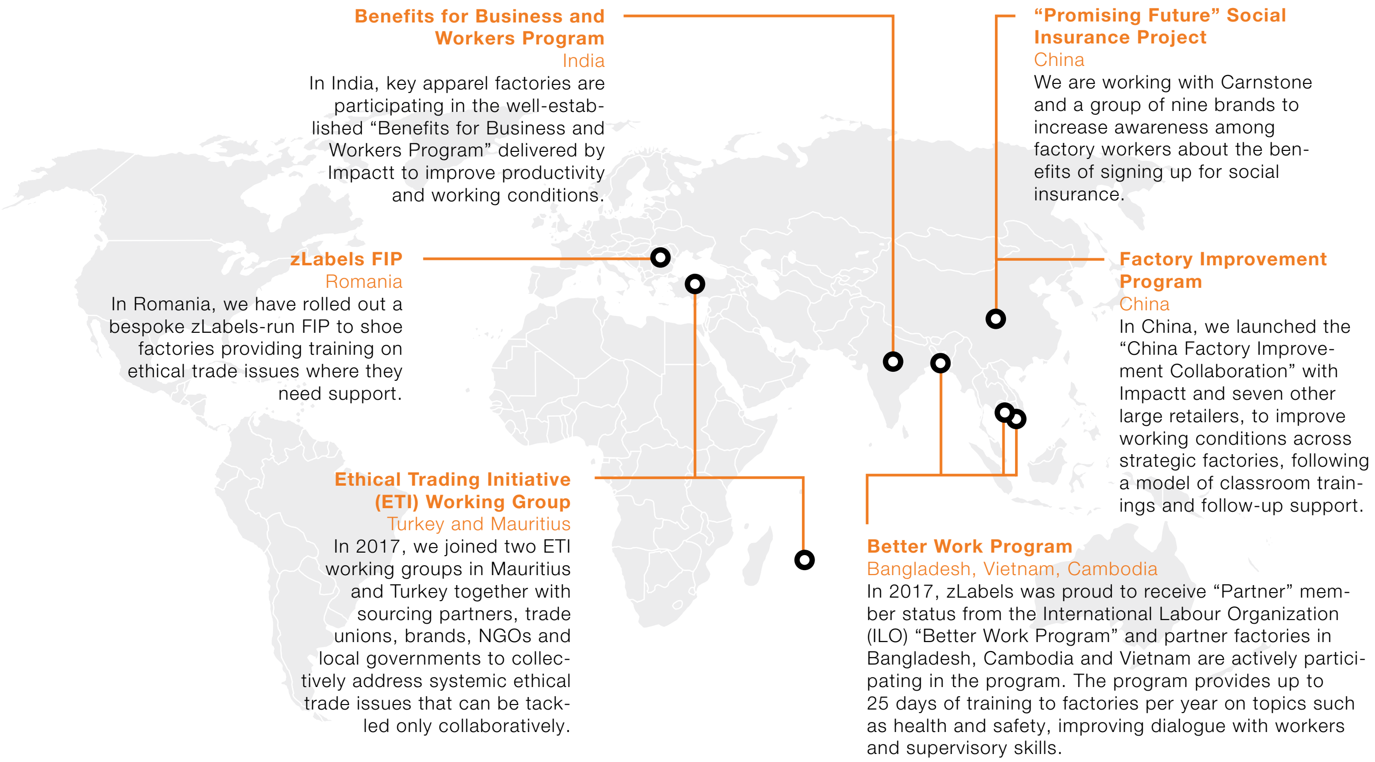
Factory Improvement Program (FIP) of Our Private Labels

zLabels is committed to improving working conditions in our supply chain and we realize that to achieve this, we need to go beyond auditing and support partners and their factories on the ground. Our FIP has grown this year, and as shown in figure 08, we now have seven programs and initiatives across eight countries, working with four independent partners. 20% of our products are sourced from participating factories. Our aim is to increase the share of products sourced from FIP factories to 25% in 2018.

We regularly review our classification of high-risk countries and focus on factories in the countries where there is the greatest need for action. We also select factories based on their respective performance and need for support.

GRI 102-12
GRI 102-13

zLabels Factory Improvement Program in 2017 → 08



Sourcing from many countries across the world, with different cultures, governance, legislation and business practices, means that we must approach factory improvement work in different ways to ensure the support we offer is tailored and relevant. This is reflected in the various programs and initiatives we choose.

We are also aware that many ethical trade issues we face in our supply chain are endemic to the countries we work in and cannot be tackled alone. We therefore work as collaboratively as possible with other brands, organizations, trade unions, NGOs, sourcing partners and government stakeholders to drive improvements through the industry together.

To incentivize factories to go beyond auditing and engage in capacity-building factory improvement work, we do not request a social audit report for the duration that a factory is in an FIP and award additional points to the zLabels ethical trade score.

We continuously monitor our factory improvement work to understand the success of each program and initiative and to ensure we are supporting our partners and their factories in a useful and meaningful way.

Our Private Labels in Dialogue with Sourcing Partners

In 2017, we repeated our Vendor Summit in Berlin, Delhi and Hanoi attended by 139 of our sourcing partners. At these summits, we updated our partners on our corporate strategy, our Code of Conduct and the implications of new legislation, such as the UK Modern Slavery Act. Through a series of workshops and moderated panel discussions, we also used the opportunity to engage in a dialogue with our business partners to discuss better ways of working.

The establishment of In-Country Sourcing Teams in Spain, Portugal, India, Hong Kong and China has given us more accessibility to factories, improved linear communication with our partners and overall enhanced the transparency of our supply chain.

At zLabels, we also have a Supplier Partnership Program (SPP) led by our Sourcing Team, which evaluates sourcing partner performance across a range of areas; e.g. quality, ethical trade, product safety, logistics and financial terms. The objective of the SPP is to gain complete transparency of our sourcing partners' performance and provide an incentive by awarding more business to higher-performing sourcing partners. In 2017, we worked closely with key sourcing partners to develop action plans to help support their improvement.

Ensuring the Safety and Quality of Our Products

GRI 103-1/-2/-3 MA Customer Health and Safety

In the interest of customers, factory workers, and the environment, Zalando sets clear guidelines on the permissibility of certain substances in products we sell. The Restricted Substances List (RSL) defines the thresholds that apply to harmful substances and that must not be exceeded. The list applies to all products and is compulsory both for the suppliers of our own brands and for our partner brands.

In addition to the high quality standards of our partner brands, we have established our own guidelines and processes for ensuring product quality. Using a scorecard approach for all product categories allows us to focus on products that exhibit a higher safety risk. We work with the suppliers in question so that these products fulfill all requirements, and we encourage communication and exchanges on best practices.

Zalando furthermore responds immediately to information and questions from various channels, such as customer ratings, customer care queries, the weekly RAPEX report, and the media. If these create doubts over the safety of a product, Zalando suspends respective sales as a precautionary measure and, if necessary, immediately recalls products that have been sold. We had 13 recalls in 2017 while our assortment range covers around 200,000 units. This is line with the 2016 numbers when we had to manage 15 recalls. GRI 416-2

Product Responsibility at Our Private Labels

We review the products sourced for our private labels at an early stage in order to be able to implement any corrective measures immediately. This way, the items that reach our customers fulfill our high standards. There were no recalls for our private label products in 2017. GRI 416-1 GRI 416-2

We want to continually reduce the volume of harmful chemicals used in the production of our private labels. This effort means less risk to customers, workers along the supply chain, and the environment. With the support of the University of Santiago de Compostela, TÜV and Bureau Veritas, we reviewed and updated our standards on restricted substances in 2017 to ensure that they were following state-of-the-art science. The chemicals restriction list now contains more than 300 restricted substances. Moreover, we successfully adjusted our chemical management system and internal guidelines to comply with international standards such as the EU systems (REACH and POP) and the standards of the US Consumer Product Safety Commission.

All sourcing partners are required to avoid the use of possibly harmful substances to ensure that our products are safe. We fine-tuned our chemical test routine and risk assessment, which led to improvements in sourcing partners' performance for good chemical management. Our bespoke Continuous Improvement Program allows us to monitor and rank our sourcing partner using a scorecard and to drive specific actions for the most challenging sourcing partners. This effort already resulted in a total improvement of 36% for the score of those sourcing partners from the spring/summer season to the fall/winter season 2017.

Throughout 2017 approximately 12,000 chemical tests were conducted for our private label products. Due to comprehensive testing, monitoring and chemical elimination programs, we were able to improve the fail rate in most critical parameters by 28% compared to 2016.

In 2017, we initiated a program to phase out critical heavy metals, where technically possible, from the manufacturing process step-by-step until 2020. As a first result, we were able to eliminate 25% of those hazards in our products.

1.2.4 do.PROTECT

do.PROTECT

→ 09

Impact vision	Aspired outcome	Targets	Timing
Decouple our environmental footprint from our economic growth	**We have mobilized our full climate protection potential across our value chain**	Reduce CO_2 emissions per order by 10% by 2020 compared to 2017 levels.	2020
		Require and enable 100% of our packaging suppliers and nation-wide carrier partners to provide us with CO_2 data for our footprint calculation and commit to reducing CO_2 emissions by 2020.	2020
	Zalando has taken sustainable packaging to the next level	We want 100% of our packaging to be sustainably sourced.*	2020

*) Packaging procured by Zalando. For packaging not procured by us, we work with our partners to achieve the 100% target over time.

Commitment to Climate Protection

GRI 103-1/-2/-3 MA Emissions

Further Information Corporate Strategy p. 80

Zalando has grown successfully in the past few years and has set itself the ambitious target of doubling its business by 2020 compared to 2017. This growth has been accompanied by a larger ecological footprint, including increasing carbon emissions. As a first step towards separating our economic growth from our environmental impact, we developed Zalando's first climate protection strategy in 2017, which will be rolled out in 2018. Teams from all relevant business units were involved, contributing their ideas on how to reduce CO_2 emissions in the future. Our aim is to activate the full climate protection potential across our value chain. This includes two targets: 1) Reduce CO_2 emissions per order by 10% by 2020 compared to 2017 levels, and 2) Require and enable 100% of our packaging suppliers and nation-wide carrier partners to provide us with CO_2 data for our footprint calculation and commit to reducing CO_2 emissions by 2020.

Measuring CO_2 Emissions Every Year

GRI 305-1
GRI 305-2
GRI 305-3

To define the strategic orientation of our climate related activities, we need transparency on the environmental impact of our business operations. That is why we regularly measure our corporate carbon footprint. We continue to do this following the guidelines of the internationally recognized Greenhouse Gas Protocol and work with ClimatePartner, an international consultancy specializing in CO_2 accounting and climate protection strategies.

We track and report our Scope 1 and Scope 2 emissions for all relevant administrative and logistics locations.[5] The Scope 3 emissions that we track include those sources that we have identified as carbon hotspots in our upstream and downstream value chain.[6] To collect meaningful data on these sources, we engage our partners along the supply chain. Emissions from waste generated in our operations and by the purchase of office materials accounted for less than 2% of our CO_2 footprint in the calculations for 2015 and 2016 and are thus not regarded as significant sources. Therefore, they will no longer be taken into account in our calculations from 2017 onward.

5) Offices and offline stores with more than 40 employees, and our fulfillment centers in Brieselang, Erfurt, Lahr, Mönchengladbach, and Szczecin (Gryfino).
6) Outbound logistics incl. returns from Fashion Store, zLabels, Lounge, Zalon; production of packaging materials used for delivering customer orders; inbound logistics (inbound transportation of zLabels products and packaging materials; storage in delivery warehouses); employee commuting based on commuting scenarios; business travel.

CO_2 Emissions

→ 02

IN METRIC TONS	2017	2016**
Scope 1	4,935	3,868
Scope 2*	21,290	18,353
Scope 3	183,425	150,392
Total	**209,650**	**172,613*** **

*) The Scope 2 emissions displayed in table 02 are market-based values, which reflect the intensity of the electricity Zalando actually purchases. The location-based value for 2017 is 33,276 metric tons of CO_2.
**) The 2016 values are not part of the non-financial report.
***) Location-based emissions in 2016 were 177,626 metric tons CO_2. This value is 6,692 metric tons CO_2 lower than the one reported in the annual report 2016. The difference is mainly due to a methodological revision in the calculation of emissions from packaging and outbound logistics.

Our corporate carbon footprint in 2017 totaled 209,650 metric tons of CO_2[7] compared with 172,613 metric tons of CO_2 in 2016. This increase can be attributed primarily to Zalando's growth. At the order level, CO_2 emissions amounted to roughly 2.54 kg.

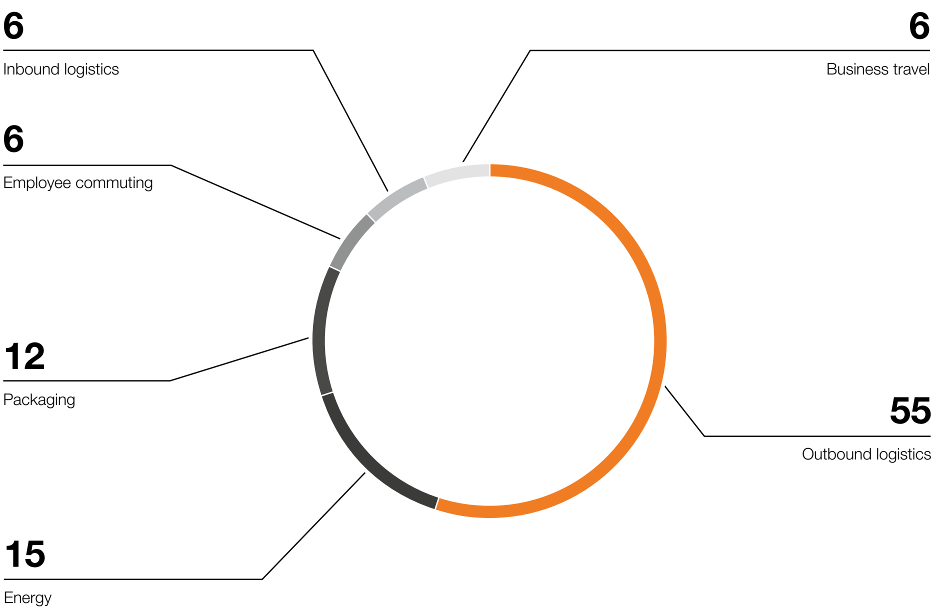
GRI 305-4

Main triggers for CO_2 emissions in the reporting year were the transportation of parcels from our fulfillment centers, including returns (55%), the energy consumed in our offices and fulfillment centers (15%), and the production of packaging materials for the products we sell (12%).

CO_2 Emissions by Source (2017)

→ 10

IN %



7) Greenhouse gas emissions are disclosed as CO_2 equivalents (CO_2e). All greenhouse gases regulated by the UN Kyoto Protocol have been accounted for: carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), sulfur hexafluoride (SF_6), hydrofluorocarbons (HFCs), and perfluorocarbons (PFCs). For better legibility, the emissions are simply referred to as carbon emissions and reported in metric tons of CO_2.

Sustainable Initiatives in the Logistics Network

GRI 102-2
GRI 103-1/-2/-3 MA
Emissions

Every day, our fulfillment centers receive products from almost 2,000 brands – products that originate from many different parts of the world. These products are sent to our more than 23m active customers in 15 European countries. In the light of these dimensions, we see efficiency, technical innovation, and raising the awareness of our service providers as the major levers for developing sustainable logistics and reducing our ecological footprint.

We rolled out a pilot project in 2017 aimed at optimizing our procurement logistics using a time slot management system. This solution enables our transport service providers to consolidate their deliveries, which improves truck loading and reduces the number of delivery trips. After the pilot, a further roll-out is planned for 2018. In addition to this, we developed a new feature in our logistics tech landscape that allows us to consolidate orders from a customer that are placed within a defined time frame into a single shipment. We thus reduce not only the environmental impact, but also the delivery costs.

zln.do/en-logistics-network

The last mile of local delivery is often reported as the largest contributor to fossil fuel consumption and CO_2 emissions.[8] Our Logistics Network Team regularly launches pilot projects that contribute both to customer satisfaction and to reducing environmental impact. In 2017, Zalando tested Tripl, a Danish electric vehicle that emits zero CO_2 and has a very low noise emission during operation, which is particularly relevant in cities. Moreover, we started piloting deliveries in a preferred 60-minute time frame, chosen by the customer in advance, in some parts of Berlin. Through this pilot, we were able to add a new partner (Hoard), which makes deliveries exclusively by bicycle, to our local delivery network in Berlin.

zln.do/en-post-order-experience

In order to activate the full climate protection potential across our value chain, we must engage with our service providers. We have therefore started to collect information on CO_2 emissions from all our transport partners as well as from smaller, localized fulfillment centers operated by partners. This way, we not only improve the data quality on our CO_2 emissions, but also gain a helpful foundation for future collaborations relating to environmental protection.

Innovative Mobility Concepts

GRI 305-3

In a growing company with a growing workforce, business travel and commuting emissions become more and more significant. These two sources account for 12% of our total CO_2 emissions.

Our travel policy puts phone or video conferencing first to reduce unnecessary travel. For distances shorter than 400 km, we strongly recommend that our employees travel by train. The policy also states that rental cars have to be chosen from the compact class, allowing us to reduce costs as well as CO_2 emissions. Our company car guidelines include the option of leasing cars with alternative drives (e.g. electric cars), thus promoting the use of sustainable mobility.

To facilitate the mobility of our employees between our Berlin offices, a mobility concept was developed in 2017, which will be rolled out in 2018. Sustainability, both economic and ecological, is one of the main criteria in selecting our future mobility business partners.

8) https://www.researchgate.net/publication/266977016_Carbon_emissions_comparison_of_last_mile_delivery_versus_customer_pickup

As the emissions from commuting (6%) can be traced back primarily to our fulfillment centers, our commitment is not limited to our Berlin locations. At our fulfillment center in Erfurt, for example, we have entered into a partnership with JobRad to make it easy for our employees to rent a bicycle locally. What's more – and also based on our wishes and the input received from the works council – a cycle path has been created from Erfurt to the Zalando fulfillment center. Additionally, our employees there can repair their bikes free of charge at professionally equipped maintenance pillars located near the bicycle shelters.

To make it easier for employees to get to our location in Lahr, we have initiated two bus routes that are now operated by local transportation companies.

Energy Management Promotes Climate Protection

GRI 103-1/-2/-3 MA Energy

The growth of our company also means that we require more floor space. As a result, our energy consumption has increased by 47.2% from 2016. We see increases in efficiency and investments in renewable energy as critical levers for conserving resources and protecting the environment.

In 2017, we expanded the use of smart meters to our main administration building. We now have real-time data available on our energy consumption and the opportunity to manage this more efficiently in the future. Furthermore, the last quarter of 2017 saw us commencing the introduction of an energy management system for our office buildings, starting with the main administration building. We intend to get an ISO 50001 certification for it by the end of 2018. A decision will then be made on expanding the certification to other offices.

In order to operate our fulfillment centers in a more energy-efficient way, we continue to pursue the goal of introducing an integrated energy management system at our locations in Germany. Technical difficulties have led to a delay in the introduction of this system, which is now planned for 2018.

In addition to increasing our energy efficiency, we are focusing on the use of renewable energies as part of our climate protection strategy. Therefore, starting in January 2018, we switched to 100% renewable electricity in our German operations. Moreover, we started using climate-neutral gas this year to heat the fulfillment centers that we operate in Germany.

Our recently constructed fulfillment center in Lahr will be partially fitted with solar panels. This is expected to cover 13% of the electricity requirement there in 2018. The CO_2 savings anticipated from this measure amount to 650 metric tons per year.

Energy Consumption

→ 03

GRI 302-1

IN MWH	2017	2016
Electricity (total)	50,840	37,159
Electricity from renewable sources	22,840	12,634
District heating	11,864	2,761
Natural gas	20,297	16,351
Car fleet	1,402	1,072
Total	**84,402**	**57,342**

Resource Efficiency in Packaging and Waste

GRI 103-1/-2/-3 MA Materials
GRI 301-1
GRI 301-2

With our business volume increasing, we also expect an increase in the amount of packaging material we use. In order to decouple our economic growth from our ecological footprint, we want to raise the sustainability of our packaging materials. For example, we aim to source 100% of our packaging material from sustainable sources by 2020[9] and to ensure it can be recycled after use. 25,149 metric tons of packaging materials were used at Zalando for customer deliveries in 2017. 93% of these came from renewable sources.

Our approach to the use of packaging materials is based both on customer-centricity and on environmental factors. To be able to offer our customers the best unpacking and return experience in the industry is enormously important for our business model. So our mailing envelopes and almost all of our boxes have an integrated return strip that makes them easy to reseal. We have noticed that some of our customers continue to use standard adhesive tape when sending back mailing envelopes and boxes, which leads to additional waste and more resources being consumed. In order to make the return process easy for our customers, but also to encourage them to refrain from using additional adhesive tape, we began marking the return strip with an additional label in 2017.

GRI 103-1/-2/-3 MA Materials

Given the limited natural resources worldwide, we use packaging material as sparingly as possible. We therefore work closely with our partners to continually reduce the amount of materials used for each box. For example, the thickness of the material of our smallest boxes has been reduced, which enabled us to save approximately 3,000 metric tons of paper in 2017.

Our shipping envelopes also offer ecological benefits. They allow our employees to adjust the size when sealing. Air holes ensure that excess air can escape, meaning the envelopes take up less space during transport. The share of total volume sent in shipping envelopes has increased from an average of 17% in 2016 to 21% in 2017.

9) Packaging procured by Zalando. For packaging not procured by us, we work with our partners to achieve the 100% target over time.

Handling Waste Properly

GRI 103-1/-2/-3 MA Materials
GRI 103-1/-2/-3 MA Effluents and Waste
GRI 301-3

Paper and municipal waste are the most frequent types of waste from our offices; in contrast, most waste in our fulfillment centers, outlets, and photo studios is caused by the packaging used to ship and return the products that we sell. 50% of the materials used as packaging in all product categories was sent back to us and recycled.

Zalando sees the recycling of packaging in our fulfillment centers as an important ecological duty, so all shipping cartons and foil bags that can no longer be used are collected, sorted, and recycled. We also involve our customers in these activities and furnish our parcels with information that the packaging is 100% recyclable.

Total Weight of Waste by Type and Disposal Method

→ 04

GRI 306-2

IN METRIC TONS*	2017	2016**
Non-hazardous waste	**17,693**	**16,312**
Waste disposal method		
Recycling	15,821	14,979
Reuse	58	329
Recovery, including energy recovery	864	–
Waste incineration	950	1,005
Hazardous waste	**1**	**55**
Total	**17,694**	**16,367**

*) The waste disposal method was determined with information provided by our waste disposal contractors.
**) This value is 138 metric tons lower than the one reported in the annual report 2016. This is mainly due to an improvement in the calculation methodology.

1.2.5 do.CONNECT

do.CONNECT

→ 11

Impact vision	Aspired outcome	Targets	Timing
Reimagine how corporates contribute to societal challenges	**Zalando has leveraged its unique mix of resources to scale existing solutions for social impact**	Through cross-sector alliances, we offer support and visibility for 100+ solutions that contribute to diverse communities or value chain transparency.	2019
		Contribute substantially to scale at least five solutions with the potential to increase value chain transparency in the fashion industry.	2020
	Zalando employees have become changemakers in their communities	20% of Zalandos engage in Corporate Citizenship activities.	2020
		Leveraging the professional expertise of our employees by increasing the share of pro bono shifts in our volunteering mix.	2020
		Empower 100+ Zalandos to bring powerful citizenship activities to their neighborhoods.	2020
	We pioneered ways to increase impact orientation in corporate citizenship	Provide access for NGO`s to capacity building on collaborating with corporates.	2018
		Test different ways to measure Zalandos societal impact.	2019

The challenges that our society is facing are large and complex, and companies can and have to reimagine how they want to contribute solving them. As a good corporate citizen, we want to get involved in this process in the same professional way as we do in our daily business. Together with experts from all parts of society, we get engaged by contributing our skills, networks, and resources. This becomes particularly meaningful in the areas in which we are well versed. In the past two years we started building the networks and infrastructure that are necessary to strategically invest an average of 1% of our EBT in our social impact from 2018 onwards focusing on two strategic areas. 1.) We will continue engaging in the communities around us in order to be a good neighbor. 2.) At the same time we want to use our expertise in tech and fashion to start taking a systemic role in our industry and invest strategically in solutions that increase transparency and sustainability in our industry. Building an accelerator for this purpose will be a major focus topic in our community engagement in 2018.

GRI 413-1

zln.do/en-neighborhood

Strengthening Diverse and Inclusive Communities

GRI 103-1/-2/-3 MA
Local Communities

Many countries have already identified powerful solutions for refugee integration, some of them even have decades of experience with them. In 2016, we invited successful social entrepreneurs from around the world to our Hello Festival in Berlin and empowered ten local organizations to transfer their valuable know-how on refugee integration to Germany. The “Hello Accelerator” was designed as a one-year support program to those organizations, providing them with trainings, mentoring and on top of EUR 285,000 project funding to pilot knowledge transfer and replication. At the core were a cross-sectoral approach and the idea of scaling solutions with a proven track record instead of reinventing the wheel – this social Zalando principle was awarded with the German CSR award 2017 in the category Successful Measures for Refugee Integration. We are delighted about the recognition of our social engagement and take it as an additional motivation to continue our path because the challenge of long-term integration has by no means been solved yet.

Just like our employees from more than 100 different countries, refugees are now also contributing to the diversity and dynamic environment of our local communities. After initially finding shelter in emergency and large-scale accommodation, many of them have now settled in the neighborhoods. That is why we will not scale back our commitment to integration, but focus on strengthening diverse and inclusive communities from now on. In a first step, we supported the first German Neighborhood Award of the nebenan.de foundation in 2017. More than 1,300 applications provided impressive testimony to the local engagement.

None of this would be possible without the engagement of our employees. They get actively involved around our locations and can have two days volunteering time off for this each year. In 2017, 954 Zalandos provided support for 60 initiatives in 816 shifts. We are collaborating with the social business Vostel to ensure that we create a win-win situation: a great experience for our employees and an actual impact for the participating project. For this vostel, collects feedback and data on the impact of our volunteering program.

Feedback on Our Volunteering Program

→ 12

In addition to measuring the impact of our activities, it is particularly important to us to increase the number of employees that volunteer. We want 20% of Zalandos to be engaged in corporate citizenship activities by 2020 and increase the share of pro bono shifts compared to 2017.

Corporate volunteering can be a great way to connect people and causes that would not necessarily meet otherwise. Beyond the personal encounters, social initiatives value the time and professional expertise Zalando employees offer. That is why a growing number of Zalandos contribute their professional skills to a good cause free of charge – pro bono. In 2017 we organized a Hack Night in which our employees worked a whole night on challenges of six social initiatives. For example, a website was optimized for search engines and a campaign concept was developed. Furthermore, Zalandos provided advice to the Hello Accelerator participants on subjects such as communication strategies, management skills, and team building. Zalandos have additionally held workshops for refugees on programming and job application skills. Finally, employees passed on their knowledge of social media communication and customer-friendly design of sales rooms for a conference of the clothing stores of the Red Cross.

zln.do/en-hack-night

Increasing Transparency in the Supply Chain

Over the past years we learned a great deal from our engagement in integration and a variety of different topics in the communities we are part of. Whereas we want to continue to contribute to those local causes as all neighbors should, we want to leverage our professional experience and networks for societal challenges too. The biggest impact we can have is where our core competences meet: fashion and technology. We believe that we need to use new technologies to increase transparency in our industry dramatically, and we are determined to find our role in accelerating this process for the good of all.

In the course of 2017, we created a watch list of promising solutions that use technology to increase transparency in supply chains and started having conversations with experts and social innovators from the field. We got inspired by their approaches and listened to their needs to identify potential ways we can contribute to their impact story. Although we are only at the beginning of a new learning journey, we are already convinced of the potential of the solutions and have therefore already begun to develop the infrastructure for our own support program, which we will launch in 2018. The program will systematically identify social innovators and their solutions and support them in scaling their impact.

As a first step, we became a partner of the Plug and Play – Fashion for Good accelerator that concentrates on finding, investing in, and bringing much-needed sustainability innovations to the market. In only one year, Fashion For Good has already built a pipeline of more than 400 startups that innovate in all parts of the supply chain. We are proud to join this industry initiative, teaming up with the C&A Foundation, Kering, and Galeries Lafayette. The challenges we face as an industry are too big to be solved by single stakeholders, so we hope to see even more partners joining us in the future.

In 2018, we will grow our investment of time, funding and expertise and team up with our business partners and leading stakeholders to help the most promising solutions to grow their impact significantly.

Dear Shareholders,

The 2017 fiscal year was another successful year for Zalando. Thanks to the strong focus on the costumers' needs, the extension of business partner services as part of the implementation of the platform strategy and the continued investments in the logistics and technology infrastructure, Zalando again delivered on its promise of profitable growth. The company is well positioned to continue its growth path under its purpose to "Reimage fashion for the good of all" and the aim to build long-term value, this year and in the years to come.

Consultation and Monitoring

The Supervisory Board duly performed its duties in accordance with statutory requirements, the Articles of Association, the Supervisory Board's Rules of Procedure as well as the German Corporate Governance Code. It received regular and detailed written and oral reports on the intended business policies, any material issues regarding financial, investment, and personnel planning as well as the progress of business and risks and opportunities. In particular, the Management Board consulted the Supervisory Board on the group's strategy. The Supervisory Board was directly

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Corporate Governance Report
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The Supervisory Board – from left to right:
Dylan Ross Member of the Supervisory Board until January 2018,
Lothar Lanz Chairperson of the Supervisory Board, chairperson of the nomination committee, member of the audit committee,
Jørgen Madsen Lindemann Member of the Supervisory Board, chairperson of the remuneration committee, member of the audit committee, member of the nomination committee,
Beate Siert Member of the Supervisory Board, member of the remuneration committee,
Dominik Asam Member of the Supervisory Board, chairperson of the audit committee,
Alexander Samwer Member of the Supervisory Board, member of the remuneration committee,
Konrad Schäfers Member of the Supervisory Board, member of the audit committee,
Shanna Prevé Member of the Supervisory Board, member of the remuneration committee,
Anders Holch Povlsen Deputy chairperson of the Supervisory Board, member of the nomination committee

involved in all material decisions. Transactions requiring approval were presented by the Management Board.

Meetings of the Supervisory Board and Its Committees

The plenum of the Supervisory Board held six meetings in fiscal year 2017. The audit committee held four meetings, the remuneration committee held seven meetings and the nomination committee held two meetings. In addition, the Supervisory Board passed 34 circular resolutions. The Supervisory Board and its committees also convened wholly or partly without the Management Board as necessary to deliberate on items that pertained to the Management Board or required internal discussion among Supervisory Board members alone. The plenum of the Supervisory Board was informed about the results of meetings of the committees at its subsequent plenary meetings. Shanna Prevé was prevented from attending one extraordinary meeting, and Kai-Uwe Ricke was prevented from attending one ordinary meeting of the Supervisory Board. The other members attended all meetings of the Supervisory Board and their respective committee meetings.

Overview of Plenary and Committee Meetings and Attendance on an Individual Basis in Fiscal Year 2017

→ 05

	Tenure	Plenum	Audit committee	Remuneration committee	Nomination committee
Dominik Asam	Since May 2017	4 / 4	2 / 2	–	–
Lorenzo Grabau	Until May 2017	2 / 2	2 / 2	2 / 2	–
Lothar Lanz	Since February 2014	6 / 6	4 / 4	2 / 2	2 / 2
Jørgen Madsen Lindemann	Since May 2016	6 / 6	2 / 2	5 / 5	
Anders Holch Povlsen	Since December 2013	6 / 6	–	–	2 / 2
Shanna Prevé	Since May 2017	3 / 4	–	5 / 5	–
Kai-Uwe Ricke	Until May 2017	1 / 2	2 / 2	–	–
Dylan Ross	Since June 2015	6 / 6	–	–	–
Alexander Samwer	Since December 2013	6 / 6	–	7 / 7	2 / 2
Konrad Schäfers	Since June 2015	6 / 6	4 / 4		–
Beate Siert	Since June 2015	6 / 6	–	7 / 7	–

Plenary Meetings

The plenum of the Supervisory Board addressed in each of its ordinary quarterly meetings the analysis and discussion of the management reports on the course of business and the company's strategy as well as the capital markets developments. The chairpersons of the committees of the Supervisory Board reported regularly to the full Supervisory Board on the activities of each of the committees. In addition, the Supervisory Board dealt with the following focus areas:

At its ordinary meeting on February 24, 2017, the Supervisory Board dealt with the financial statements and consolidated financial statements for 2016 presented by the Management Board. In accordance with the recommendations of the audit committee, the Supervisory Board adopted the financial statements for 2016 and approved the consolidated financial statements for 2016. It followed the Management Board's profit utilization proposal for financial year 2016. In addition, the Supervisory Board adopted a resolution regarding its report for the financial year 2016 and dealt with the agenda for the annual general meeting 2017. The Supervisory Board also discussed the results of its 2016 efficiency evaluation, which was carried out by way of a questionnaire focusing on the supply of information to the Supervisory Board, the structure and efficiency of meetings, the set-up and procedures of the Supervisory Board's committees as well as the composition of the Supervisory Board and its succession planning. No noteworthy shortcomings were identified.

At its ordinary meeting on May 5, 2017, the Supervisory Board dealt in particular with the preparation of the annual general meeting 2017 as well as with the changes to the German Corporate Governance Code and the associated implications. It prepared a profile of skills and expertise for the entire Supervisory Board. In addition, the Supervisory Board discussed the female representation target for the Management Board and the Supervisory Board according to Section 111 (5) AktG and determined the target of 0% for the Management Board and 22% for the Supervisory Board, in each case within the time limit until June 30, 2022.

At its meeting on May 31, 2017, following the annual general meeting and the election of the shareholder representatives, the Supervisory Board mainly dealt with the election of Lothar Lanz as the chairperson as well as the election of Anders Holch Povlsen as the deputy chairperson of the Supervisory Board and resolved on the new composition of the committees of the Supervisory Board, which can be found in the Corporate Governance Report on page 52.

zln.do/
en-annual-general-meeting

At its extraordinary meeting on June 27, 2017, the Supervisory Board discussed the introduction of a new incentive program for certain key employees of the Company proposed by the Management Board.

As in previous years, the Supervisory Board paid particular attention to the company's strategy and decided to again hold an annual strategy session. The ordinary meeting on August 29, 2017, was specifically devoted to the strategy of the company which was presented by the Management Board and discussed at length with the Supervisory Board members. At the end of the meeting, the Supervisory Board members attended a training session on rights and duties of the Supervisory Board conducted by an external legal advisor.

zln.do/en-strategy

At its ordinary meeting on December 4, 2017, the Supervisory Board dealt primarily with and discussed the budget for the financial year 2018. Besides, it discussed its own diversity concept as well as the application of a specific diversity concept for the Management Board. The Management Board and the Supervisory Board jointly resolved on the declaration of conformity with the German Corporate Governance Code. The Supervisory Board also discussed the format of the annual self-assessment of its efficiency. The examination was performed based on questionnaires. Every member of the Supervisory Board was asked to provide feedback on the work of the full board as well its committees and the cooperation with and information by the Management Board.

Based on the law and the requirements laid down in the Articles of Association and the Management Board's Rules of Procedure, certain transactions and measures require the prior approval of the Supervisory Board. These transactions were presented to the Supervisory Board for its approval. The Supervisory Board addressed inter alia the construction of new logistic sites in Poland and Italy, a lease agreement for new office space in Berlin, the acquisition of the multi-channel basketball retailer KICKZ and the creation of the joint venture FashionTrade to develop the B2B online fashion wholesale marketplace.

Audit Committee

The audit committee analyzed the annual financial statements 2016 and the consolidated financial statements 2016, including the combined management report for 2016, as well as the quarterly statement for the first quarter, the half-year report and quarterly statement for the third quarter of 2017. The audit committee regularly reviewed and discussed the focus of the audit, the status reports on GRC (Governance, Risk & Compliance), litigation and the work of the internal audit, the treasury reports and capital structure considerations and addressed the new requirements for the non-financial reporting and the approval of non-audit services. The audit committee was involved in the preparation of the Supervisory Board's proposal to the annual general meeting 2017 for the appointment of the auditor and group auditor. The chairperson of the audit committee conferred with the auditors on the audit focus.

Remuneration Committee

The remuneration committee dealt with the review of the Management Board's performance, the succession planning as well as the design and introduction of the new compensation system for the Management Board members. The discussions will be finalized in the reporting year 2018. Besides, the remuneration committee addressed the introduction and status updates of employee incentive programs.

Nomination Committee

The nomination committee dealt with the preparation of the proposals of the Supervisory Board to the annual general meeting regarding the election of the members of the Supervisory Board.

Conflicts of Interest

No conflicts of interest of any Supervisory Board member occurred in the context of the work of the Supervisory Board. To avoid the appearance of a potential conflict of interest, Supervisory Board member Anders Holch Povlsen decided to abstain from participating in the discussion and the resolution regarding the creation of the joint venture FashionTrade between the Bestseller group and the Zalando group to develop the B2B online fashion wholesale marketplace.

Audit and Ratification of the Annual Financial Statements and Consolidated Financial Statements

The Management Board forwarded the annual financial statements and the consolidated financial statements for fiscal year 2017, the combined management report and the non-financial report for ZALANDO SE and the group as well as the proposal of the Management Board for the appropriation of profit to the chairperson of the Supervisory Board and the chairperson of the audit committee immediately upon their completion in February 2018 and before they were finally attested. The annual financial statements for 2017 and the consolidated financial statements for 2017, as well as the combined management report for the company and the group were examined by the auditor who rendered an unqualified audit opinion on them.

Further Information Combined Management Report p. 78

The financial statements and the auditor's reports were sent to the members of the Supervisory Board.

In a first step, the audit committee closely examined the financial statements and the proposal for the appropriation of profit in the presence of the auditor. The auditor reported on the most significant matters of the audit. Thereafter, the Supervisory Board discussed the financial statements, the non-financial report and the proposal for the appropriation of profit in detail.

The Supervisory Board approved the audit results. It examined the annual financial statements and consolidated financial statements, the combined management report and the non-financial report for ZALANDO SE and the group as well as the proposal of the Management Board for the appropriation of profit. The findings of the preliminary audit conducted by the audit committee and the Supervisory Board's own findings corroborate the findings of the external auditor. Based on this final review, the Supervisory Board raised no objections to the audit. The Supervisory Board has therefore approved and adopted the annual financial statements for 2017 and approved the consolidated financial statements for 2017 and the non-financial report. The Supervisory Board concurred with the proposal of the Management Board for the appropriation of profit (to be carried forward to new account), in consideration of particularly the company's annual result, liquidity, financial planning and strategy.

Further Information
Consolidated Financial Statements p. 134

Corporate Governance

The annual declaration of conformity was issued by the Management Board and the Supervisory Board in December 2017. The complete text of the declaration can be found in section 1.4.1 on page 52. The declarations are made permanently available under the section on Corporate Governance on the company's website.

zln.do/en-governance

More information on corporate governance can be found in the Corporate Governance Report and associated declaration on page 52. With regard to the remuneration structure for the members of the Management Board for fiscal year 2017 and to avoid repetition, please see the Remuneration Report on page 66.

Further Information
Corporate Governance Report p. 52

Personnel Matters

The term of office of the shareholder representatives in the Supervisory Board expired at the end of the general meeting on May 31, 2017. Lorenzo Grabau and Kai-Uwe Ricke did not seek re-election. The Supervisory Board would like to thank Lorenzo Grabau and Kai-Uwe Ricke for their valuable contributions to the work of the Supervisory Board and the trust-based cooperation.

The annual general meeting 2017 re-elected Lothar Lanz, Jørgen Madsen Lindemann, Anders Holch Povlsen and Alexander Samwer and newly elected Dominik Asam and Shanna Prevé as members of the Supervisory Board. All members were elected until the end of the general meeting that resolves on the discharge for fiscal year 2018. Lothar Lanz was re-elected as chairperson of the Supervisory Board, and Anders Holch Povlsen was elected deputy chairperson of the Supervisory Board.

On January 15, 2018, the term of office of Dylan Ross, one of the employee representatives on the Supervisory Board, expired due to him leaving the Zalando group. The Supervisory Board would like to also thank Dylan Ross for his commitment and dedication to the work on the Supervisory Board. Based on the legal provisions and the Agreement on the Participation of Employees in ZALANDO SE of March 17, 2014, the company's SE works council is currently conducting an election procedure in order to determine a successor for Dylan Ross as well as a substitute. The SE works council will propose a new member and a corresponding substitute member both to be appointed by the ordinary general meeting of ZALANDO SE scheduled for May 23, 2018. The general meeting is bound by these proposals.

The Supervisory Board would like to thank the Management Board and all employees of the company for their high level of commitment and the excellent achievements in fiscal year 2017.

Berlin, February 26, 2018

Lothar Lanz

The following overview lists all of the companies and enterprises in which the members of the Supervisory Board of ZALANDO SE currently are members of a statutory supervisory board of the companies or members of a comparable controlling body in Germany or abroad.

Current and Past Seats

→ 06

Name of Supervisory Board Member	Mandates pursuant to Section 125 (1) Sentence 5 AktG
Dominik Asam	Infineon Technologies Austria AG, Villach, Austria (member of the Supervisory Board)
	Infineon Technologies Americas Corp., Delaware, USA (member of the Board of Directors)
	Infineon Technologies Asia Pacific Pte., Ltd., Singapore (member of the Board of Directors)
	Infineon Technologies China Co., Ltd., PRC (member of the Board of Directors)
	Until May 2017: EPCOS AG (member of the Supervisory Board)
Lorenzo Grabau (until May 31, 2017)	Qliro Group AB, Sweden (member of the Board of Directors)
	Millicom International Cellular S.A., Luxembourg (member of the Board of Directors)
	Tele2 AB, Sweden (member of the Board of Directors)
Lothar Lanz	Axel Springer SE (member of the Supervisory Board)
	Bauwert AG (member of the Supervisory Board)
	Home24 AG (member of the Supervisory Board, chairperson)
	Kinnevik AB (member of the Board of Directors)
	TAG Immobilien AG (member of the Supervisory Board, deputy chairperson)
	Since January 2018: Dermapharm Holding SE, Grünwald (member of the Supervisory Board)

→ 07

Name of Supervisory Board member	Mandates pursuant to Section 125 (1) Sentence 5 AktG
Anders Holch Povlsen*	Intervare A / S 25169158, Denmark (member of the Board of Directors, chairperson) Nemlig.com A / S, Denmark (member of the Board of Directors, chairperson) J.Lindeberg AB 556533-7085, Sweden (member of the Board of Directors) J.Lindeberg Holding AB, Sweden (member of the Board of Directors) J.Lindeberg IP HK Limited, Hong Kong (member of the Board of Directors) J.Lindeberg Holding (Singapore) Pte. Ltd., Singapore (member of the Board of Directors) JL Schweiz AG, Switzerland (member of the Board of Directors, chairperson)
Shanna Prevé	–
Kai-Uwe Ricke (member until May 31, 2017)	United Internet AG, Montabaur (member of the Supervisory Board) *Mandates in affiliated companies:* Until March 2017: United Internet Ventures AG, Montabaur (member of the Supervisory Board) 1&1 Internet SE, Montabaur (member of the Supervisory Board) 1&1 Telecommunication SE, Montabaur (member of the Supervisory Board) 1&1 Mail & Media Applications SE, Montabaur (member of the Supervisory Board, chairperson) Since October 2017: Drillisch AG (member of the Supervisory Board, deputy chairperson) Until January 2018: EUN Holdings LLP, Delaware (member of the Board of Directors) Delta Partners, Dubai (member of the Board of Directors) SUSI Partners AG, Switzerland (member of the Board of Directors) Virgin Mobile CEE B.V., Netherlands (member of the Board of Directors) Since May 2017: STRATO AG (member of the Supervisory Board) Since November 2017: Cash Credit Limited, Cayman Islands (member of the Board of Directors)
Jörgen Madsen Lindemann**	Turtle Entertainment GmbH (member of the Advisory Board)
Alexander Samwer	Home24 AG, Germany
Beate Siert	–
Dylan Ross	–
Konrad Schäfers	–

*) Mr. Povlsen is also member of Boards of Directors at various foreign group entities of the Bestseller group as well as foreign entities with a family connection.
**) Mr. Lindemann is also member of Boards of Directors at various foreign group entities of the Modern Times Group MTG.

The Management Board members are also member of an executive body at the following companies:

Current and Past Seats of the Management Board → 08

Name of Management Board member	Mandates Pursuant to Section 125 (1) Sentence 5 AktG
David Schneider	Anatwine Ltd., UK (member of the Board of Directors) Trivago N.V., Germany (member of the Supervisory Board, since December 2016)
Robert Gentz	–
Rubin Ritter	–

1.4 Corporate Governance Report

Corporate governance, as practised by Zalando, involves responsible management and control of the company geared towards long-term goals. ZALANDO SE's Management Board and Supervisory Board value good corporate governance very highly and align their approach to the recommendations set out in the German Corporate Governance Code. In the following, the Management Board and Supervisory Board submit the corporate governance report together with the statement on corporate governance in accordance with Sections 289f and 315d HGB (German Commercial Code), as the content of the two is closely linked. In accordance with Sections 289f and 315d HGB, the statement on corporate governance forms part of the management report.[10]

1.4.1 Declaration of Conformity

Declaration by the Management Board and the Supervisory Board of ZALANDO SE regarding the recommendations of the Government Commission German Corporate Governance Code pursuant to Section 161 Aktg (German Stock Corporation Act).

The Management Board and Supervisory Board submitted the annual declaration of conformity pursuant to Section 161 AktG in December 2017. The declaration of conformity of December 2017 is made available on the company's website.

zln.do/en-governance

The Management Board and the Supervisory Board of ZALANDO SE declare that ZALANDO SE has, since the publication of the last annual declaration of conformity in December 2016 and except for the deviations stated and explained therein, acted in conformity with the recommendations of the Government Commission German Corporate Governance Code in its version of May 5, 2015, published by the Federal Ministry of Justice and Consumer Protection on June 12, 2015, in the official section of the Federal Gazette (Bundesanzeiger) as well as with the updated version of the recommendations dated February 7, 2017, published by the Federal Ministry of Justice and Consumer Protection on April 24, 2017, in the official section of the Federal Gazette (Bundesanzeiger) (hereinafter the "Code").

The Management Board and the Supervisory Board of ZALANDO SE declare that ZALANDO SE will in the future act in conformity with the recommendations of the Code with the following deviations:

- **No. 3.8 Paragraph 3:** according to the Code's recommendations, a deductible shall be agreed upon for the members of the Supervisory Board when taking out D&O policy. The company takes the view that such a deductible is not in itself suitable to increase the performance and sense of responsibility of the Supervisory Board members. Furthermore, it reduces the attractiveness of Supervisory Board positions and thus the company's opportunities when competing for qualified Supervisory Board candidates.
- **No. 4.2.1 Sentence 1:** according to the Code's recommendations, the Management Board shall have a chairman or spokesman. So far the three members of the Management Board of ZALANDO SE have worked together on an equal footing without any member performing the function of chairman or spokesman. The Supervisory Board does not see any reason why it should change this established and successful cooperation.

10) The statements on corporate governance in accordance with Sections 289f and 315d HGB are unaudited part of the combined management report.

- **No. 4.2.3 Paragraph 2 Sentences 4, 6 and 7:** according to the Code's recommendations, both positive and negative developments shall be taken into account when determining variable components of the compensation paid to members of the Management Board. The amount of compensation shall be capped, both overall and for the variable compensation components, and the variable compensation components shall be related to demanding, relevant comparison parameters. The current compensation system for the Management Board, which had been determined before the initial public offering and thus before the application of the Code's recommendations, provides for a share option scheme as the variable component of the Management Board compensation, which was assessed to be appropriate by an independent compensation consultant.
- This share option scheme does not contain an explicit rule requiring the consideration of negative developments. It includes performance targets linked to the average annual growth rate of the aggregated retail value of all sales transactions with persons or enterprises not belonging to the Zalando group. Negative developments are taken into account only by the fact that the execution of option rights, due to the strike price for the execution of the option rights, can become unattractive; therefore, we declare, for reasons of precaution, a deviation from No. 4.2.3 paragraph 2 Sentence 4. With regard to the recommended cap for the amount of compensation within the meaning of No. 4.2.3 paragraph 2 Sentence 6, the share option program provides for a cap in relation to the number of shares that will be allocated upon the exercise. No cap is foreseen on the achievable amount upon the exercise of the share options. In the opinion of the Supervisory Board, such a cap would not be appropriate as it would interrupt the alignment of interest between the shareholders and the members of the Management Board. According to its rationale, the share-based compensation aims to achieve adequate participation in the economic risks and chances of the company by the members of the Management Board. As no cap in relation to the variable component is determined, consequently also no cap in relation to the overall amount of the compensation is determined, so that a deviation from No. 4.2.3 paragraph 2 Sentence 6 is declared. Lastly, it cannot be excluded that the agreed performance targets do not comply with the requirements laid down by the Code regarding demanding parameters. Therefore, we also declare, for reasons of precaution, a deviation from No. 4.2.3 paragraph 2 Sentence 7.
- The Supervisory Board is convinced that the option scheme for the Management Board is well balanced and appropriate. In the opinion of the Supervisory Board, the compensation, due to the variable, i.e. share-based, compensation component being linked to the share price and due to the long-term nature of the defined targets as well as the significant strike price for exercising the share options, is oriented toward the situation of the company and its long-term positive development.
- **Nos. 4.2.4 and 4.2.5:** according to the Code's recommendations, the compensation of the members of the Management Board shall be disclosed by name, divided into fixed and variable components as well as fringe benefits. These recommendations are not complied with because the general meeting of ZALANDO SE resolved on 11 July, 2014 in accordance with Sections 286 (5), 314 (3) Sentence 1, 315e (1) (previously 315a (1)) HGB in connection with Article 61 of the SE Regulation that the compensation of the members of the Management Board shall not be disclosed by name in the annual and consolidated financial statements of ZALANDO SE to be prepared for fiscal years 2014 up to (and including) 2018. For the duration of a corresponding "opt-out" resolution passed by the general meeting, the company will

abstain from including in the compensation report the disclosures recommended under No. 4.2.5 paragraph 3 of the Code in individualized form.

— **No. 5.1.2 Sentence 2:** according to the Code's recommendation the Supervisory Board shall take diversity into account when appointing Management Board members. The Supervisory Board acknowledges and appreciates the importance of diversity. With regard to the Management Board's composition, qualification shall still be the decisive criterion. The Supervisory Board strives to adequately consider the various fields of core competences of the business model. For the time being, the Supervisory Board does not apply a specific diversity concept with respect to the Management Board. The Supervisory Board hereby takes into account that the company since its founding in 2008 has always been and still is a founder-led company with a very lean Management Board structure of only three members cooperating on an equal footing. This lean structure has proven successful in the past. Besides, the Supervisory Board acknowledges that the Management Board for its part appreciates and promotes the importance of inclusion and diversity in the company overall and in the management of the company in particular. The Management Board targets to further increase the diversity in the management levels below itself, paying attention particularly to a variety of professional experience and expertise, aiming for an appropriate consideration of women and internationality. The Supervisory Board will continuously reconsider this decision on a diversity concept in the long-term succession planning and develop a diversity concept for the Management Board in the future when considered appropriate.

1.4.2 Corporate Governance

ZALANDO SE's corporate governance is determined in particular by applicable law, the recommendations set out in the German Corporate Governance Code, and internal rules of procedure and guidelines.

Sustainable corporate governance is ensured by combining economic success with environmentally compatible and socially balanced activities. The company sees investments in corporate responsibility as an essential success factor for the business to maintain its social license to operate, and wants to engage employees, customers, and partners. Detailed information on Zalando's corporate responsibility strategy and activities can be found in the Corporate Responsibility section on page 12.

Further Information Corporate Responsibility p. 12

A system of internal financial reporting controls is in place to ensure the accuracy of bookkeeping and accounting and the reliability of financial reporting, which comprises preventive, monitoring, and detection measures designed to ensure security and control in accounting and operational functions.

The company maintains a Governance, Risk & Compliance (GRC) Department to detect, manage, and monitor risks and opportunities at an early stage. The GRC Department's manual was updated in the reporting period to reflect the increasing complexity of its internal organization and increasing scope of responsibilities. The GRC Department ensures that risks and opportunities are assessed and managed using a uniform approach throughout the company. Potential compliance risks are included in this assessment. All employees of Zalando are required to be aware of risks inherent in their work and prevent risks that could jeopardize the company's

GRI 103-1/-2/-3 MA Anti-Corruption
GRI 102-11
GRI 205-1

Further Information Risk and Opportunity Report p. 107

ability to continue as a going concern. Zalando's compliance management system institutes guidelines and offers advisory services and trainings to employees to prevent compliance infringements such as, inter alia, corruptive behavior (including, but not limited to, extortion, fraud, or bribery), violations of antitrust law, data protection regulations, or insider law. In the reporting period, all compliance-related trainings (face-to-face trainings as well as e-learnings) were integrated into Zalando's training platform. Mandatory compliance trainings (carried out as face-to-face training for leads and as e-learning for remaining employees) give all employees the overview on compliance at Zalando, our Code of Ethics, Code of Conduct and selected essential policies, including anti-corruption related policies, e.g. our Group Policy Benefits & Gifts. Furthermore, they reinforce awareness of the significant regulatory framework and internal rules and regulations and provide information regarding the established processes within the compliance management system.

All employees are also assigned a basic data protection e-learning. Furthermore, trainings on specific topics such as antitrust law, insider trading, or deep-dive trainings on data protection are carried out for specific groups of employees. Selected trainings, such as currently data protection, security- or antitrust-related trainings must be repeated annually.

Each mandatory training must be repeated regularly, typically every two years. The employee receives an automatic reminder to fulfill his training obligations. If an employee does not fulfil his obligations, the lead will be informed and reminded repeatedly until the training is completed. The outreach of the Compliance function was furthermore increased by face-to-face trainings in Zalando's subsidiaries outside Berlin and by integration efforts regarding newly acquired companies, which also involved intensive face-to-face onboarding on Zalando's compliance standards, processes, and policies. New employees are immediately instructed on compliance during the onboarding process.

The company's Code of Ethics, which is available on the corporate website and was communicated to the employees in various languages, sets expectations and provides guidance on how Zalando wants to do business and is the basis of all group policies. Under the Code of Ethics, all employees are required inter alia to comply with anti-corruption practices, anti-trust regulations and insider compliance provisions. The details are set out in internal guidelines and policies.

zln.do/en-principles

The Code of Ethics also stipulates the obligation for all employees to comply with our high data protection standards, which are set out in internal policies and guidelines as well. Protecting personal data and collecting, processing, and using the data in accordance with the law are very important concerns to Zalando as a tech company. Specialized teams ensure that the requirements for data security are complied with in all business divisions. Zalando complies with European and national data protection regulations which is one of the strongest worldwide and we closely monitor the changing legal requirements.

GRI 102-16
GRI 103-1/-2/-3
MA Customer Privacy
GRI 418-1

In the reporting period, Zalando has furthermore updated its Code of Conduct for Business Partners and published it on the corporate website. It clearly states that Zalando does not accept any form of corrupt practices including, but not limited to, extortion, fraud, or bribery. Business Partners are expected to comply with applicable national and international regulations and shall establish appropriate anti-bribery and anti-corruption policies, which shall be communicated to all business areas. Zalando carries out Business Partner due diligence for defined group of business partners and in cases where potential compliance risks are apparent.

Various communication channels have been installed to facilitate the reporting of presumed compliance infringements to the Compliance function – on an anonymous basis if preferred. The anonymous and protected reporting channels are available to employees as well as third parties. A compliance panel has been set up to clarify and assess potential compliance infringements. In fulfilling its duties, the GRC Department works in close collaboration with the Legal Department and Internal Audit to ensure a uniform approach to appropriately evaluating and mitigating risks across functions. The Management Board bears overall responsibility for the proper functioning of the risk and compliance management system and the Supervisory Board monitors the effectiveness of the system.

Information on detected compliance infringements, important updates of processes or policies, as well as training attendance quotas are reported to the Management Board at least on a quarterly basis in a review format together with the General Counsel and experts from Internal Audit and Tax.

1.4.3 Management Board and Supervisory Board Procedures

Management Board Procedures

The Management Board bears responsibility for managing the company's business. It is bound to act in the interest of the company and to increase the long-term value of the company. The three members of the Management Board, Robert Gentz, David Schneider, and Rubin Ritter, manage the company in partnership and, as members of the Management Board with equal rights, are responsible for the company's strategy and its day-to-day implementation.

The Management Board develops the company's strategy, consults regularly with the Supervisory Board on this, and ensures that it is implemented. It also manages the company's business transactions with the diligence of a prudent and conscientious manager. The Management Board's collaboration with other corporate bodies and employee representatives is open and trusting for the benefit of the company.

The collaboration and responsibilities of the Management Board members are determined in the Rules of Procedure set out by the Supervisory Board. Each member of the Management Board has sole responsibility for the area of business allocated to him. Each area of business is managed consistently by aligning it to targets agreed upon in resolutions passed by the Management Board. The members of the Management Board take joint responsibility for the overall management of the company irrespective of the allocation of areas of business. They work collaboratively and inform each other constantly about any significant measures and events within their areas of responsibility.

The Management Board meets regularly, typically every two weeks. The Management Board is in regular contact with the chairperson of the Supervisory Board, informs him on the progress of the business and the situation of the company and of group entities and consults with him on strategy, planning, business development, and risk management within the company. Should an important event occur or should any business issue arise that could be of significant importance to the evaluation of the situation, the development or the management of the company, the Management Board informs the chairperson of the Supervisory Board immediately.

Each member of the Management Board is obliged to disclose any conflicts of interest to the Supervisory Board immediately. All transactions between the company or group entities and the members of the Management Board as well as their related parties must be conducted at arm's length conditions and material transactions require Supervisory Board approval.

Composition of the Management Board

GRI 103-1/-2/-3 MA Diversity and Equal Opportunity
GRI 405-1

zln.do/en-management-board

The Management Board currently does not have any female members. The female representation target according to Section 111 (5) AktG of 0% was met within the determined deadline of June 30, 2017. The Supervisory Board renewed its resolution in accordance with Section 111 (5) AktG to establish a female representation target of 0% to be achieved by June 30, 2022. The Supervisory Board acknowledges and appreciates the importance of diversity. A diverse composition of management and supervising bodies can promote new perspectives in decision-making processes and discussions and help to further improve performance. For the time being, the Supervisory Board does not apply a specific diversity concept with respect to the Management Board. The Supervisory Board takes into account that the company since its founding in 2008 has always been and still is a founder-led company with a very lean Management Board structure of only three members cooperating on an equal footing. This lean structure has proven successful in the past. Besides, the Supervisory Board acknowledges that the Management Board for its part appreciates and promotes the importance of inclusion and diversity in the company overall and in the management of the company in particular. The Management Board aims to further increase the diversity in the management levels below it, paying attention particularly to a variety of professional experience and expertise, aiming for an appropriate consideration of women and internationality. The Supervisory Board will regularly reconsider this decision on a diversity concept in the long-term succession planning and develop a diversity concept for the Management Board in the future when considered appropriate. While performance and qualification rather than age are and will remain the decisive factors when selecting Management Board members, such members should not be older than 65 when elected.

Supervisory Board Procedures

The Supervisory Board advises and monitors the Management Board on the management of the company. It is directly involved in decisions of fundamental importance to the company. The Supervisory Board works with the company's best interest in mind in close and trusting collaboration with other corporate bodies, in particular with the Management Board. ZALANDO SE's Supervisory Board has nine members, three of whom are employee representatives.

Members of the Supervisory Board in Fiscal Year 2017 → 09

Dominik Asam (member since May 31, 2017)*
Lorenzo Grabau (member and deputy chairperson until May 31, 2017)*
Lothar Lanz (chairperson)*
Jørgen Madsen Lindemann*
Anders Holch Povlsen (deputy chairperson since May 31, 2017)
Shanna Prevé (member since May 31, 2017)*
Kai-Uwe Ricke (member until May 31, 2017)*
Dylan Ross*
Alexander Samwer*
Konrad Schäfers*
Beate Siert*

*) Considered independent members of the Supervisory Board in the meaning of Section 5.4.2 of the German Corporate Governance Code.

zln.do/en-supervisory-board

The Supervisory Board has adopted Rules of Procedure. They govern the procedures and allocation of duties of the Supervisory Board and its committees. The Supervisory Board convenes at least one meeting per quarter; further meetings are convened as necessary. The Supervisory Board regularly reviews the efficiency of its activities. In addition to the qualitative criteria to be determined by the Supervisory Board, the purpose of the review includes assessing the procedures in the Supervisory Board, as well as the information provided to the Supervisory Board, both in terms of timing and whether the content is sufficient.

Each member of the Supervisory Board must disclose conflicts of interest to the Supervisory Board, particularly those that might arise as a result of an advisory or committee function at customers, suppliers, creditors, borrowers or other third parties. If a member of the Supervisory Board has a significant, non-temporary conflict of interest, that member of the Supervisory Board should resign from office.

The Supervisory Board has set up an audit committee, a remuneration committee and a nomination committee. These committees comprise at least three members each.

Composition of the Supervisory Board

GRI 103-1/-2/-3 MA Diversity and Equal Opportunity
GRI 405-1

The Supervisory Board of ZALANDO SE has set targets regarding its composition. It strives for a composition that takes account of and safeguards the particular needs of the company so that the Management Board is monitored, supervised, and advised in a competent and professional manner. Every member of the Supervisory Board has the knowledge, skills, and professional experience needed to properly fulfill his or her duties and responsibilities. The Supervisory Board has prepared a profile of skills and expertise for the entire board. The competence profile of the Supervisory Board as a whole comprises industry competence (in particular in the fields of fashion, technology and commerce) and finance competence as well as competencies in the areas of strategy, supervision and innovation. The members of the Supervisory Board as a group shall be familiar with the sector in which the company operates. In addition, each member ensures he or she has sufficient time to carry out his or her duties. A maximum of two former members of the Management Board are permitted to be members of the Supervisory Board. The members of the Supervisory Board may not accept mandates for bodies of or advisory activities for significant competitors of the company.

While qualification remains the decisive criterion, the Supervisory Board strives to adequately reflect the international character, the various fields of core competences of the business model as well as the competence profile of the Supervisory Board. At the same time, the Supervisory Board pays attention to diversity, in particular as regards professional experience and expertise, internationality and adequate female representation. In order to accommodate the international character of the company, the Supervisory Board should as a rule have no fewer than two international members. The Supervisory Board strives to adequately consider women in the diversity of its composition, with the specific target that no fewer than two women should be members of the Supervisory Board.

The female representation target of 22% that was established in 2015 was met as of June 30, 2017. In accordance with Section 111 (5) AktG, the Supervisory Board has renewed its target of 22% female members on the Supervisory Board by the deadline of June 30, 2022. The Supervisory Board continues to strive to increase female representation on the Supervisory Board and agreed to intensify the search for qualified and suitable female candidates.

The single most important factor for nominating a member to the Supervisory Board is the candidate's qualifications, which is not dependent on the candidate's age. As a result, the Supervisory Board sees no benefit in introducing fixed age limits. As a rule, however, Supervisory Board members should not be older than 70 when elected.

Furthermore, no fewer than five members of the Supervisory Board should be independent, as defined in Section 5.4.2 of the German Corporate Governance Code, with no fewer than two of such independent members representing the shareholders. Candidates who are likely to be confronted with an increased level of conflicts of interest should not be proposed for election by the general meeting. For the names of the members of the Supervisory Board considered independent in fiscal year 2017, please refer to the table on page 58.

In general, a Supervisory Board member should not serve as a member for longer than twelve years. The Supervisory Board is convinced that such composition ensures an independent and efficient consultation and oversight of the Management Board.

The nomination committee of the Supervisory Board considers the above described targets regarding the composition of the Supervisory Board when it prepares the proposals of the Supervisory Board to the general meeting regarding the election of Supervisory Board members.

The composition of the Supervisory Board of ZALANDO SE in fiscal year 2017 met the composition targets it had set itself in all respects. The required expertise is represented in the Supervisory Board, the competence profile has been completed and the targets of the diversity concept are met.

Audit Committee

The audit committee prepares, among other things, the negotiations and resolutions of the Supervisory Board on the audit and ratification of the separate financial statements and the approval of the consolidated financial statements, the proposed resolution of the Management Board on the appropriation of profits, and the proposal of the Supervisory Board to the general meeting on the appointment of the auditor. In addition, the audit committee handles questions regarding accounting, the discussion of financial reports, the approval of non-audit services by the auditor, monitoring the effectiveness of the internal risk management and control systems, the internal audit system, and questions regarding compliance and monitoring of the audit. The audit committee also discusses the audit reports with the auditor as well as its findings, and provides recommendations in this respect to the Supervisory Board.

Members of the Audit Commitee → 10
Dominik Asam (member and chairperson since May 31, 2017)
Lothar Lanz
Jørgen Madsen Lindemann (member since May 31, 2017)
Kai-Uwe Ricke (member and chairperson until May 31, 2017)
Lorenzo Grabau (member until May 31, 2017)
Konrad Schäfers

The chairperson of the audit committee, Dominik Asam, and the previous chairperson of the audit committee, Kai-Uwe Ricke, both have the requisite expertise in the area of accounting or auditing pursuant to Section 100 (5) AktG. Dominik Asam is and Kai-Uwe Ricke was an independent member of the Supervisory Board.

Remuneration Committee

The remuneration committee deals with the company's remuneration system and its refinement as well as with the amount and appropriateness of Management Board remuneration and provides recommendations as a basis for decision-making by the Supervisory Board.

Members of the Remuneration Committee → 11
Lorenzo Grabau (member and chairperson until May 31, 2017)
Lothar Lanz (member until May 31, 2017)
Jørgen Madsen Lindemann (member and chairperson since May 31, 2017)
Shanna Prevé (member since May 31, 2017)
Alexander Samwer
Beate Siert

Nomination Committee

The nomination committee is exclusively composed of shareholder representatives. The nomination committee prepares the proposals of the Supervisory Board to the general meeting regarding the election of Supervisory Board members, taking into account the specific targets of the Supervisory Board regarding its composition.

Members of the Nomination Committee → 12

Lorenzo Grabau (chairperson and member until January 5, 2017)
Lothar Lanz (chairperson and member since January 12, 2017)
Jørgen Madsen Lindemann (member since May 31, 2017)
Anders Holch Povlsen
Alexander Samwer (member until May 31, 2017)

1.4.4 Target of Female Representation in Management Levels below the Management Board

GRI 103-1/-2/-3 MA Diversity and Equal Opportunity
GRI 405-1

In accordance with Section 76 (4) AktG, the Management Board established a target for the representation of women in the two management levels below the Management Board for the first time in fiscal year 2015. Zalando attaches great importance to inclusion and diversity throughout the company and has always considered the representation of women in the workforce and in the management of Zalando to be an important aspect of a diverse employee structure. In order to send out a clear signal of Zalando's aim to support women in top-level management, the Management Board had set an ambitious target of increasing female representation in the first level directly below the Management Board from 0% to 15% by June 30, 2017, and to further increase female representation in the next management level to 30%. The company has not only reached the target in the first level directly below the Management Board, but has in fact even exceeded this target figure. As of June 30, 2017, the female representation in the first level below the Management Board stood at 25%. At the end of the reporting year 2017 – after the departure of one female Senior Vice President (SVP) – the female representation however fell below 25%. The company reaffirms its goal to increase the diversity within the top-level management with the representation of women being an important aspect of diversity. Thus, the target figure in the first management level below the Management Board was determined at 25% by June 30, 2022. On the second level directly below the Management Board, the representation of women stood at 21% as of June 30, 2017, i.e. on this level the ambitious target of 30% was missed. The company continues to strive to increase the female representation also in the second level below the Management Board and considers gender diversity as one relevant aspect in the hiring and promotion process when filling open positions at this level. The Management Board set the target to increase female representation in the second management level to 30% by June 30, 2022.

1.4.5 Management Board and Supervisory Board Shareholdings

As of the end of fiscal year 2017, the co-founders of the company and members of the Management Board Robert Gentz and David Schneider each held 1.85% of shares in the company. Management Board member Rubin Ritter held less than 1% of shares. Supervisory Board member Anders Holch Povlsen held 10.09% of shares at the end of fiscal year 2017. The other Supervisory Board members cumulatively held less than 1% of shares.

A report on the transactions conducted during fiscal year 2017 by persons discharging managerial responsibilities is published on the ZALANDO SE website in the Investor Relations section.

zln.do/en-IR

1.4.6 Takeover Law Disclosures Pursuant to Sections 289a (1), 315a (1) HGB and Explanatory Report[11]

The disclosures required according to Sections 289a (1), 315a (1) HGB are listed and explained below.

Composition of Issued Capital

With respect to the composition of the issued capital, please refer to the notes, section 3.5.7 Notes to the Consolidated Statement of Comprehensive Income and Statement of Financial Position.

Restrictions Relating to Voting Rights or the Transfer of Shares

At the end of the reporting year, ZALANDO SE had 178,965 treasury shares that do not grant rights in accordance with Section 71b AktG.

Shareholdings That Exceed 10% of the Voting Rights

At the end of fiscal year 2017, Verdere S.àr.l. (Luxembourg) and Anders Holch Povlsen each held an indirect shareholding in ZALANDO SE that exceeded the threshold of 10% of voting rights. Information on the amount of the above-mentioned shareholding in the company can be found in section 1.5 The Zalando Share – 2017 in Review on page 73.

Statutory Regulations and Provisions of the Articles of Association Concerning the Appointment and Removal from Office of Management Board Members, and Concerning Modifications to the Articles of Association

According to Article 9 (1), Article 39 (2) and Article 46 of the SE Regulation, Sections 84 and 85 AktG and Article 7 (4) of the Articles of Association, the Supervisory Board appoints the members of the Management Board for a maximum term of five years. Reappointments are permissible. The Supervisory Board is authorized to revoke the appointment of a Management Board member for an important reason (for details, see Article 9 (1), Article 39 (2) of the SE Regulation, Section 84 AktG). According to Article 7 of the Articles of Association, the Management Board consists of one or more members. The number of members of the Management Board shall be determined by the Supervisory Board.

The general meeting passes the resolutions to amend the Articles of Association. According to Art. 20 (2) of the Articles of Association, amendments to the Articles of Association require a majority of

11) Takeover law disclosures pursuant to Sections 289 (4), 315 (4) HGB are part of the combined management report and also form part of the corporate governance report with the declaration of conformity.

two-thirds of the valid votes cast or, if at least one-half of the share capital is represented, the simple majority of the valid votes cast unless this conflicts with mandatory legal provisions.

According to Article 12 (5) of the Articles of Association, the Supervisory Board is entitled to make changes and additions to the Articles of Association that pertain to the wording only. Pursuant to Article 4 (3) and (4) of the Articles of Association, the Supervisory Board is authorized to adjust the wording of the Articles of Association to reflect the implementation of the increase of the registered share capital from authorized capital or after the term of the authorization has expired.

Authority of the Management Board to Issue Shares or Acquire Treasury Shares

The Management Board of the company is authorized to increase the registered capital of the company until October 28, 2018, with the consent of the Supervisory Board, once or several times, by up to a total of EUR 2,736,745 by issuing up 2,736,745 new no-par value bearer shares against contributions in cash (Authorized Capital 2013). The subscription rights of the shareholders are excluded. The Authorized Capital 2013 serves the implementation of acquisition rights (option rights) resulting from the options that have been granted to or agreed with employees or managing directors of the company and its affiliated companies by shareholders of the company or by the company prior to its conversion into a stock corporation or by affiliated companies between March 2009 and September 2013 (inclusive) and shares out of the Authorized Capital 2013 may be issued only for this purpose. The Management Board is authorized to determine, with the consent of the Supervisory Board, the further scope of the shareholders' rights pertaining to the shares to be newly issued and the further conditions for the issue of new shares; this also includes the determination of the point in time when the new shares will participate in the profits, also for a previous fiscal year if legally admissible.

The Management Board is authorized to increase the registered share capital of the company until June 1, 2020, with the consent of the Supervisory Board, once or several times, by up to a total of EUR 94,694,847 by issuing up to 94,694,847 new no-par value bearer shares against contributions in cash and/or in kind (Authorized Capital 2015). The shareholders are, in principle, entitled to subscription rights. The Management Board is authorized to exclude the subscription right of the shareholders with the consent of the Supervisory Board in the cases described in the authorization. The total shares issued under the authorization with the exclusion of subscription rights must not exceed 20% of the registered share capital either at the time the authorization becomes effective or at the time it is exercised. Before the issue of shares with the exclusion of subscription rights, there shall be counted towards the aforesaid 20% limit (i) treasury shares sold with the exclusion of subscription rights, and (ii) shares to be issued to service bonds with conversion and/or option rights or obligations, insofar as the bonds were issued with the exclusion of shareholders' subscription rights on the basis of the authorization by the general meeting of June 2, 2015. The Management Board is authorized, with the consent of the Supervisory Board, to determine any further details of the capital increase, the further content of the rights arising from the shares and the conditions of the share issue.

The share capital of the company is conditionally increased by up to EUR 9,817,500 by issuing up to 9,817,500 no-par value bearer shares (Conditional Capital 2013). The Conditional Capital 2013 may be used only to fulfill the subscription rights that have been granted to the members of the Management Board of the company in connection with the Stock Option Program 2013 in accordance with the resolution of the general meeting of December 18, 2013, as amended by the company's general meeting of June 3, 2014, and of July 11, 2014. The conditional capital increase will be implemented to the extent only that such subscription rights have been or will be issued in accordance with the Stock Option Program 2013, the holders of the subscription rights exercise their rights and the company does not deliver treasury shares to satisfy the subscription rights. The Supervisory Board is exclusively competent regarding the granting and settlement of subscription rights to the members of the Management Board of the company.

The share capital of the company is conditionally increased by up to EUR 6,732,000 by issuing up to 6,732,000 no-par value bearer shares (Conditional Capital 2014). The Conditional Capital 2014 may be used only to fulfill the subscription rights that have been granted to employees of the company as well as members of the management bodies and employees of companies affiliated with the company in the meaning of Sections: 15 et seq. AktG in connection with the Stock Option Program 2014 in accordance with the resolution of the general meeting on June 3, 2014, as amended by the company's general meeting of July 11, 2014. The conditional capital increase will only be implemented to the extent that such subscription rights have been or will be issued in accordance with the Stock Option Program 2014, the holders of the subscription rights exercise their rights and the company does not deliver treasury shares to satisfy the subscription rights.

The share capital is conditionally increased by up to EUR 73,889,248 by issuing up to 73,889,248 no-par value bearer shares (Conditional Capital 2015). The purpose of the conditional capital increase is to grant shares to the holders/creditors of convertible bonds and/or bonds with warrants or a combination of all of these instruments issued pursuant to the authorization on which a resolution was passed by the general meeting on June 2, 2015, under agenda item 10 lit. a) until June 1, 2020, by the company or any subordinate group company of the company and that grant a conversion or option right to new no-par value bearer shares of the company or provide for a conversion or option obligation or an option entitling the issuer to deliver shares to the extent that they are issued against cash contributions. The new shares are issued in each case at a conversion price or option price to be stipulated pursuant to the authorization resolution specified above. The conditional capital increase is carried out only to the extent to which use is made of conversion or option rights or conversion or option obligations are fulfilled or an option entitling the issuer to deliver shares is exercised and no other forms of fulfillment of delivery are used. The Management Board is authorized, with the consent of the Supervisory Board, to determine the further details of the implementation of conditional capital increases.

The share capital of the company is conditionally increased by up to EUR 5,098,440 against contribution in cash and in kind by issuing up to 5,098,440 new no-par value bearer shares with a pro rata share in the share capital of EUR 1.00 to fulfill subscription rights to shares of the company (Conditional Capital 2016). The Conditional Capital 2016 may be used once or several times only to fulfill the subscription rights that have been granted until May 30, 2021 – partly as a component of stock appreciation rights – in accordance with the resolution of the general meeting of May 31, 2016. The new shares shall be subscribed either against a cash payment in the amount of the lowest issue price in the meaning of Section 9 (1) AktG or against the contribution of the participants' remuneration entitlements under the stock appreciation rights granted to them, which are granted in accordance with the resolution of the general meeting of May 31, 2016. The conditional capital increase will be implemented only to the extent that subscription rights or stock appreciation rights with subscription rights have been or will be issued in accordance with the resolution of the general meeting of May 31, 2016, the holders of subscription rights exercise their rights and the company grants no treasury shares or cash payments for the satisfaction of the subscription rights.

The new shares from the Conditional Capital 2013, the Conditional Capital 2014, the Conditional Capital 2015 and the Conditional Capital 2016 shall participate in the profits from the beginning of the fiscal year in which they are issued; notwithstanding this, the new shares shall participate in the profits from the beginning of the fiscal year preceding the fiscal year in which such new shares are created if the general meeting has not yet adopted a resolution on the appropriation of the distributable profit of the fiscal year preceding the fiscal year in which such new shares are created.

The Management Board is authorized until June 1, 2020, to acquire treasury shares for any permissible purpose totaling up to 10% of the share capital existing as of the date of the resolution or, if the amount is lower, share capital existing at the time this authorization is exercised. Shares acquired may not at any time amount to more than 10% of the total share capital when taken together with other treasury shares held by the company or allocable to the company in accordance with Section 71a et seq. AktG. In addition to this, the Management Board is authorized until June 1, 2020, to use derivatives to acquire treasury shares. All shares that are acquired using derivatives are limited to shares that pertain to at most 5% of the share capital existing as of the date of the resolution of the general meeting or, if the amount is lower, share capital existing at the time this authorization is exercised. We refer to the resolutions proposed by the Management Board and the Supervisory Board in items 7 and 8 of the company's general meeting agenda for June 2, 2015, which was published in the German Federal Gazette on April 23, 2015, with regard to details of the authorization to acquire treasury shares.

Company Compensation Agreements That Have Been Entered into with Managment Board Members or Employees in the Event of a Takeover Bid

The Stock Option Program SOP 2013 allows for stock option rights held by the Management Board to be supplemented in the case of a change of control. The Supervisory Board and/or the Management Board are entitled to request the proportionate cancelation of the vested outstanding options in line with the share in the company obtained by the acquiring company as a result of the change of control in exchange for payment by the company. With respect to the stock options not yet vested at the time of a change in control, the Supervisory Board is authorized at its own discretion to grant other performance-based compensation similar in terms of value (including share appreciation rights, phantom stocks or other stock options) in exchange for the cancelation of the stock options granted within the scope of SOP 2013.

Significant Company Agreements Subject to a Change of Control Due to a Takeover Bid

The material agreements that are subject to the condition of a change of control involve the revolving credit facility and various reverse factoring agreements. In the event of a change of control, these agreements provide, as is customary for creditors, the right to terminate the agreement and accelerate repayment or, for factors, the right to terminate the agreement or renegotiate the contractual terms.

1.4.7 Remuneration Report[12]

Basic Features of the Remuneration System for Members of Zalando's Management Board

Total remuneration consists of two elements – fixed base salary and long-term incentive through option programs.

The total remuneration is appropriate to the tasks and performance of each member of the Management Board. The criteria used to determine the appropriate level of remuneration is driven by each member's responsibilities and personal 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.

Pursuant to the resolution passed at the company's extraordinary general meeting held on July 11, 2014, information on the individual remuneration of each member of the Management Board is not disclosed in accordance with Sections 286 (5), 314 (3) Sentence 1 and 315a (1) HGB in conjunction with Section 61 of the SE Regulation.

The term of the current appointment of the members of the Management Board ends with the expiry of November 30, 2018. Thus, the Supervisory Board dealt in the reporting year 2017 with the review of the Management Board's performance, the succession planning as well as the design and introduction of the new compensation system for the Management Board members. The discussions will be finalized in the reporting year 2018.

Non-Share-Based Payments (Non-Performance-Based Remuneration)

The members of the Management Board receive non-share-based remuneration, such as salaries, non-cash payments and other benefits.

The salaries of the members of the Management Board are paid in monthly installments. The members of the Management Board as a group received annual salaries totaling EUR 0.6m in fiscal year 2017 (prior year: EUR 0.6m). In addition, the members of the Management Board were entitled to non-cash payments (such as the use of company cars) and other benefits totaling EUR 0.04m in fiscal year 2017 (prior year: EUR 0.05m). Other benefits include reimbursement of standard expenses, such as travel expenses, contributions towards health insurance, and monthly gross amounts that correspond to the employer's contributions to the statutory pension and unemployment insurance.

Share-Based Payments (Long-Term Incentives)

No new option rights were granted to the Management Board in fiscal year 2017.

The members of the Management Board participated in the option programs SOP 2011 and SOP 2013 in fiscal year 2017 (as they did in the prior year).

The SOP 2011 was granted to the Management Board in fiscal year 2011. The SOP 2011 consists of options that entitle the members of the Management Board, as a group, to acquire a total of 3,085,500 new shares in the company after a certain period of service. The exercise price is

12) This remuneration report is part of the combined management report and also forms a component of the corporate governance report with the declaration of conformity.

EUR 5.65 per option. Each option entitles the beneficiary to acquire one share. The issuance of options under the scope of SOP 2011 is closed.

The options granted to the beneficiaries vest in tranches. The options vest if the beneficiary serves as a member of the Management Board of Zalando for the vesting period of the respective tranche. The last tranche of the SOP 2011 will vest in October 2018. Vested options are forfeited if the beneficiary leaves the group before the end of the respective vesting period. The beneficiaries have no claim to cash payment.

The number of outstanding options within the scope of SOP 2011 developed as follows in the reporting period:

Development Options SOP 2011

→ 13

	Number	Weighted average exercise price (in EUR)
Outstanding options as of Jan 1, 2016	**2,730,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	187,000	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**2,543,200**	**5.65**
Options vested as of Dec 31, 2016	**1,870,000**	**5.65**
Outstanding options as of Jan 1, 2017	**2,543,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	691,900*	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**1,851,300**	**5.65**
Options vested as of Dec 31, 2017	**1,486,650**	**5.65**

*) For 589,050 of the 691,900 options exercised, the issuance of the shares from authorized capital and thus the receipt by the Management Board took place only in the financial year 2018.

The options issued by the company can be exercised as of the vesting date. The beneficiaries can exercise vested options for an unlimited period. The weighted average share value on the date of exercise of an option exercised in the reporting period 2017 amounted to EUR 41.39 (prior year: EUR 30.93).

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

The options granted to the members of the Management Board vest in 60 tranches over a period of five years. The condition of a tranche relating to the period of service is met if the beneficiary holds the office as a member of the Management Board of Zalando over the vesting period of the respective tranche. The performance condition stipulates that Zalando must achieve a certain level of contractually agreed revenue growth over a period of four years, starting on the grant date. If the contractual revenue target is not achieved, the options are forfeited without replacement. The waiting period commences on the date on which the options are granted. It also lasts for a period of four years. The beneficiaries can exercise vested options after the waiting period within a certain time frame over a period of five years. Within the five-year exercise period, options can be exercised within three weeks of the publication of each of the quarterly, half-year and annual financial statements.

The beneficiaries have no claim to cash payment.

The number of outstanding options within the scope of SOP 2013 developed as follows in the reporting period:

Development Options SOP 2013

→ 14

	Number	Weighted average exercise price (in EUR)
Outstanding options as of Jan 1, 2016	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**9,817,500**	**15.63**
Options vested as of Dec 31, 2016	**5,856,840**	**15.63**
Outstanding options as of Jan 1, 2017	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**9,817,500**	**15.63**
Options vested as of Dec 31, 2017	**7,809,120**	**15.63**

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

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

Other Notes

For the duration of their employment, any professional activities undertaken by members of the Management Board outside of the group require the prior written consent of the Supervisory Board. Moreover, every service contract contains a non-competition clause that prohibits members of the Management Board from working for companies in direct or indirect competition with the company or that are affiliated with competitors of this kind. Notwithstanding this, each member of the Management Board is free to invest in a competitor, as long as the stake does not exceed 2% of the voting rights of the company. The non-competition clause for the members of the Management Board also applies to business segments in which affiliates operate.

The conditions stipulated in the service contracts between the members of the Management Board and the company entered into force when the change in the company's legal form to a stock corporation was entered in the commercial register. These contracts are valid until November 30, 2018. The service contracts can be terminated only for good cause during this period. When a member of the Management Board is dismissed, the service contract does not end automatically.

Pursuant to the respective provisions of the AktG, the members of the Management Board are also covered by insurance policies for directors and officers (D&O insurance) with adequate coverage and deductibles amounting to 10% of the loss, but no more than 150% of the annual fixed salary. The D&O insurance policies cover financial losses caused by breaches of duty on the part of the members of the Management Board in the performance of their tasks.

Apart from the service contracts, there are no service or employment contracts between the members of the Management Board and their related parties and the company or their subsidiaries.

Total Compensation

The members of the Management Board were granted total remuneration of EUR 0.6m in fiscal year 2017 (prior year: EUR 0.6m).

Benefits

→ 15

	Management Board members			
IN EUR	2017	2017 (min)	2017 (max)	2016
Fixed compensation	583,065	583,065	583,065	600,000
Fringe benefits	40,050	40,050	40,050	48,023
Total	**623,115**	**623,115**	**623,115**	**648,023**
One-year variable compensation	0	0	0	0
Multi-year variable compensation	0	0	0	0
Total	**623,115**	**623,115**	**623,115**	**648,023**
Pension expense	0	0	0	0
Total	**623,115**	**623,115**	**623,115**	**648,023**

The following table shows allocations for fiscal 2017 of fixed compensation, fringe benefits, one-year variable compensation and multi-year variable compensation – by reference year – as well as the expense of pension benefits. This table includes the actual figure for multi-year variable compensation granted in previous years and allocated in fiscal year 2017.

Allocation

→ 16

	Management Board members	
IN EUR	**2017**	**2016**
Fixed compensation	583,065	600,000
Fringe benefits	40,050	48,023
Total	**623,115**	**648,023**
One-year variable compensation	0	0
Multi-year variable compensation	**3,886,702**	**7,924,554**
SOP 2011*	3,886,702	7,924,554
SOP 2013	0	0
Total	**4,509,817**	**8,572,577**
Service cost	0	0
Total	**4,509,817**	**8,572,577**

*) Exercise of options

Remuneration of Supervisory Board Members

The remuneration of Supervisory Board members is governed by Article 15 of the Articles of Association and comprises only fixed annual payments. The amount is based on the responsibilities and scope of the activities carried out by the respective Supervisory Board member as well as the company's economic situation.

According to the Articles of Association, every member of the Supervisory Board receives annual fixed remuneration of EUR 65,000. The chairperson of the Supervisory Board receives a fixed remuneration of EUR 150,000 and the deputy chairman of the Supervisory Board receives a fixed remuneration of EUR 90,000. Supervisory Board members acting as members of the audit committee receive an additional fixed remuneration of EUR 15,000. The chairperson of the audit committee receives an additional remuneration of EUR 35,000. In addition to the remuneration mentioned above, the company reimburses the members of the Supervisory Board for reasonable out-of-pocket expenses that arise when performing their duties as Supervisory Board members as well as the value-added tax on their remuneration and out-of-pocket expenses. Supervisory Board members who hold office as members or chairpersons for only part of a fiscal year receive a proportionate share of remuneration. The remuneration of the Supervisory Board members falls due after the annual general meeting which accepts the consolidated financial statements for the fiscal year for which the remuneration is paid or decides on their approval.

The members of the Supervisory Board are covered by a D&O insurance policy held by the company.

Remuneration for fiscal year 2017 breaks down as follows:

Supervisory Board Remuneration

→ 17

IN EUR	2017	2016
Cristina Stenbeck (until May 31, 2016)	0	41,370
Lorenzo Grabau (until May 31, 2017)	43,269	75,000
Lothar Lanz (since February 10, 2014)	165,000	100,000
Kai-Uwe Ricke (until May 31, 2017)	41,209	89,658
Alexander Samwer (since December 9, 2013)	65,000	50,000
Anders Holch Povlsen (since December 9, 2013)	79,698	50,000
Konrad Schäfers (since June 2, 2015)	80,000	50,000
Dylan Ross (since June 2, 2015)	65,000	50,000
Beate Siert (since June 2, 2015)	65,000	50,000
Jørgen Madsen Lindemann (since May 31, 2016)	73,819	29,315
Shanna Prevé (since May 31, 2017)	38,214	0
Dominik Asam (since May 31, 2017)	58,791	0
Total	**775,000**	**585,343**

1.5 The Zalando Share – 2017 in Review

- Positive business development reflected in Zalando share performance
- High capital market awareness: 28 covering research analysts across Europe and US, regularly reporting on Zalando
- Increase in free float to 58.31% (YE 2016: 49.47%)

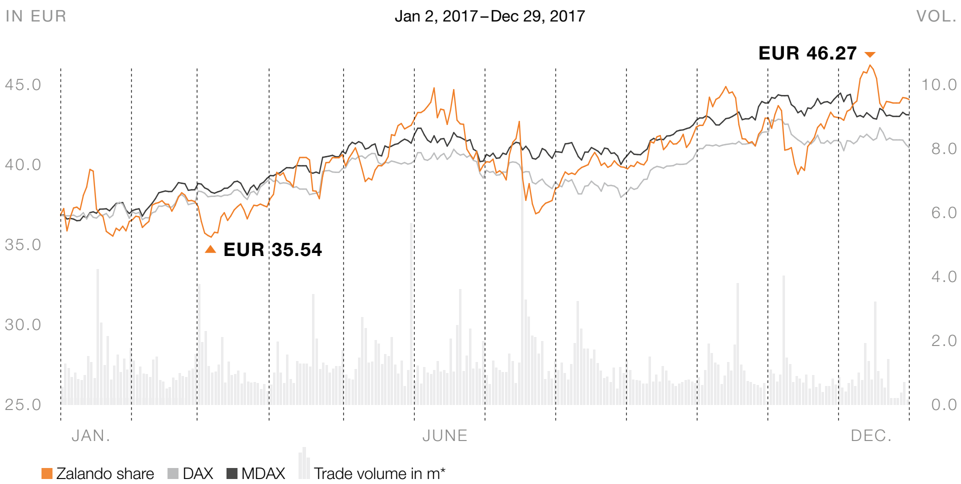
1.5.1 Capital Markets and Share Price Development

The development of international capital markets continued to be driven by the low-interest rate environment in 2017. Compared to other asset classes, equity capital markets remained highly attractive to investors, which was reflected in the positive development of international stock indices, including the German index DAX. The latter reached a new all-time high of 13,479 points in November. Political events, such as federal elections in Germany or France, uncertainty over Catalan independence and the tense relationship between the US and North Korea, were frequently discussed topics on the trading floors.

The Zalando share started 2017 at EUR 36.44 and developed positively in the first quarter, in line with German stock markets. A rise in government bond yields and a related appreciation of the euro weighed on the German stock market in the summer months. Consequently, the DAX traded at its summer low in August at 11,946 points. This trend was also reflected in the development of the Zalando share and resulted in a temporary low at the end of July with a share price of EUR 36.99. This was followed by a recovery period of the German stock market and a positive stock price development of the Zalando share, marked by the all-time high of EUR 46.27 on December 13. Zalando closed the trading year at EUR 44.12. The market capitalization as of December 31 amounted to EUR 10.9bn (basic).

zln.do/en-share

Development of the Zalando Share, DAX and MDAX → 13



*) Based on trading on XETRA, German stock exchanges, electronic communication networks ("ECNs") and over-the-counter ("OTC") trading.
Source: Bloomberg

Share Performance 2017

→ 18

Opening price on Jan 2, 2017	EUR 36.44
High 2017 (Dec 13)	EUR 46.27
Low 2017 (March 7)	EUR 35.54
Closing price on Dec 29, 2017	EUR 44.12
Performance 2017	21.1%
Average daily trading volume 2017 (shares)*	1.3m
Average daily trading volume 2017 (EUR)*	EUR 50.8m

*) Based on trading on XETRA, German stock exchanges, electronic communication networks (“ECNs”) and over-the-counter (“OTC”) trading. Source: Bloomberg

The Zalando Share

→ 19

Type of shares	Ordinary bearer shares with no par value (“Stückaktien”)
Share capital	EUR 247,384,898
Total numbers of shares outstanding (Dec 31, 2017)	247,384,898
ISIN	DE000ZAL1111
WKN	ZAL111
Bloomberg	ZAL GR
Thomson Reuters	ZALG.F

1.5.2 Shareholder Structure: Increase in Free Float

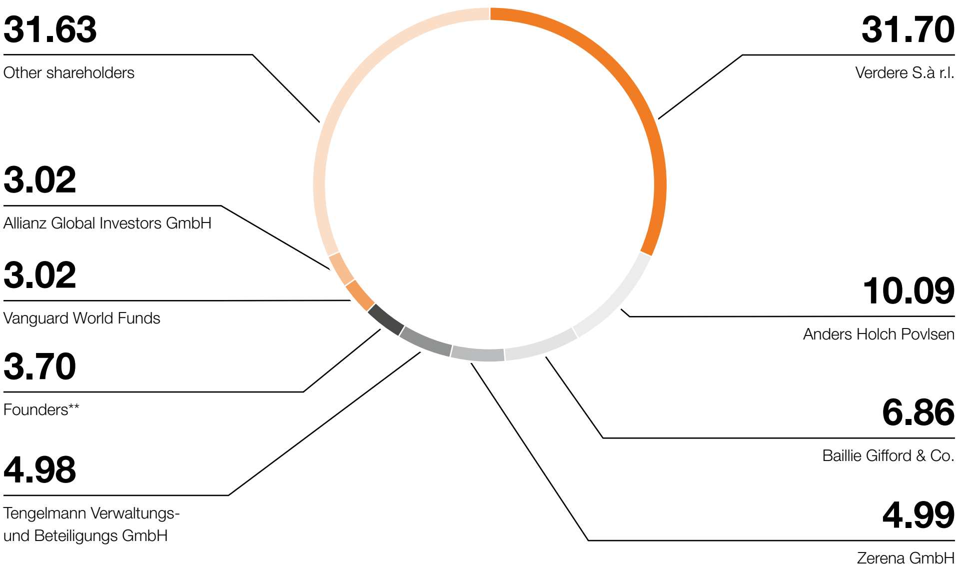
Free float as defined by Deutsche Börse AG amounted to 58.31%[13] at year-end (year-end 2016: 49.47%) due to Zerena GmbH reduction below the five percent threshold. Apart from that, the stake of Anders Holch Povlsen increased slightly from 10.05% to 10.09% in April, and Allianz Global Investors GmbH increased its stake to 3.02% in September, exceeding the reporting threshold of 3%.

13) In this annual report, we report the free float as defined by Deutsche Börse Group. In the 2016 annual report, we used a different definition and reported the free float using the 3% threshold method. The 2017 free float would translate to 31.63% applying the method from the prior year (prior year-end: 30.90%).

Shareholder Structure in Percent as of Dec 31, 2017* → 14

GRI 102-5

IN %



*) Voting rights held directly or by a subsidiary. The overview reflects the notifications pursuant to Section 21 WpHG (BaFin-notifications) and Section 26a WpHG (change in total voting rights) received by ZALANDO SE as of September 28, 2017.
**) Aggregate shareholding of the founders.

1.5.3 Research Coverage

Similar to 2016, by the end of 2017 the Zalando share was covered by 28 research analysts from Germany and abroad, resulting in a high capital market awareness of the Zalando share.

Institutions That Cover Zalando → 20

Arete	DZ BANK AG	Pareto Securities
Baader Bank	Equinet Bank	Quirin Bank
Bankhaus Lampe	Exane BNP Paribas	RBC Capital Markets
Barclays	Goldman Sachs	Redburn
Berenberg	Handelsbanken	Société Générale
Bryan, Garnier & CO	Hauck & Aufhäuser	Stifel
Citi	J. P. Morgan Cazenove	UBS
Commerzbank	Kepler Cheuvreux	Warburg
Credit Suisse	Macquarie Research	
Deutsche Bank	Morgan Stanley	

1.5.4 Stock Indices

The Zalando share belongs to various key indices (selection), thereby raising the visibility and trading volume in the Zalando share.

Selection of Stock Indices → 21

Index	**Region**
MDAX	Germany
STOXX Europe 600	Europe
STOXX Europe Mid 200	Europe
FTSE4GOOD	Global

1.5.5 Third Annual General Meeting

On May 31, 2017, ZALANDO SE hosted its third annual general meeting at Westhafen Event & Convention Center in Berlin. Shareholders in attendance, representing 89.2% of the voting share capital, approved all proposed resolutions put forward by the company's Management Board and Supervisory Board. Lothar Lanz, Jørgen Madsen Lindemann, Anders Holch Povlsen and Alexander Samwer were re-elected as members of the Supervisory Board. Shanna Prevé and Dominik Asam were elected as new members of the Supervisory Board. Lorenzo Grabau and Kai-Uwe Ricke did not seek re-election.

zln.do/en-annual-general-meeting

From left to right:
Rubin Ritter member of the Management Board, **Robert Gentz** Co-founder and member of the Management Board and **David Schneider** Co-founder and member of the Management Board during the annual general meeting 2017.

1.5.6 Constant Exchange with Capital Markets

A key element of our external communication is a continuous and transparent dialogue with all capital market participants. We fostered and deepened existing relationships through extensive discussions at numerous conferences and roadshows about the Zalando strategy, business model and value drivers.

In fiscal year 2017, our Management Board, our Senior Vice President Finance and the Investor Relations Team spent 27 days on roadshows and attended nine national and international conferences in major European and North American financial hubs. We also granted interested analysts and investors access and insights into our tech and fashion hubs in Berlin as well as the fulfillment centers in Erfurt and Mönchengladbach.

Our third Capital Markets Day took place on June 20, 2017, in our Berlin fashion hub. Management Board and senior management presented our strategic initiatives and the current course of business to more than 100 participating investors and analysts. In addition, the participants had the opportunity to visit our fulfillment center in Mönchengladbach the day before. All presentations and audio webcasts are available on our Investor Relations website.

zln.do/en-publications

Zalando showcasing fashion collection with catwalk during Capital Markets Day 2017.

2

Combined Management Report_

2.1 Background to the Group

- Zalando is Europe's leading online platform for fashion
- ZALANDO SE and its 40 subsidiaries thus cover the entire supply chain of an online retailer
- Continued strategic investments to cement partnerships with customers and suppliers and in infrastructure
- Targeted investments in logistics infrastructure are an essential part of this
- Sustainability is integrated in Zalando's daily business

2.1.1 Business Model

Skip to p. 80

GRI 102-1
GRI 102-2
GRI 102-4
GRI 102-6

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

zln.do/en-business-fields

Zalando's assortment of almost 2,000 international brands ranges from popular global brands, fast-fashion and local brands, and is complemented by private label products. Zalando's offering has been extended and enhanced with Zalando Lounge, which offers registered members special offers at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt and Cologne opened between 2012 and 2016 and serve as additional sales channels for excess inventory. The parent company, ZALANDO SE, was founded in 2008 and has its registered offices in Berlin. Zalando's localized offering addresses the distinct preferences of its customers in each of the 15 European markets being served: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Poland, Spain, Sweden, Switzerland and the United Kingdom. The logistics network with five centrally located fulfillment centers allows Zalando to efficiently serve its customers throughout Europe, supported by fulfillment centers in Northern Italy, France and Sweden with a focus on local customer needs. Zalando's management believes that the integration of fashion, operations and online technology provides the capability to deliver a compelling value proposition to both customers and fashion brand partners.

2.1.2 Group Structure

Governance and Control

GRI 102-3
GRI 102-5
GRI 102-7
GRI 102-18
GRI 102-45

The Zalando group is managed by its ultimate parent company, ZALANDO SE, based in Berlin, Germany, which bundles all management functions and generates the vast majority of group revenues. In addition to the parent company, Zalando is comprised of 40 subsidiaries that operate in the areas of fulfillment, customer service, product presentation, advertising, marketing, and private labels developed in-house. ZALANDO SE and its subsidiaries represent the entire value chain of an online retailer. ZALANDO SE has control over all subsidiaries, either indirectly or directly.

As a result, group reporting essentially corresponds to the reporting for ZALANDO SE. Supplementary information concerning the separate financial statements is presented in section 2.6.

The Management Board of ZALANDO SE comprises three members, who are responsible for the group's strategy and management. Rubin Ritter is responsible for the Zalando online shop, finance, corporate governance, and corporate communication. Robert Gentz is responsible for the off-price and emerging businesses, and for human resources, strategy, and technology infrastructure. David Schneider's area of responsibility comprises the Partner Solutions and zLabels businesses, and the Zalando brand. Consisting of nine members, the Supervisory Board advises the Management Board and monitors its management activities. The Supervisory Board is directly involved in decisions of fundamental importance to the company. In particular, it reviews the financial statements and management reports and it reports on the audit to the annual general meeting. Zalando's Supervisory Board represents long-term investors, employees and independent experts. The remuneration of the Management Board and the Supervisory Board as well as the incentive schemes are detailed in the remuneration report. The remuneration report and takeover disclosures pursuant to Sections 289 (4) and 315 (4) HGB, which are components of the combined management report, are presented in the corporate governance report. The corporate governance report also includes the declaration of conformity.

Further Information
Corporate Governance Report
p. 52

Group Segments

ZALANDO SE's internal reporting structure is primarily based on a sales-channel-related perspective. The Management Board monitors the development of the business for the main sales channel, Zalando online shop, by breaking it down geographically into the regions DACH (Germany, Austria and Switzerland) and Rest of Europe. All other sales channels are grouped under the Other segment, which mainly comprises revenues generated by the Zalando Lounge and outlet sales channels and the new platform initiatives.

2.1.3 Corporate Strategy

Skip to p. 83

zln.do/en-strategy

With EUR 423bn[14] in annual retail spent in 2016, the European fashion market is one of the largest and most attractive consumer markets in the world. In the last few years, we have witnessed a digitalization wave sweep over the entire fashion industry. A wide variety of industry players have embraced digital platforms and strategies in order to seize the opportunities arising from double-digit online growth rates. While the size of the overall fashion industry in Europe remained largely stable between 2010 and 2016, online fashion sales have more than doubled during the same period, expanding from EUR 24bn to EUR 51bn[15]. Growth has been driven by new technology, as it plays a key role in matchmaking supply- and demand-side players in the fashion industry. This has made it possible to connect the entire fashion ecosystem: customers, brands, retailers, manufacturers, stylists, content creators, logistics, and service providers. But most importantly, by opening up new opportunities to co-create value, technology is establishing new and more efficient ways to consume, produce, and invest in fashion.

14) Euromonitor, Europe excl. Russia; fashion excl. beauty category
15) Euromonitor, Europe excl. Russia; fashion excl. beauty category

Our Opportunity to Reimagine Fashion for the Good of All

The fashion market presents an exciting and attractive opportunity, but it is also a market that is characterized by specific challenges that create structural inefficiencies, raising operational costs and introducing pain-points throughout the entire customer shopping journey:

- Limited end-to-end transparency on inputs and production processes
- Faster fashion cycles
- Growing complexity of global supply chains
- Increasing importance of sustainability compliance practices
- Rapidly changing customer preferences
- Lack of accurate sizing and fitting solutions

We strive to find solutions that produce the best results for all in the fashion industry, be it customers, fashion brands, manufacturers, stylists, content creators, logistics or service providers. Every single stakeholder plays an important role – directly or indirectly – in Zalando's growing ecosystem.

We are well positioned to meet the challenges and seize the opportunities in the fashion industry. With a robust and growing presence in 15 markets, Zalando has become Europe's leading online fashion destination to more than 23m active customers. Our expanding technology and logistics infrastructure, combined with our customer reach – now surpassing 2.5bn visits per year – grant us access to almost 2,000 brands, for many of which we are their largest retail account. Our fashion competence is virtually unmatched, enabling us to position ourselves as brands' most trusted partner and customers' go-to fashion companion.

zln.do/en-profile

More specifically, we rely on the following strengths:

Our Focus on the Fashion Category and Localized Solutions

Given the idiosyncratic nature of the fashion ecosystem, successful industry players are required to build unique capabilities at each stage of the value chain. In this regard, our focus on the fashion category and strong partnerships with multiple fashion stakeholders has enabled us to develop a broad and comprehensive understanding of the needs of the fashion ecosystem. In turn, we leverage this expertise to design unique and compelling fashion experiences that delight customers and to develop industry-specific solutions that help brand partners grow.

To maintain a competitive edge in our home market, we leverage our central core strengths – advanced technological capabilities, vast fulfillment network, and direct relationship with suppliers – and focus on building highly localized solutions for each of our 15 European markets. We are committed to tailoring our services to local tastes and to making Europe accessible for fashion brands and retailers. Our thorough understanding of local specificities will continue to be a core differentiator.

Our Value Proposition for Customers

Zalando has gained customers' trust by consistently offering a unique fashion experience that provides inspiration, empowers customers, caters to their different needs, and gives them confidence in their personal fashion choices. A fashion companion that connects customers with fashion in new, fun, and inspiring ways by:

- Offering an up-to-date, unique, and comprehensive assortment of in-season fashion merchandise
- Building the most fashion-competent destination via discovery and inspiration, catalog curation, as well as content and selection freshness
- Providing unique and vivid storytelling behind trends, brands, and products
- Delivering an unmatched level of personalization and relevance
- Offering a smooth, better-than-offline experience: the most convenient way to discover, check-out, pay, receive, and return fashion items

Our Value Proposition for Fashion Brands and Suppliers

Zalando has built credibility among fashion brands as a trusted fashion-competent and technology partner. We help fashion brands and retailers grow and tackle some of the most challenging and complex issues inherent in online fashion by:

- Providing technology and operations infrastructure that enables brands and retailers to optimize results across the entire value chain (e.g. through more accurate sales forecasts, insights into customer buying behavior, targeted advertising, and smart fulfillment services)
- Empowering brands to present themselves in a brand equity accretive, engaging way and enabling them to localize their content in every single country in which we operate
- Granting brands access to a vibrant fashion ecosystem where they can connect, create, and share value with different fashion stakeholders
- Offering instant access to the European fashion market through our unprecedented customer reach across Europe

Zalando's Platform Vision

Our platform strategy outlined in 2016 remains largely unchanged. We remain convinced that a platform business model provides the best approach to becoming the operating system of the fashion world, with multiple ways of integrating numerous fashion contributors and stakeholders, catering to their specific needs. We are dedicated to making sure our platform enables fashion stakeholders to grow with us and reach their full potential by offering them a wide array of digital and infrastructure services such as analytics, advertising, and fulfillment.

zln.do/en-platform-strategy

By moving towards a platform business model, we acknowledge that the best and most sustainable business solutions are being built jointly between multiple stakeholders in the fashion industry, and not solely within the walled gardens of a single company. From this perspective, we believe that by attracting a diverse set of key players active in the fashion ecosystem (e.g. fashion brands, manufacturers, stylists, content creators, logistics, and service providers), we can enhance our inspiration capabilities and convenience proposition at scale through:

- Overall increased availability of styles and sizes
- Access to the most sought-after brands
- Integration of credible niche/specialty players with unique content and assortment
- Long-tail and local inventory with volumes catering for the needs of specific fashion lovers
- Scalable personalization and more inspiring content, not limited to Zalando's production capacity (e.g. media partners, stylists)
- Tailored sizing and fitting advice provided by innovative technology partners
- Additional options to access local inventory and fast delivery solutions

Our strategy focuses on igniting and sustaining self-reinforcing network effects on the Zalando platform. By facilitating partners' ability to connect to our platform, we increase our merchandise selection and offering, inspirational content and curation, access to fashion expertise, and the range of delivery options available to customers. This, in turn, expands our customer reach, and vice-versa. The greater the number of players plugged into our platform, the better our ability to match and facilitate interactions between customers and partners at scale. Interactions and the subsequent data generated are at the heart of our platform business model.

Our Strategic Investment Areas

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Investment in Our Customer Proposition

We will continue investing in four key customer propositions to strengthen our positioning as the most fashion-competent destination.

Assortment

zln.do/en-assortment

In pursuit of our mission to offer a "one-stop" shopping experience for all, we will expand into the beauty category to ensure that our customers can truly buy a complete look across all price points and from head to toe. Furthermore, to remain customers' preferred fashion companion, we will continue to invest in ensuring that we always offer the broadest assortment selection, latest fashion trends, sustainable options, and the widest range of in-season fashion brands to cater to our customers' diverse fashion tastes and budgets. Additionally, we leverage zLabels, our private label offering, to create inspiring fashion brands and products to meet customers' specific demands and further enhance our product selection. We combine our assortment offer with continual inspiration and personalization to help our customers navigate the ever-changing world of fashion.

Convenience

zln.do/
en-post-order-experience

We continue to invest in more personalized delivery experiences to take our customers on the smoothest fashion purchase journey possible with ultra-fast delivery, flexible payment options, and a hassle-free return process.

Brand

Our determination to enhance our brand equity is closely intertwined with our commitment to further strengthen our relationships with customers and suppliers. We invest in expanding our capabilities and boosting our fashion competence and credibility in order to ensure that we consistently meet our customers' and suppliers' expectations. Building stronger customer and supplier relationships is at the core of our brand equity, and it is what makes us one of the leading fashion destinations in Europe. We are also investing in strategic brand marketing initiatives to increase customer engagement. One such initiative is the Bread & Butter event, which acts as a platform for brands and consumers to directly interact with each other during the event and digitally.

zln.do/en-bold

Multiple Channels/Apps/Devices

As a customer-centric company, we invest in our capabilities to be present where the customer is, to innovate in order to tackle emerging and foreseeable customer needs and pain-points. It is about meeting the customer anytime, anywhere: be it on our mobile app, our desktop site, social apps, or other connected devices.

Investment in Our Supplier Proposition

To maintain our position as our fashion suppliers' preferred and most trusted e-commerce partner, we will continue investing in the following areas.

Wholesale Solutions

We invest in optimizing our wholesale capabilities by driving innovations through data and automation, and empowering our fashion partners to take more active ownership in selecting and pushing the right merchandise on the Zalando platform.

Partner Program

We invest in providing our fashion partners with an alternative solution through which they own inventory and retain control over pricing and assortment. Our goal is to reach a 20% – 30% share of enabled transactions.

zln.do/en-partner-solutions

Off-Price Solutions

We invest in developing both online and offline distribution channels to help brands effectively manage excess inventory across Europe without diminishing their brand equity.

Digital Services

We invest in providing a one-stop shop with end-to-end e-commerce services to help our partners connect with customers and successfully navigate the complex fashion ecosystem through advertising and media products, stock integration, payment solutions, customer analytics, and content management.

zln.do/en-zms

Fulfillment Services

We invest in expanding our fulfillment infrastructure to provide our brand partners with highly customized and reliable solutions through Zalando Fulfillment Solutions (ZFS), enabling them to sell their merchandise through our platform without having to worry about logistics concerns.

zln.do/en-zfs

Investments in Our Supporting Infrastructure: Technology and Operations

Our investments in technology and operations infrastructure strengthen our core foundation on which we develop compelling customer and supplier propositions.

Technology

We are investing in optimizing our logistics operations, enhancing our technology capabilities, and expanding our services powered by artificial intelligence (AI). Proprietary technology solutions form the backbone of Zalando and drive all workflows from purchasing to ordering processes and fulfillment.

zln.do/en-gift-finder

The technology underpinning our warehouse processes is constantly being upgraded to ensure that we stay ahead of the competition. We are committed to building some of the most-sophisticated fulfillment centers dedicated to online fashion. Accordingly, we are investing heavily to automate order fulfillment processes and to scale up our "Hub & Spoke" system in order to optimize performance and reduce delivery times. We are also investing to leverage the wealth of data available to us. For instance, fast replenishment algorithms are being introduced to provide recommendations on what fashion items to replenish and in what quantity.

Our focus is on expanding our technology talent pool by providing an attractive and innovative work environment. We recently announced the opening of our third technology hub outside of Germany, in Lisbon. The Lisbon Team will focus on developing an enhanced digital experience for customers visiting Zalando. This follows the expansion of our Technology Teams in Dublin, Helsinki, Dortmund, and Berlin. The focus of operations in Ireland is deep-data science and engineering, involving the development of measures related to building a real-time insight platform around fashion. In Finland, the Technology Team works on many of the cornerstones of the Zalando platform, including personalization and innovative customer-facing products. While in Germany, our Dortmund hub is working on optimizing the payment flow from checkout to refund, and the small-but-excellent Zalando Research Team in Berlin is focused on applying cutting-edge research to tackle challenges that customers face throughout the shopping journey.

zln.do/en-lisbon

Our investments in artificial intelligence are geared towards strengthening our search, personalization, and sizing capabilities. We are striving to enhance our understanding of user intention in order to improve sorting and personalized search. The focus of personalization is on building the infrastructure needed to extend product recommendations to personalized fashion advice. Furthermore, we have set up a dedicated Sizing Team to develop AI methods to improve sizing advice for customers and generate sizing insights for brand partners.

zln.do/en-sizing

Operations

Our focus is on enhancing our pan-European fulfillment network by opening up new facilities. Over the coming year, we plan to quickly ramp-up our new fulfillment center in Poland and to initiate new warehouse projects in Poland and Italy. Additional capacity will enable us to fuel our wholesale growth and further enable the Partner Program ramp-up through the scale up of our Zalando Fulfillment Solutions (ZFS). ZFS will in turn improve our delivery speed and help our partners to maintain or improve customer experience standards in all of our 15 markets across Europe. Our employees are the key to our operational success. Our commitment to create a healthy corporate culture and fair working conditions will continue to guide us as we strive to expand our European footprint.

GRI 102-4
GRI 102-10

zln.do/en-logistics-network

We are confident that our platform strategy provides a systematic approach to building sustainable and differentiating advantages throughout the online fashion value chain. In the coming years, we will continue our efforts to further scale up our platform by connecting more fashion stakeholders, developing new technology solutions to tackle current and emerging fashion needs, and increasing our level of personalization to address customers' growing expectations.

Given the rapid pace and scale of transformation in the online fashion industry, we are aware that our vision and strategy will need to evolve accordingly. The magnitude of the opportunities and challenges ahead is great, but we trust that our relentless customer-centric focus combined with our demonstrated ability to learn and innovate will enable us to stay ahead of the curve.

2.1.4 Corporate Responsibility

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Our purpose "Reimagine fashion for the good of all," is based on our ambition to tackle the endemic challenges that our industry is facing. These challenges include a lack of transparency in increasingly complex supply chains and related risks for people and the environment. As a company, we want to do

zln.do/en-responsibility

our bit for a more sustainable fashion industry by providing a systemic contribution beyond our own business. We believe that our contribution is most effective if we combine our strengths in technology, fashion, and logistics and actively engage our customers, partners and employees.

Of course, at first we had to do our homework to get the basics right. However, we feel that we have reached a point where we could go one step further with our sustainability strategy (do.STRATEGY) and have defined additional strategic visions and targets in four key areas:

zln.do/en-do-strategy

- Employees: we want to provide a workplace for the future and impact the future of work. This implies offering our employees a culture of continuous growth and development as well as an innovative and attractive work environment.
- Fashion: we want to contribute to a more sustainable fashion industry. It is our ambition to develop our online shop into a leading online destination for sustainable fashion and to further improve the social and environmental footprint of our private label products.
- Environment: we want to decouple our ecological footprint from our economic growth. To this end, we developed our first climate protection strategy and strive to take sustainable packaging to the next level.
- Corporate citizenship: we want to reimagine how corporates contribute to solving societal challenges. In line with the social Zalando principle, we intend to strategically invest 1% of our EBT in existing solutions for societal impact, e.g. to increase transparency in the supply chain, and help them scale.

We see a pressing urgency in addressing the challenges of our industry together with our partners, and we are eager to learn and iterate while striving towards a systemic contribution. At the same time, we are convinced that our sustainability strategy is also a key element for our future business success.

Additional information regarding our sustainability strategy and our separate combined non-financial report in accordance with Section 289b (1) and (3) and Section 315b (1) and (3) HGB (German Commercial Code) which is published together with the combined management report on the Company's website (https://corporate.zalando.com/en/) is provided in the separate section 1.2 Corporate Responsibility[16] of the annual report.

Further Information
Corporate Responsibility
p. 12

2.1.5 Management System

In addition to revenue, EBIT, adjusted EBIT and capex, other key financial performance indicators for corporate management include EBIT margin, adjusted EBIT margin, the adjusted fulfillment and marketing cost ratios, along with EBITDA and adjusted EBITDA. Operating and free cash flows are also taken into account. The Management Board steers the company at a consolidated group level.

Further Information
Report on Economic Position
p. 88

In addition to these financial indicators, Zalando also uses a range of non-financial performance indicators to manage the company.

- **Ratio of mobile site visits to total site visits:** users are making greater use of mobile devices to access the internet. In our effort to offer customers the opportunity to enjoy high-quality shopping on their mobile devices, Zalando continues to develop and refine its mobile websites

16) The sustainability report is not part of the audited combined management report.

and apps. As a result, the ratio of shop visits from mobile devices to the total number of shop visits increased by around 5.1 percentage points in 2017, rising from 65.6 in 2016 to 70.7.

- **Number of active customers:** the Zalando group measures its success by the number of active customers. Each customer that has placed at least one order within the preceding 12 months (based on the reporting date) is considered active. Compared to the prior year, the number of active customers increased by 3.2m, rising from 19.9m to 23.1m in 2017.
- **Number of orders:** in addition to revenue, the number of orders placed is a key performance indicator for the management of the group. This indicator is monitored independently from the value of merchandise and is a key driver of growth. In 2017, the number of orders placed increased from 69.2m in 2016 to 90.5m.
- **Average number of orders per active customer:** the average number of orders placed by active customers during the last twelve months totaled 3.9 as of December 31, 2017 (prior year: 3.5). This KPI is an important indicator of the trust customers place in the company and is also influenced by customer age and shopping channel.
- **Average basket size:** similar to the number of orders placed, the average basket size has a direct effect on the revenue of the group. The average basket size (after returns) decreased slightly in fiscal year 2017 from EUR 66.6 to EUR 64.5. It is influenced by assortment composition, customer age, and shopping channel. Young customers who prefer fast fashion articles and shopping mobile tend to shop more frequently, but with a lower basket size.

2.1.6 Research and Development

Zalando develops key components of its software internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes in particular are supported using internally developed software. Important technical developments in 2017 included: on-site personalization initiative, Fashion Insights Platform, Smart Product Platform, Fashion Content Platform, product availability, Search & Personalization, same day delivery, and many more.

zln.do/en-personalization

Software development at Zalando relates to the structured, labor-intensive phase of programming and implementing significant system upgrades, further developing components and enhancing functionalities along the entire value and process chain.

Development work at Zalando is performed by teams of developers that are organized by the respective function or line, for example Fashion Store, Payments, Partner Solutions, Zalon, zLabels, Off-Price.

In 2017, the group recognized development costs of EUR 51.2m (prior year: EUR 57.7m), of which EUR 36.8m relate to prepayments and assets under development (prior year: EUR 36.4m). The increase in development costs is attributable to the enhancement of the above-mentioned software and new technical projects.

Research costs were immaterial.

2.2 Report on Economic Position

- European internet retailing and online fashion sales once again grow considerably more strongly than the economy as a whole
- Zalando closes a successful fiscal year and captures shares in all markets
- Revenue growth of 23.4% to EUR 4,489m is driven by all segments
- EBIT stands at EUR 187.6m, the EBIT margin at 4.2%
- Cash flow from operating activities comes to EUR 193.7m

2.2.1 Macroeconomic and Sector-Specific Environment

The online shopping mega-trend continued in 2017. The European online retail sector grew by 13.5% in 2017, while the general retail industry grew just 3.0%[17]. A similar trend was found in the fashion sector.

www.euromonitor.com

The European fashion retail sector closed 2017 with a trading volume of around EUR 422bn, up 1.4%[18] nominally. This was outperformed by the online fashion market, which grew much faster (11.9%) compared to the previous year, closing at EUR 56bn.

Consistent with the European landscape, the German overall retail market grew at 2.0% with online sales increasing by 10.7% in 2017[19]. Fashion trading volumes increased by a mere 0.6%[20] as a result of a decline in consumer footfall in brick-and-mortar stores to a volume of EUR 76bn[21]. It is reported that footfall dropped by 2.0% in 2017 from 2016[22]. Nevertheless, online fashion retail sales grew by almost 15.0% in 2017, to a market value of around EUR 14bn[23].

Due to the positive outlook for European fashion and online retail, we believe our business model is in a favorable position. This advantage can be attributed to some sector-specific factors.

- Technological advancements are the key drivers behind the second wave of e-commerce. Advancements especially in machine learning will lead to a further increase in the online fashion business. Market penetration of internet fashion is expected to continue to increase at the expense of traditional brick-and-mortar retailers.
- Moreover, the increased usage of mobile devices and their extended range of applications have influenced the strong growth in online retail trade, including online fashion. Smartphones and tablets provide retail access anytime and nearly anywhere. Due to this convenience, consumers increasingly use them to shop for fashion. Forecasts for mobile commerce demonstrate that this trend is likely to continue. The annual growth rate for mobile retailing in Europe is expected to be 18.4% in the coming year and about 15.2% for the coming five years[24].
- Europe remains a very attractive fashion market with a high concentration of affluent customers. In Europe, purchasing power increased by 1.9%[25] in 2017 compared to 2016. Moreover, in our key market Western Europe the per capita spending on fashion amounted to EUR 764 in 2017[26], which is significantly higher than in most places in the world.
- Lastly, average gross margins for online fashion retailers range between 40% and 60%[27], considerably more attractive than average margins in other online product categories, such as electronics.

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

2.2.2 Business Development

Skip to p. 93

zln.do/en-investment-and-growth

ZALANDO SE, Europe's leading online platform for fashion, looks back on a successful business performance in fiscal year 2017. Compared to 2016, the group reported 23.4% revenue growth in the period to EUR 4,489m (prior year: EUR 3,639m). All segments contributed to revenue growth: revenues in the DACH region increased by 18.3%, in Rest of Europe by 25.7% and in the Other segment by 45.0%. Zalando continued to gain market share in all its markets.

Apparel remained Zalando's biggest product category, followed by shoes and sports. The customer base continued to grow strongly, reaching 23.1 million active customers at the end of 2017 (19.9 million at the end of 2016). In 2017, Zalando continued to invest in the three areas that are essential for the company's success: customers, partners and infrastructure.

As in previous years, Zalando put customer satisfaction as its main objective and invested significantly in its customer proposition, including assortment, convenience, brand and multiple channels, apps and devices.

Throughout the year, notable additions to Zalando's brand portfolio included Oysho, Stradivarius, Pull&Bear (Inditex), Nudie Jeans and Armani. The Zalando brand raised its visibility and reach, supported for example by the "Man Box"/James Franco and the "Remix Fashion" campaigns. The number of available items increased to more than 300,000, further enriching the breadth and depth of Zalando's well-curated offering.

zln.do/en-plus

Zalando introduced Zalando Plus, a new program that offers customized premium services like faster delivery and pickup of returns on demand. The first phase ran by invite only in four different cities in Germany: Berlin, Leipzig, Frankfurt and Hannover. Zalando Plus introduced benefits along the entire customer journey: members get early access to sales and benefit from faster delivery, including same day, and from the new return on demand service, which enables customers to have their returns picked up within two hours at a time and location of their convenience.

zln.do/en-zfs

Zalando also strengthened the Partner Program, in which brands can integrate their stock directly into the Zalando Fashion Store. Partners now have access to the Zalando customers in 13 countries where the Partner Program operates. In 2017, Zalando introduced Zalando Fulfillment Solutions, a service through which our partners have the option to handle their entire logistics through us. This service allows partners to leverage Zalando's logistics expertise and network, improving customer satisfaction and scaling their business internationally.

Investment in infrastructure underpins Zalando's strength in technology and enables the expansion of its platform strategy. Almost 2,000 brands have found a home at Zalando. Our technology provides the tools for the brands to design and control the content of their shops and obtain feedback and insights from their customers. Zalando has a team of almost 2,000 dedicated technology engineers who develop and drive all critical processes in-house. Among other achievements, this allowed Zalando to significantly improve its mobile offering. An impressive 70.7% of visits to the Zalando Fashion Store were conducted from a mobile device in 2017.

Zalando's operational structure provides the best fulfillment experience for online fashion in Europe. In 2017, the company successfully launched a fulfillment center in Szczecin (Gryfino, Poland) and satellite warehouses in Paris (Moissy-Cramayel) and Stockholm (Brunna).

Similar to existing locations in Mönchengladbach, Erfurt and Lahr, the new fulfillment center in Szczecin (Gryfino) has around 130,000 square meters of space. The location is operated by a third-party service provider. Once fully ramped up, it will supply all 15 markets of the Zalando Logistics network but especially customers in Poland, Germany and the Nordics.

A new satellite warehouse near Paris was put into operation in March 2017. This fulfillment center caters to the needs of Zalando's French customers and fulfills the increasing demands of one of the biggest fashion markets in Europe. In addition to reducing delivery times, the new fulfilment center enables a more efficient management of the distribution chain in France.

The new Stockholm fulfillment center, which is still under construction, started first test operations in the fourth quarter of 2017 and will ensure that Zalando's strong and growing Nordic customer base experiences a more convenient consumer journey and receives orders faster. The fulfillment center in the Stockholm area will decrease lead times significantly. Once the fulfillment center is fully ramped up, Zalando will be able to cut lead times in half across the Nordic region (to 1–2 days for Sweden and Denmark, and 1–3 days for Norway and Finland).

zln.do/en-logistics-network

Zalando now has seven fulfillment centers, including three outside Germany. New sites in the logistics network are also planned near Verona, Italy, and close to Lodz, Poland.

The number of employees increased by about 26%, strongly driven by the headcount increase in Operations to more than 9,289 employees. This reflects the growth of our logistics infrastructure.

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

The Zalando share is listed in various important domestic and foreign indices, including the German MDAX, the STOXX Europe Mid 200 Index and the broader European STOXX Europe 600 Index. The Zalando share closed 2017 at EUR 44.12.

Further Information
The Zalando Share – 2017 in Review p. 73

2.2.3 Economic Situation

Financial Performance of the Group

The consolidated income statement for 2017 shows strong revenue growth above prior year's level, coupled with solid profitability. We believe investing in growing our market share now is the value-maximizing strategy for the company.

GRI 103-1/-2/-3 MA
Economic Performance
GRI 201-1

Consolidated Income Statement

→ 22

IN EUR M	Jan 1 – Dec 31, 2017	As % of revenue	Jan 1 – Dec 31, 2016	As % of revenue	Change
Revenue	4,489.0	100.0%	3,639.0	100.0%	0.0pp
Cost of sales	–2,529.6	–56.4%	–2,029.6	–55.8%	–0.6pp
Gross profit	**1,959.4**	**43.6%**	**1,609.4**	**44.2%**	**–0.6pp**
Selling and distribution costs	–1,530.8	–34.1%	–1,223.7	–33.6%	–0.5pp
Administrative expenses	–242.9	–5.4%	–191.3	–5.3%	–0.2pp
Other operating income	11.8	0.3%	16.7	0.5%	–0.2pp
Other operating expenses	–9.9	–0.2%	–4.1	–0.1%	–0.1pp
Earnings before interest and taxes (EBIT)	**187.6**	**4.2%**	**207.0**	**5.7%**	**–1.5pp**

Further Information
Consolidated Statement of Comprehensive Income p. 135

Other Consolidated Financial Information

→ 23

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
EBIT margin (as % of revenue)	4.2%	5.7%	–1.5pp
Adjusted EBIT (excl. equity-settled share-based payments and non-operative one-time effects)	215.1	216.3	–1.2
Adjusted EBIT margin (as % of revenue)	4.8%	5.9%	–1.2pp
EBITDA* (in EUR m)	246.4	255.3	–8.9
EBITDA margin (as % of revenue)	5.5%	7.0%	–1.5pp
Adjusted EBITDA (excl. equity-settled share-based payments and non-operative one-time effects)	273.8	264.5	9.3
Adjusted EBITDA margin (as % of revenue)	6.1%	7.3%	–1.2pp

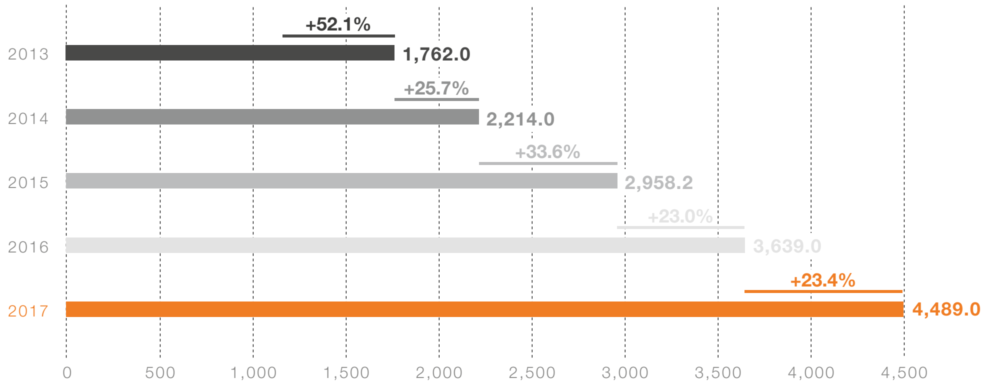
*) EBITDA is the EBIT before depreciation and amortization of property, plant and equipment and intangible assets. Depreciation and amortization of property, plant and equipment and intangible assets amounts to EUR 58.7m in 2017 (prior year: EUR 48.2m).

Development of Revenue

Annual Revenue Growth (2013 – 2017)

→ 15

IN EUR M

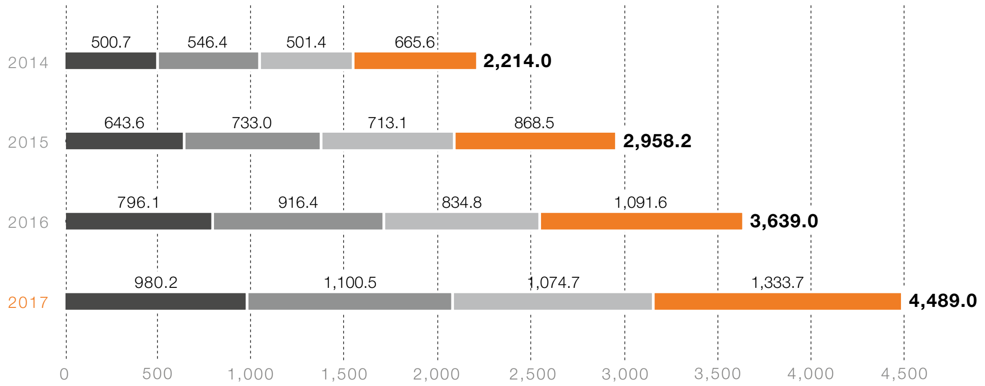


In 2017, Zalando increased its revenue by 23.4% or EUR 850.0m from EUR 3,639.0m to EUR 4,489.0m.

Revenue by Quarter (2014 – 2017)

→ 16

IN EUR M



The variance in revenue over the course of the year reflects the seasonality of the business. Typically, the fall and winter collections are sold at higher prices than the spring and summer goods. This means that revenue levels tend to be higher in the second half of the fiscal year than the first half. In addition, the second and fourth quarters tend to be stronger than the first and third quarters as they do not contain the sale periods that are typically towards season end. At EUR 1,333.7m, group revenue in the fourth quarter was up 22.2% on the comparable period of the prior year (Q4 2016: EUR 1,091.6m).

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

Key Performance Indicators

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KEY PERFORMANCE INDICATORS*	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
Site visits (in millions)	2,563.5	1,991.6	28.7%
Mobile visit share (as % of site visits)	70.7	65.6	5.1pp
Active customers (in millions)	23.1	19.9	16.2%
Number of orders (in millions)	90.5	69.2	30.8%
Average orders per active customer	3.9	3.5	12.6%
Average basket size (in EUR)	64.5	66.6	–3.2%
Revenue (in EUR m)	4,489.0	3,639.0	23.4%
Adjusted fulfillment cost ratio (as % of revenue)	25.9	23.2	2.7pp
Adjusted marketing cost ratio (as % of revenue)	7.9	10.3	–2.4pp
EBIT (in EUR m)	187.6	207.0	–9.4%
EBIT margin (as % of revenue)	4.2	5.7	–1.5pp
Adjusted EBIT (in EUR m)	215.1	216.3	–0.6%
EBITDA (in EUR m)	246.4	255.3	–3.5%
EBITDA margin (as % of revenue)	5.5	7.0	–1.5pp
Adjusted EBITDA (in EUR m)	273.8	264.5	3.5%
Adjusted EBITDA margin (as % of revenue)	6.1	7.3	–1.2pp
Net working capital (in EUR m)	–62.4	–127.6	–51.1%
Cash flow from operating activities (in EUR m)	193.7	275.8	–29.8%
Capex (in EUR m)	–243.9	–181.7	34.2%
Free cash flow (in EUR m)	–85.0	63.7	<–100.0%

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

Zalando’s most important performance indicators are revenue, EBIT, adjusted EBIT, capex, the number of active customers and the average number of orders per active customer. These are forecast for fiscal year 2018 in section 2.5 Outlook.

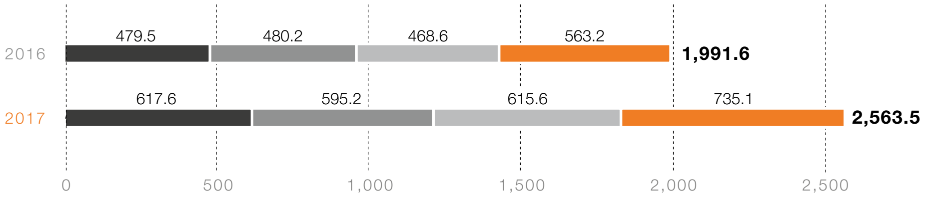
The rise in revenue is mainly attributable to a larger customer base and an increase in the number of orders. As of December 31, 2017, the group had 23.1 million active customers. This corresponds to an increase of 16.2% compared to the prior year. The larger customer base ordered more frequently compared to the prior year with the average number of orders per active customers rising 12.6%. The higher number of customer orders, which increased by 30.8%, was driven in particular by a 28.7% increase in site visits. The considerable rise in these revenue drivers was enabled through our continued focus on investing in the consumer and brand proposition as well as in our technology and operations infrastructure.

The higher traffic on the website also relates to a significant increase in the share of visitors who access the website on mobile devices. Compared to the prior year, the share of site visits via mobile devices rose by 5.1 percentage points to 70.7% in 2017.

Site Visits by Quarter (2016 – 2017)

→ 17

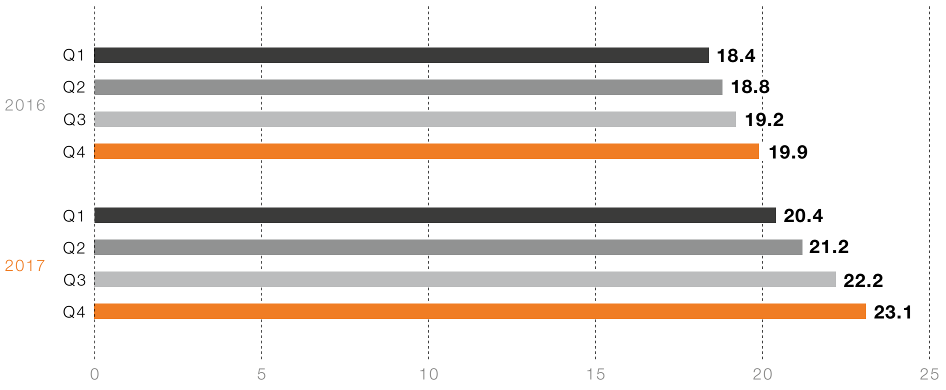
IN M



Number of Active Customers by Quarter (2016 – 2017)

→ 18

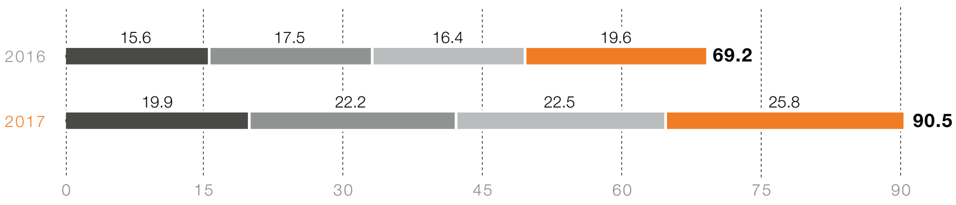
IN M



Number of Orders by Quarter (2016 – 2017)

→ 19

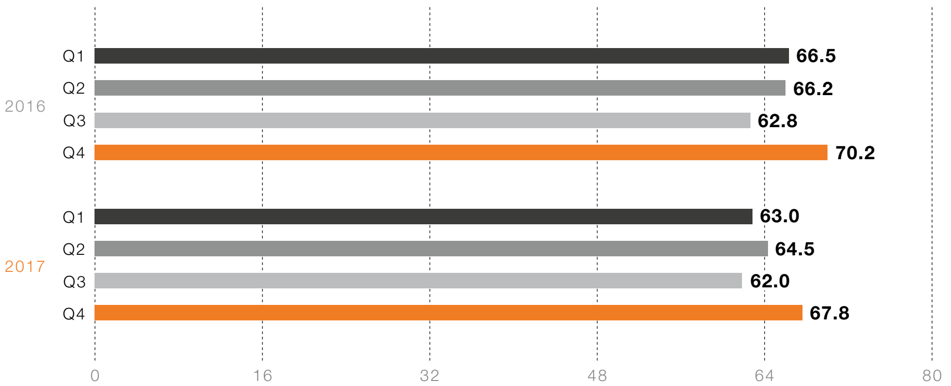
IN M



Average Basket Size by Quarter (2016 – 2017)

→ 20

IN EUR



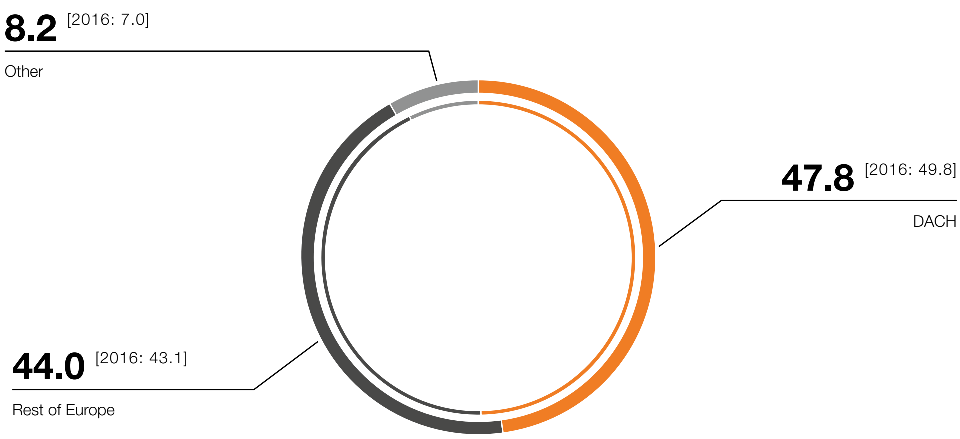
Zalando is benefiting from a strong increase in active customers by offering better and faster services to its customers, especially in the DACH region and France. An additional driver is the disproportionate growth in male customers as Zalando puts continued focus on communicating to male customers through brand marketing campaigns.

Revenue by segment breaks down as follows:

Revenue by Segment

→ 21

IN %



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In fiscal year 2017, DACH countries generated around half of the total annual revenue. At the same time, revenue recorded in the Rest of Europe and Other segments increased significantly, also contributing strongly to the overall revenue growth.

In the DACH segment, revenue reached EUR 2,145.6m in 2017 (prior year: EUR 1,813.8m), equivalent to an increase of 18.3% compared with 2016, thereby strongly re-accelerating growth as compared to 2016 (prior year growth rate: 14.8%).

The Rest of Europe segment generated revenue of EUR 1,973.6m in 2017 (prior year: EUR 1,570.2m). This corresponds to a 25.7% increase in revenue compared to 2016.

The Other segment achieved revenue of EUR 369.9m in 2017 (prior year: EUR 255.1m), increasing by 45.0%. The Other segment mainly comprises the business activities of Zalando Lounge, Outlet sales channels and projects derived from our platform initiatives. The revenue from the Zalando Lounge stems from additional sales campaigns for selected products at reduced prices for registered users.

Development of EBIT

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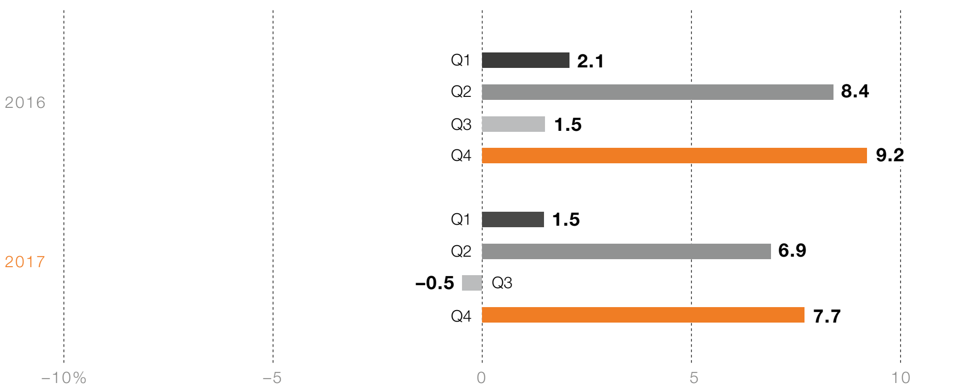
The group recorded an EBIT of EUR 187.6m in 2017 (prior year: EUR 207.0m) which corresponds to an EBIT margin of 4.2% (prior year: 5.7%) and represents a decrease of 1.5 percentage points. The decrease in EBIT margin is mainly driven by a higher fulfillment cost ratio that could not be fully offset by a lower marketing cost ratio. This is the result of a strong focus on revenue growth and continued investments in our consumer experience, brand proposition and expanding infrastructure.

EBIT Margin by Quarter (2016–2017)

→ 22

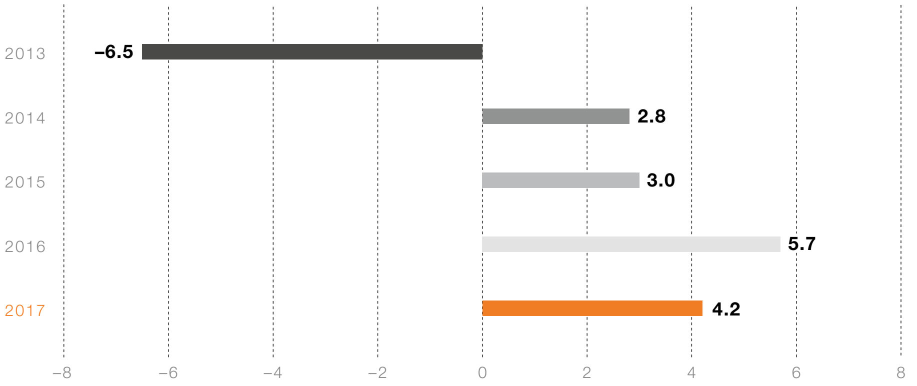
IN %



Yearly EBIT Margin (2013 – 2017)

→ 23

IN %

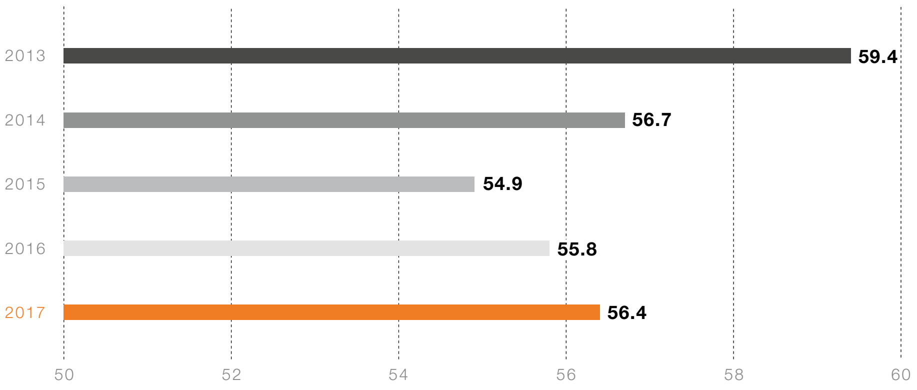


Five-Year Summary of Cost Items (Non-Adjusted)

Cost of Sales (2013 – 2017)

→ 24

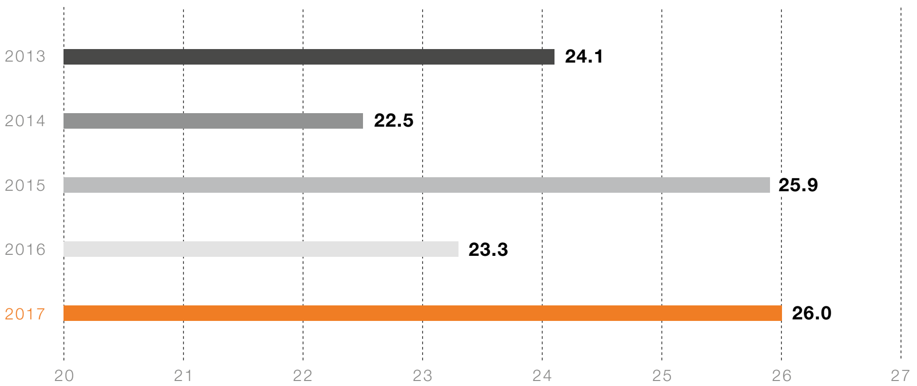
AS % OF REVENUE



Fulfillment Costs (2013 – 2017)

→ 25

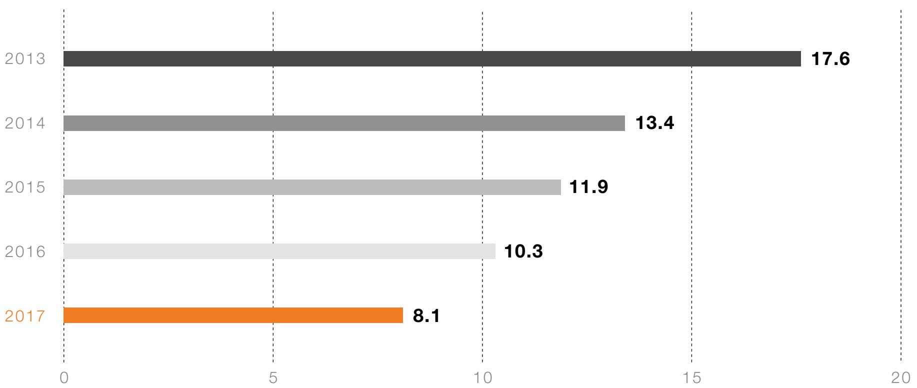
AS % OF REVENUE



Marketing Costs (2013 – 2017)

→ 26

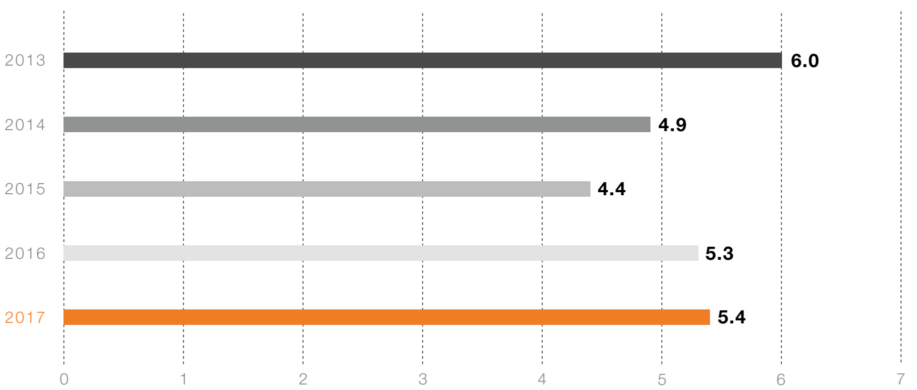
AS % OF REVENUE



Administrative Expenses (2013 – 2017)

→ 27

AS % OF REVENUE



Cost of sales rose by 24.6% year on year from EUR 2,029.6m to EUR 2,529.6m with the gross margin decreasing slightly by 0.6 percentage points from 44.2% to 43.6%, mostly due to a slightly higher discount level, which experienced a mix effect with the more discount-oriented Rest of Europe segment growing faster than DACH. Furthermore, Zalando attracts a growing number of younger customers who prefer to shop for fast fashion articles at lower gross margin levels. Economies of scale from continued negotiation successes with brand partners and a growing Partner Program share partially offset the aforementioned effects.

Selling and distribution costs rose by 25.1% year on year from EUR 1,223.7m to EUR 1,530.8m. This corresponds to an increase of 0.5 percentage points as a percentage of revenue, an increasing ratio from 33.6% in 2016 to 34.1% in 2017. Selling and distribution costs consist of fulfillment and marketing costs.

The fulfillment cost ratio as a percentage of revenue increased by 2.7 percentage points from 23.3% in 2016 to 26.0% in 2017. The increase in the fulfillment cost ratio is primarily attributable to higher logistics costs as Zalando is building up a diverse logistics network and continues its investments in the customer and brand proposition. Noteworthy developments include the ramp-up of new fulfillment centers in southern Germany, France, Italy, Sweden and Poland, continued investments in convenience to enhance our customer experience like same day delivery, and the ramp-up of our Zalando Fulfillment Solutions service for brand partners, where we take on the fulfillment services for brands that are selling in our Partner Program. Through those investments in convenience, we were able to achieve a very high service level and fast delivery times, even at peak times around Black Friday and Christmas. The investments in convenience also include Zalando Plus, a new membership program that offers additional benefits such as faster delivery as well as customized premium services like the pickup of returns on demand. Payment costs are included in fulfillment costs; they remained overall in line with the prior year. Zalando continued to put a strong focus on optimizing and improving its steering of payment options and thus reducing the risk of fraudulent activities.

zln.do/en-plus

Marketing costs decreased by EUR 13.4m to EUR 362.5m compared to the prior year. Relative to revenue, marketing costs decreased by 2.3 percentage points, resulting primarily from savings and efficiency gains, in particular within performance marketing. Nevertheless, the number of active customers grew strongly by 16.2% to 23.1m. Overall, Zalando continued to shift marketing spending to fulfillment investments as a higher long-term return is expected on these investments. Marketing spend included the "Man Box" campaign with US actor James Franco and the "Remix Fashion" campaign with US rapper A$AP Rocky as well as our second Bread & Butter event.

zln.do/en-bold

Administration expenses increased from EUR 191.3m in 2016 to EUR 242.9m in 2017. The increase mainly results from the higher headcount to strengthen the Zalando platform and the associated office expenses.

The EBIT margin decreased by 1.5 percentage points in comparison to the prior year, from 5.7% in 2016 to 4.2% in 2017. In absolute terms, EBIT decreased by EUR 19.4m from EUR 207.0m to EUR 187.6m. The main driver was the increase of 2.7 percentage points in the fulfillment cost ratio, which could not be fully offset by an improvement of 2.3 percentage points in the marketing cost ratio. With a net income of EUR 101.6m, Zalando remains overall sustainably profitable.

Adjusted EBIT

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

Zalando recorded an adjusted EBIT of EUR 215.1m in 2017 (similar to the prior-year amount of EUR 216.3m), which translates into an adjusted EBIT margin of 4.8% in 2017 (prior year: 5.9%).

EBIT comprises the following expenses from equity-settled share-based payments.

Share-Based Compensation Expenses per Functional Area

→ 25

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
Expenses for equity-settled share-based payments	**27.5**	**19.9**	**7.6**
Cost of sales	6.9	5.0	1.9
Selling and distribution costs	13.7	9.9	3.8
thereof marketing costs	6.9	5.0	1.9
thereof fulfillment costs	6.9	5.0	1.9
Administrative expenses	6.9	5.0	1.9

EBIT contains no non-operating one-time effects in 2017. The prior year's EBIT included a non-operating one-time effect of EUR 10.6m in other operating income (see section 3.5.7 (13.)). This was eliminated from adjusted EBIT accordingly.

Expenses for equity-settled share-based payments increased by EUR 7.6m compared to the prior-year period. As no non-operating one-time effects were recorded in 2017, but non-operating other income of EUR 10.6m was included in the prior-year period, adjusted EBIT decreased by only 1.2 percentage points compared to the prior-year period, whereas unadjusted EBIT decreased by 1.5 percentage points.

Results by Segment

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

Consolidated Segment Results → 26

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Revenues		
DACH	2,145.6	1,813.8
Rest of Europe	1,973.6	1,570.2
Other	369.9	255.1
Earnings before interest and taxes (EBIT)		
DACH	175.6	221.4
Rest of Europe	9.6	–6.2
Other	2.5	–8.1
Adjusted EBIT		
DACH	188.5	226.3
Rest of Europe	21.6	–3.3
Other	5.0	–6.7

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

Share-Based Compensation Expenses per Segment → 27

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016	Change
Equity-settled share-based compensation expenses	**27.5**	**19.9**	**7.6**
DACH	12.9	9.9	3.0
Rest of Europe	12.1	8.2	3.9
Other	2.5	1.9	0.7

EBIT contains no other non-operating one-time effects in 2017. The prior year's EBIT included non-operating one-time effects of EUR 4.9m in the DACH segment, EUR 5.3m in the Rest of Europe segment and EUR 0.4m in the Other segment.

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

In 2017, revenue grew by 18.3% in the DACH segment, by 25.7% in the Rest of Europe and by 45.0% in the Other segment, compared to the prior year.

Although revenue growth re-accelerated in the DACH segment in 2017, it showed good profitability with an EBIT margin of 8.2%. Compared to the prior year, EBIT margin decreased by 4.0 percentage points, which results from increased fulfillment costs, especially logistics costs, from a slightly decreased gross margin and from non-operating one-time effects in other operating income in the prior year, partly offset by an improvement in the marketing cost ratio. The increased volume of our curated shopping service, Zalon, which is especially strong in the DACH segment, also contributes to increasing fulfillment costs.

The EBIT margin in the Rest of Europe segment recorded an increase of 0.9 percentage points resulting in an EBIT margin of 0.5%. The EBIT margin increased primarily due to savings and efficiency gains in marketing costs, outweighing higher fulfillment costs. The EBIT margin in the Other segment improved by 3.9 percentage points from –3.2% to 0.7% in 2017, thereby reaching profitability in 2017. The increase mainly results from a gross margin uplift due to profitable sourcing deals.

Adjusted EBIT by Segment

In order to assess the operating performance of the segments, Zalando management also considers EBIT and EBIT margin before expenses for equity-settled share-based payments and non-operating one-time effects, if applicable. The DACH segment generated an adjusted EBIT margin of 8.8% in 2017. Compared to the prior year, the adjusted EBIT margin decreased by 3.7 percentage points. The Rest of Europe segment recorded an improvement in the adjusted EBIT margin compared to the prior year, which rose by 1.3 percentage points from –0.2% to 1.1%. The Other segment's profitability significantly increased, as adjusted EBIT margin improved by 4.0 percentage points from –2.6% in 2016 to 1.3% in 2017.

Cash Flows

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

Further Information Consolidated Statement of Cash Flows p. 140

Condensed Statement of Cash Flows

→ 28

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Cash flow from operating activities	**193.7**	**275.8**
Cash flow from investing activities	**–88.3**	**–277.1**
Cash flow from financing activities	**–10.6**	**–2.9**
Change in cash and cash equivalents	94.8	–4.1
Exchange-rate related and other changes in cash and cash equivalents	–1.9	0.5
Cash and cash equivalents at the beginning of the period	972.6	976.2
Cash and cash equivalents as of December 31	**1,065.5**	**972.6**

In fiscal year 2017, Zalando generated a positive cash flow from operating activities of EUR 193.7m (prior year: EUR 275.8m). Further to a decrease in pre-tax income (which decreased from EUR 192.9m in the prior year to EUR 175.2m in the reporting year), cash flow from operating activities decreased largely due to a higher cash outflow from working capital (prior year: cash inflow). This was partly offset by the increase in cash inflows for VAT receivables and VAT payables and prepayments received.

The capital employed in net working capital increased compared to the prior year and thus negatively impacts the cash flow. Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities, increased from a low level of EUR –127.6m in the prior year to EUR –62.4m as of December 31, 2017 (also see section 2.2.3 Financial Position for details on net working capital development).

The cash outflow from investing activities mainly results from investments in the logistics infrastructure relating primarily to the fulfillment centers in Mönchengladbach, Lahr and Szczecin and capital expenditures on internally developed software as well as furniture and fixtures. Capex, being the sum of the payments for investments in fixed and intangible assets excluding payments for acquisitions, amounted to EUR 243.9m (prior year: EUR 181.7m). Cash flow from investing activities further consists of cash disinvested in term deposits with an original term of more than three months and is therefore presented in cash flow from investing activities. As of December 31, 2017, an amount of EUR 40.0m was still invested in such term deposits (December 31, 2016: EUR 220.0m). In 2017, an amount of EUR 34.9m was invested in corporate acquisitions (prior year: EUR 30.4m).

Free cash flow decreased by EUR 148.7m from EUR 63.7m to EUR –85.0m compared to the prior year. The main factor for the decrease is the lower cash inflow from operating activities and the higher capex.

As a result, cash and cash equivalents increased by EUR 92.9m during the year, resulting in Zalando carrying cash and cash equivalents of EUR 1,065.5m as of December 31, 2017.

Zalando's liquidity position – as the sum of cash and cash equivalents plus term deposits with an original term of more than three months but less than twelve months – declined by EUR 87.1m in 2017.

Credit Facility

On December 15, 2016, ZALANDO SE concluded a revolving credit facility in the amount of EUR 500m with a group of banks, renewing its EUR 200m revolving credit facility secured in 2014. This facility can be drawn in various currencies. The revolving credit facility can be utilized for general business purposes (including acquisitions) as well as for guarantees. The facility expires on December 15, 2022, and may be extended until December 15, 2023. As of December 31, 2017, an amount of EUR 61.9m was utilized by bank guarantees and letters of credit.

Financial Position

The group's financial position is shown in the following condensed statement of financial position.

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Further Information Consolidated Statement of Financial Position p. 136

Assets

→ 29

IN EUR M	Dec 31, 2017		Dec 31, 2016		Change	
Non-current assets	569.6	19.1%	392.6	15.5%	177.0	45.1%
Current assets	2,410.7	80.9%	2,145.6	84.5%	265.0	12.4%
Total assets	**2,980.3**	**100.0%**	**2,538.2**	**100.0%**	**442.1**	**17.4%**

Equity and Liabilities

→ 30

IN EUR M	Dec 31, 2017		Dec 31, 2016		Change	
Equity	1,538.9	51.6%	1,407.5	55.5%	131.4	9.3%
Non-current liabilities	71.9	2.4%	32.5	1.3%	39.3	120.9%
Current liabilities	1,369.5	46.0%	1,098.2	43.3%	271.3	24.7%
Total equity and liabilities	**2,980.3**	**100.0%**	**2,538.2**	**100.0%**	**442.1**	**17.4%**

In 2017, total assets increased by 17.4%. The statement of financial position is dominated by working capital, cash and cash equivalents and equity.

In 2017, investments in intangible assets amounted to EUR 108.7m (prior year: EUR 80.0m), while investments in property, plant and equipment totaled EUR 189.7m (prior year: EUR 135.7m).

Key components of the software used by the group are developed internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes are supported using internally developed software. In fiscal year 2017, additions related to capitalized development costs of EUR 51.2m (prior year: EUR 57.7m), of which EUR 36.8m is contained in prepayments and assets under development (prior year: EUR 36.4m).

Inventories in 2017 mainly represent goods required for Zalando's wholesale business. The EUR 201.9m increase in inventories to EUR 778.9m resulted from the increased business volume and from holding larger amounts of inventory in stock in order to increase availability and thus customer satisfaction.

Trade and other receivables as reported on December 31, 2017, are all current. The increase of EUR 62.7m to EUR 278.7m is primarily attributable to the higher volume in business.

Equity rose from EUR 1,407.5m to EUR 1,538.9m in the fiscal year. The EUR 131.4m increase primarily stems from the net income in the period. In the reporting period, the equity ratio fell from 55.5% at the beginning of the year to 51.6% as of December 31, 2017, on account of the rise in total assets.

Further Information
Consolidated Statement of Changes in Equity p. 138

Current liabilities increased by EUR 271.3m in the reporting period. This increase is mainly attributable to trade payables and similar liabilities, which rose by EUR 199.5m from EUR 920.5m last year to EUR 1,120.0m in the reporting period. The increase is largely due to deliveries of merchandise in light of the higher business volume and longer payment terms. Moreover, under reverse factoring agreements, suppliers' claims against Zalando totaling EUR 328.9m were transferred to various factors as of December 31, 2017 (December 31, 2016: EUR 282.3m). These items were recognized in the statement of financial position under trade payables and similar liabilities.

Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities, increased from a low EUR –127.6m in the prior year to EUR –62.4m as of December 31, 2017. The increase results mainly from the increase in inventories, which reflects the higher business volume and the holding of larger amounts of inventory in stock in order to improve availability and thus customer satisfaction.

Overall Assessment

The Management Board views the business development in 2017 as positive. Zalando consciously focused on growth opportunities, made key strategic investments and yet remained clearly profitable in the process. The Zalando group increased its revenue markedly in fiscal year 2017 and captured additional market share. As Zalando continued to push forward with growth investments in the consumer and brand proposition plus infrastructure, the EBIT margin decreased slightly.

The company's revenue target was fully met in 2017, whereas the EBIT and EBIT margin targets had to be slightly adjusted during the year. The 2016 group management report anticipated revenue growth in 2017 in the corridor between 20% and 25% and an adjusted EBIT margin between 5.0% and 6.0%. In the second quarter of 2017, Zalando specified its guidance for revenue growth to the upper half of its guided range of 20% to 25% and for adjusted EBIT margin to the lower half of the range. In a challenging market environment, we had a weaker-than-expected October in 2017, which resulted in a slight guidance adjustment for adjusted EBIT margin in the fourth quarter. The modified guidance for an adjusted EBIT margin of slightly below 5% was met by year-end. In this context, a strong increase in the number of orders and a similar level of average basket size was expected. Sales growth met our guidance as sales increased by 23.4%. Thus, the group achieved its growth target for the third year in a row and delivered solid profitability slightly below the target set in the 2016 group management report.

2.2.4 Employees

At the end of 2017, Zalando had 15,091 employees (prior year: 11,998), representing an increase of 25.8% on the prior year. The average headcount grew by 2,904 to 13,940. The significant growth was strongly driven by the increasing headcount in the Operations Department.

Additional information regarding our sustainability strategy is provided separately in section 1.2 Corporate Responsibility.[28]

Further Information
Corporate Responsibility
p. 12

28) The sustainability report is not part of the audited combined management report.

2.3 Subsequent Events

There were no significant events occurring after the end of the fiscal year that could materially affect the presentation of the financial performance and position of the group.

2.4 Risk and Opportunity Report

- Comprehensive risk and opportunity management implemented throughout the group
- Risks and opportunities are continuously monitored and managed
- The risk matrix clusters risks by probability of occurrence and qualitative impact
- Zalando wants to use the opportunities to create added value
- There is no indication in the current opportunity and risk situation that the existence of ZALANDO SE as a going concern is jeopardized

Zalando is permanently confronted with risks and opportunities that may negatively or positively impact the group's financial performance and market position. The risk and opportunity report outlines our company's most important risks and opportunities.

2.4.1 Integrated Risk and Opportunity Management System

The Management Board of ZALANDO SE assumes overall responsibility for setting up and operating an effective risk and opportunity management system for the Zalando group.

GRI 102-11

Successful risk management depends on group-wide standards for systematically handling risks and opportunities. For this purpose, Zalando created the Governance, Risk & Compliance (GRC) Department which identifies risks and opportunities at an early stage. The GRC function continuously refines the implemented risk management instruments and methodology and coordinates the defined core process (GRC cycle). The GRC cycle is designed to support the decision-making process with consistent, comparable and transparent information via standardized procedures to identify, assess, monitor, document and report on risks and the measures implemented. These standards are defined in the GRC manual and aligned with the Management Board.

The GRC function reports on the overall risk situation to the Management Board and to the Supervisory Board's audit committee on a biannual basis. If needed, the regular reporting process is supplemented by ad-hoc reporting. All employees of Zalando are requested to manage risks in their activities adequately and prevent or mitigate risks that could jeopardize the company's ability to continue as a going concern. The Internal Audit Team reviews the functional capacity and appropriateness of the risk management system regularly. In addition, the audit committee of the Supervisory Board, with the involvement of the statutory auditor, also monitors the effectiveness of the internal control, risk management and audit systems.

2.4.2 Countermeasures and Internal Control System

Zalando reviews all identified risks and opportunities at least twice a year to determine whether they are still valid and assessed correctly. The documentation is updated during each GRC cycle in the comprehensive risk catalog, which is set up as a risk control matrix (RCM). Relevant countermeasures, controls and responsibilities are assigned to each risk. The adherence and effectiveness of the relevant countermeasures and controls is assessed on a risk-based approach by the Internal Audit Team as part of their scheduled audits throughout the Zalando group.

System of Internal Financial Reporting Controls

In addition to the overall risk and opportunity management system described above, Zalando has implemented a more detailed system of internal financial reporting controls. Pursuant to Section 315 (4) HGB the key features of this system are explained below. It aims to identify, assess and manage all risks that could have a significant impact on the proper preparation of the separate and consolidated financial statements. As an integral component of the accounting and reporting process, the system of internal financial reporting controls comprises preventive, monitoring and investigative control measures in accounting and operational functions which ensure a methodical process for preparing the financial statements. The control system is based on the various company processes that have a significant impact on financial reporting.

These processes and the relevant risk for the financial reporting are analyzed and documented. A cross-process risk control matrix contains all controls, including a description of the control, type of control, frequency with which it is carried out, the covered risk and the person responsible. The control mechanisms implemented affect multiple processes and thus frequently overlap. These mechanisms, among other things, include determining principles and procedures, defining processes and controls, introducing approval and testing plans and guidelines. The group-wide accounting manual provides detailed accounting instructions; the processes for assessing inventories and receivables are central components. The system of internal controls is subject to regular reviews by the Accounting Department and modifications resulting from risk workshops conducted by the GRC Department or risk-based assessments performed by Internal Audit.

2.4.3 Risk Methodology and Reporting

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All risks identified are assessed based on their probability of occurrence and their potential impact within a one-year time horizon after the assessment date.

The impact assessment is conducted either on a quantitative scale (preferred) or a qualitative scale. The quantitative classes are based on a scale relating to the potential financial impact on profit (EBIT). Qualitative classes are based on criteria considering the impact on the company's reputation or the effect of criminal prosecution (with special focus on compliance risks). The risks are presented net, meaning the risk-minimizing measures implemented are considered in the scoring of risks.

Each risk is positioned in the risk matrix using the following approach:

Zalando Risk Matrix

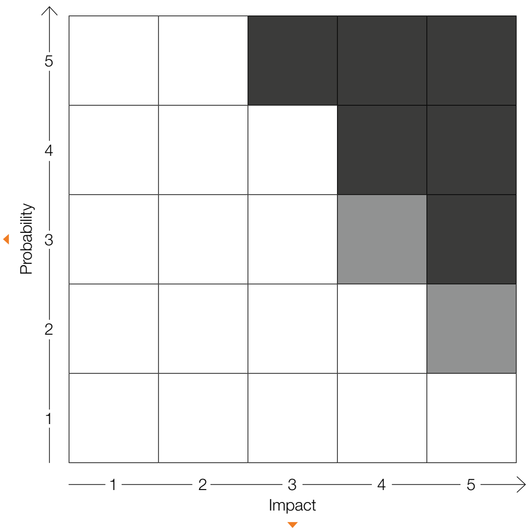
→ 28

Skip to p. 118

Probability of occurence (within the following year)

Class	Probability	Average
1	very low (0%–5%)	2.5%
2	low (5%–25%)	15%
3	medium (25%–50%)	37.5%
4	high (50%–75%)	62.5%
5	very high (75%–100%)	87.5%

■ Zalando top risks
■ Zalando expanded risk focus



Quantitative impact (preferred)

Class	Loss amount
1	EUR 0.075m–EUR 0.2m
2	EUR 0.2m–EUR 1.5m
3	EUR 1.5m–EUR 10m
4	EUR 10m–EUR 75m
5	> EUR 75m

Qualitative impact (alternative)

Class	Reptutational effect	Criminal prosecution
1	very low	very low
2	low	low
3	medium	medium
4	high	high
5	very high	very high

In addition, risks in impact class 5 (quantitative) that exceed EUR 250m are denoted as risks that could jeopardize the company's ability to continue as a going concern.

All single risks and opportunities assessed as significant (Zalando top risks; Zalando expanded risk focus) using this methodology are described in detail in the section below. Overarching market opportunities and general opportunities are described in a separate section.

2.4.4 Overview of Current Risks and Opportunities

In general, it cannot be ruled out that potential risks that are currently unknown or considered as insignificant may negatively impact the business in the future. Despite all countermeasures implemented to manage the identified risks, residual risks for all corporate activities that cannot be completely eliminated by a comprehensive risk management system still remain. Altogether, the risks are to be regarded as customary to an online retail business.

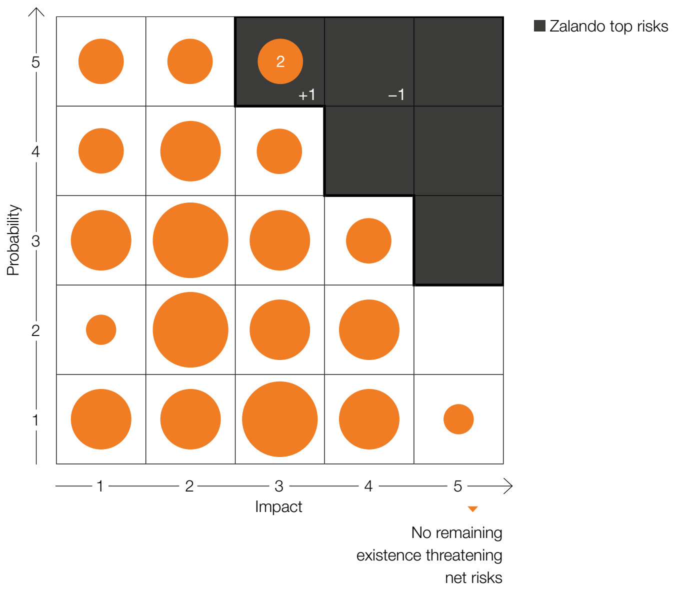
There are currently no net risks that would jeopardize the company's ability to continue as a going concern. Nevertheless, we deem two risks to be significant (top risks described below).

Risks with a Crucial Combination of Probability and Impact (Top Risks)

Based on the net risk view, risks are defined as top risks if they display a crucial combination of probability and impact (denoted by the dark grey-shaded area in the matrix).

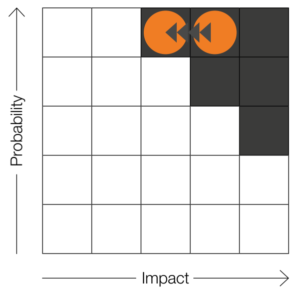
Number of Top Risks (Net)

→ 29



Currently, risks from bad debt loss/external fraud and risks from overall outages with customer impact are considered as top risks for Zalando. Both risks were also part of the top risk section in fiscal year 2016 and are outlined below.

Risks of Payment Default / External Fraud (Focus on Payment Transactions in the Retail Business)

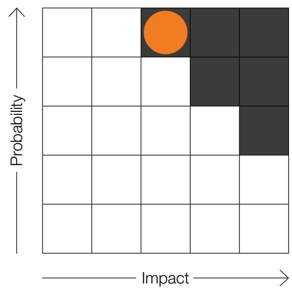


Probability: very high
Impact: medium

The business concept of Zalando includes the offering of deferred payments (invoice) to its customers. Inherent to this payment method is a certain default quota that is to some extent anticipated by Zalando. The default risk is the risk that customers do not fulfill their contractual obligations and receivables remain unpaid. This can be the result of customers' payment habits or financial situation, or can be the result of fraud. Although applying multiple measures including a comprehensive payment and fraud management system to cope with the financial risk from default, the risk's probability remains at a high level. The size of Zalando's overall business produces large absolute deviations even with minor deviations from the planned relative ratios.

For the assessment of the risk, we considered a deviation from the anticipated level of bad debt loss. This anticipated bad debt loss is budgeted in our planning. In previous years, a general assessment of the bad debt loss was applied where the risk represented the full amount of defaults. As we anticipate the majority of the bad debt loss actually occurring as part of Zalando's business model and provide for it in the planning process, the risk assessment has been revised. Hence, the displayed risk shows the probability and deviation from the anticipated bad debt loss.

Risks from Overall Outages with Customer Impact (Focus on Technology)



Probability: very high
Impact: medium

As an e-commerce company, Zalando is dependent on the functionality and stability of various online sites and services. Disruptions or outages would lead directly to revenue losses. The risk of unstable IT systems also applies to merchandise management and logistics. Interrupted workflows or inconsistent updates of stock may also result in considerable short-term revenue losses.

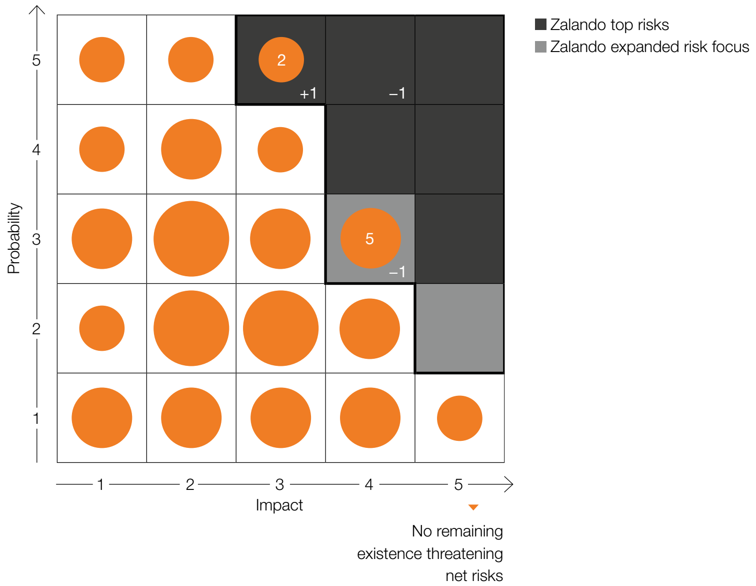
Monitoring systems are used, and incident management processes are established and documented. Incident management includes monitoring the financial impact and enables material incidents to be prioritized and solved. A system dashboard, which is continuously being improved, is utilized. Outsourced services (e.g. data center) are integrated in the monitoring processes, and adequate service level agreements are contracted. The Platform Infrastructure Team is responsible for ensuring these standards are in place throughout the development and deployment processes. Moreover, a "lessons-learned" process is implemented that, in case of system breakdowns, ensures that adequate measures derived from each incident are taken.

Preventive measures are implemented, and, in most cases, redundant systems are implemented, depending on the respective system. The group-wide incident management process was optimized with the implementation of a new automated incident management solution. To enable the teams to react faster, 24/7 availability of the teams was rolled out for approx. 60% of the technical engineers. To further improve monitoring and incident management, it is planned that SLI (service level indicators) & SLO (service level objectives) for each application are defined based on criticality, interdependencies to other systems, and customer impact.

Expanded Risk and Opportunity Area

Risks and opportunities delineated by the light grey margin as shown in the matrix are considered to be significant risks due to the combination of a certain level of probability and a certain level of impact.

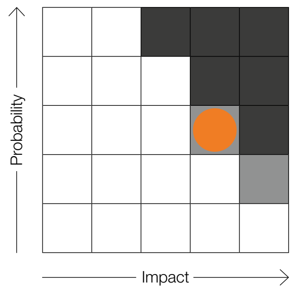
Number of Significant Net Risks → 30



The number of risks within the Zalando expanded risk focus was reduced from six to five compared with fiscal year 2016, as additional implemented countermeasures are mitigating the "risk of missing market opportunities due to insufficient branding of private labels." Despite the fact that the risk is no longer part of the expanded risk area, it is still closely monitored by the respective department, and additional countermeasures are planned for implementation.

Risk of Strike

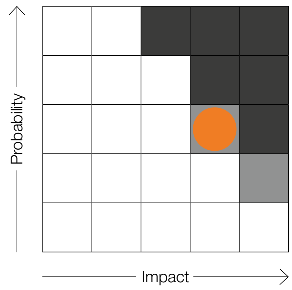
Risks may emerge from strikes by workers employed in our warehouse facilities. The risk depends on various internal and external factors, including the degree to which the workforce is organized (membership in unions), the satisfaction of the workforce with the working conditions as well as activities of the unions regarding the industry in general or Zalando in particular. Strikes can lead to increased fulfillment costs, e.g. from dealing with backlogs and delays.



Probability: medium
Impact: high

Zalando invests into good relationships with its employees. Zalando implements social standards audited by an external audit company and an open and continuous dialogue with its employees. The comprehensive wage strategy is guided by the relevant regional collective agreements for the logistics industry. Furthermore, Zalando strives to offer a good working environment and conditions, offers comprehensive employee development programs, and nurtures open and constructive communication with employees and their representatives.

Opportunities from Improved Forecasts Planning and Alignment of the Categories and Assortment



Probability: medium
Impact: high

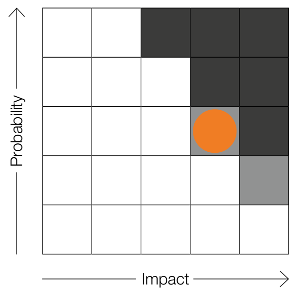
Opportunities may be put at risk due to insufficient coordination of higher-level sales and sourcing planning. Lack of coordination and changes to plans may lead to planning errors. Furthermore, there is a risk that forecasts may be incorrect, meaning that predetermined budgets were calculated inaccurately. This, in turn, could lead to suboptimal budgeting in the different categories and unfavorable sourcing activities as well as missing logistics capacities.

Likewise, a forecast that delivers reliable predictions in combination with adequate coordination of higher-level sales and sourcing planning will enable Zalando to generate additional value throughout the budgeting and sourcing activities.

Zalando has set up a planning process on a rolling basis, which is carried out twice a year. The process is supported by the Merchandise Financial Planning function (MFP) and is managed overall by Category Controlling. Pre-season planning is prepared by the teams responsible for country clusters in cooperation with the individual Category Management Teams and brought into line with the higher-level category management planning. The plans are continuously refined with regular updates during the seasons (in-season planning). As deviations from the planned budget are likely to occur, adjustments in budgets are possible at short notice. Regular meetings on updates of plans take place, and the plans are aligned between category managers and other relevant departments.

The product-specific sales risk is countered by continuous sales analyses and budget planning. Zalando uses a detailed indicator system to identify negative discrepancies at an early stage and to implement appropriate measures in order to monitor and manage sales and stock levels. Additional flexibility can be achieved through follow-up orders. Returns to the supplier are negotiated and contracted to further mitigate the risk. In addition, Zalando recognizes write-downs on inventories to a sufficient extent. Inventory risk is an inherent risk to our business model and can have an impact anywhere along the supply chain.

Risks from Lack of “State of the Art“ Shop and Service

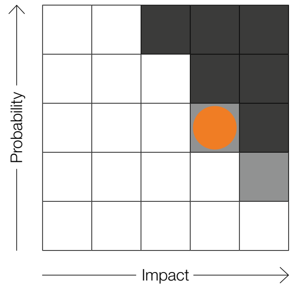


Probability: medium
Impact: high

In order to meet the rising and changing demands on lifestyle products and service and to realize market opportunities, innovative and appropriate adjustments constantly have to be made to the shops. Neglecting the necessary adjustments or inadequate implementation of such measures can lead to customer migration away from Zalando, followed by significant revenue losses.

A significant overarching countermeasure is the establishment of the Digital Experience Team for the Fashion Store with dedicated ownership for the evolution of the Fashion Store on-site experience. The team identifies and suggests relevant developments and adjustments and coordinates implementation with stakeholders, thus ensuring the continuous development of the shops.

Risks from Changing Regulatory Requirements within the Markets



Probability: medium
Impact: high

With business activities in various countries, risks can arise from the quickly changing regulatory environments in many of them. Potential risk scenarios involve additional costs for necessary adjustments (customs, product safety, working conditions, product offering, consumer protection, etc.). In addition, subsequent events (exchange rate changes, unexpected customer behavior, reputational risks) can lead to increased damage. The risk exposure is mainly driven by anticipation of near-future to mid-term regulatory instruments in the context of the Digital Single Market initiative (DSM), the e-commerce sector inquiry of the EU Commission and the ePrivacy legislation. Risks might also arise due to legal uncertainties with regard to the implementation of recent enacted regulatory changes, such as the General Data Protection Regulation (GDPR) becoming applicable in May 2018. Attempts to address related issues within the member states or by events subsequent to Brexit are another risk factor. Changes in the regulatory framework can necessitate amendments to processes and business cases entailing an increase of costs or reduction of sales.

To reduce negative impact from regulatory changes, the GRC Department has implemented a Regulatory Watch process. This process ensures that relevant regulatory and legal topics are additionally allocated to the individual internal functions (e.g. Tax) that ensure the monitoring of changes throughout the markets by mandatory regular reports from these functions. The implementation of appropriate measures is initiated by the department to which responsibility for the respective topic is assigned.

The Regulatory Watch process is supported by Zalando´s Legal Teams, who monitor regulatory changes by utilizing different channels (e.g., conferences and seminars, cooperation with external law firms, latest specialist literature) and initiate appropriate countermeasures together with the departments affected.

With regard to the main risk drivers, Zalando initiated the following mitigation measures:

DSM: Zalando's Public Affairs Team has started a dialogue with external stakeholders at EU level to give feedback and receive updates concerning planned regulations. Developments are being monitored and examined by the Legal Team for possible effects on Zalando's business case.

GDPR: The Data & IT Law Team, in close cooperation with the teams in Digital Foundation and Tech-Security, have set up and are executing a GDPR project, implementing previously identified new and changed regulatory requirements arising under the GDPR. In the process, the teams are reviewing, updating and refining the overarching privacy design and information security setup at Zalando.

ePrivacy: The Data & IT Law Team performed an in-depth analysis of the regulatory changes set out in the drafts of the ePrivacy regulation (ePrivacy Drafts) published by EU policy makers during the 2017 fiscal year. Together with relevant internal stakeholders, potentially affected business cases have been identified, and the risks emanating from the ePrivacy Drafts have been assessed, qualified and prioritized. Subsequently, mitigation measures were put into action. These include engagement with policy makers on the national and EU levels in close coordination with the Public Affairs Team and the preparation and roll-out of innovative solutions, workarounds and initiatives with external business partners, each with a view to reducing the potential impact on the identified business cases.

EU e-commerce sector inquiry: Zalando cooperated with the EU Commission and provided appropriate information following a request for information. The EU Commission adopted the final report on its inquiry and subsequent enforcement measures are being monitored closely by Zalando.

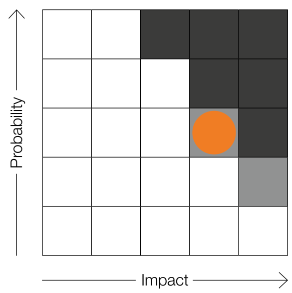
Brexit: a task force has been set up by the Legal Team to gather and evaluate Zalando-specific risks as a result of Brexit.

Risks from a Lack of Innovation Capabilities

The ability to promptly implement innovations as well as products catering to current market trends is a precondition for sustainable success. A strong innovation culture needs to exist throughout the company. Structures, decision making and budgets need to ensure the desired innovation capability.

To ensure innovativeness, the management ensured that a number of management principles were implemented to foster an innovative culture, such as the concept of agile software development (radical agility) and the concept of de-centralized decision making (dedicated ownership).

Project proposals are continuously being prepared and validated by dedicated owners, and projects concerning customer benefits are being prioritized.



Probability: medium
Impact: high

Financial Risks

Zalando is required to describe its financial risks pursuant to Section 289 (2) No. 1b HGB. In the course of its ordinary activities, Zalando is exposed to counterparty risk, liquidity risk, and currency and interest-rate risks. The aim of financial risk management is to limit the risks resulting from operating activities through the use of selected derivative and non-derivative hedging instruments. Derivative financial instruments are used solely for the purpose of risk management.

Counterparty Risk

Counterparty risk refers to the risk that a counterparty may default on its obligation to Zalando. The default risk mainly arises from trade receivables and, to a lesser extent, in terms of probability of occurrence from claims originating from financial contracts with other parties, e.g. term deposits, derivative financial assets and bank account balances.

The company addresses this exposure by distributing its derivative financial instruments and cash held at banks over multiple financial institutions to minimize risk exposure to a single counterparty (also by setting maximum investment amounts). In addition, counterparty credit rating criteria are applied as well.

Liquidity Risk

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

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

Currency and Interest Rate Risk

The currency risk is defined as the risk of differences in actual and planned foreign exchange revenue and cost items as a result of fluctuating exchange rates, with a potential negative impact on the company’s financial results. Likewise, the interest rate risk is defined as the risk of changes in interest due on maturing debt as a result of varying reference interest rates, with potential negative implications for interest expenses.

Zalando operates in different markets and is therefore exposed to foreign currency risk generated from revenues and sourcing transactions in foreign currencies. Currency exposure is managed by means of regular cash pooling to the EUR as the functional currency, natural hedging, and forwards hedging.

Forward contracts are recognized as cash flow hedges if the conditions of hedge accounting are fulfilled. Once the hedged item has been realized as a cash flow hedge, the forward exchange contracts are used as fair value hedges to compensate for market value fluctuations of the outstanding trade receivables and trade payables and similar liabilities denominated in foreign currency. Forward exchange contracts are concluded with a term not exceeding 18 months. Derivative financial instruments are concluded and processed in accordance with internal guidelines that set out binding rules for the scope of action, responsibilities, reporting and controls.

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

If the euro had appreciated by 5% against the foreign currencies as of December 31, 2017, earnings before taxes would have been EUR 5.0m lower (prior year: EUR 7.3m). If the euro had depreciated 5% compared with the exchange rate as of December 31, 2017 earnings before taxes would have been EUR 5.6m higher (prior year: EUR 8.1m).

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

Foreign Currency Sensitivity on Profit or Loss 2017

→ 31

	Impact on profit or loss							
IN EUR M	CHF	DKK	GBP	NOK	PLN	SEK	USD	Total
FX rate as Dec 31, 2017	**1.1702**	**7.4449**	**0.8872**	**9.8403**	**4.1770**	**9.8438**	**1.1993**	
5% increase in FX rate	– 1.2	– 0.4	0.0	– 0.3	– 1.9	– 0.2	– 0.9	– 5.0
5% decrease in FX rate	1.3	0.5	0.0	0.3	2.1	0.2	1.0	5.6

The reserve for derivatives in group equity would have been EUR 38.8m higher (prior year: EUR 34.6m higher) if the euro had appreciated 5% compared with the exchange rate as of December 31, 2017. This reserve would have been EUR 42.9m lower (prior year: EUR 38.2m lower) if the euro had depreciated 5%.

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

Foreign Currency Sensitivity on Other Comprehensive Income 2017

→ 32

	Impact on other comprehensive income							
IN EUR M	CHF	DKK	GBP	NOK	PLN	SEK	USD	Total
FX rate as Dec 31, 2017	**1.1702**	**7.4449**	**0.8872**	**9.8403**	**4.1770**	**9.8438**	**1.1993**	
5% increase in FX rate	26.4	0.0	– 0.8	5.1	8.0	7.0	–6.9	38.8
5% decrease in FX rate	– 29.2	0.0	0.9	– 5.7	– 8.9	– 7.8	7.7	– 42.9

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

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

Market Opportunities

Macroeconomic Development

The European Commission projects eurozone growth of 1.8% in 2018 and EU growth of 1.8%[29]. Private consumption is expected to be one of the main drivers of growth during the forecast period. Labor market gains across important European economies will also contribute to an increase of disposable income in real terms. The World Bank's forecast is also optimistic, with growth in the region predicted to accelerate to 2.1% in 2018 – and an average of 1.6% between 2019–2020[30], driven by a recovery in commodity-exporting economies and improved confidence. This outlook is predicated on the basis of a continued, but modest, recovery in commodity prices and easing geopolitical tension.

In Germany, it is expected that growth momentum will continue. The solid labor market, resilient exports and booming construction investment are expected to provide a boost to growth and drive private consumption. These developments give Zalando a favorable economic and consumer market to reinforce its market position and increase its revenue.

Growing Fashion Market in Europe

European online fashion sales amounted to roughly EUR 55.6bn in 2017, making up 13%[31] of all fashion retail[32]. While the overall market for fashion in Europe (excluding Russia) remained virtually unchanged between 2016 and 2017, online fashion sales grew at a considerably faster rate with average annual growth (CAGR) of approximately 12% during the past 5 years.[33] This trend is forecasted to continue as the percentage of people in the overall population who became familiar with digital technology at a young age continues to rise.

Europe is a highly attractive fashion market with concentrated wealth and a high population density. These factors work to the advantage of online fashion sales.

Zalando is well positioned to benefit from these favorable market conditions due to the strength of its fashion brand, its consumer reach, its brand partner relationships, the scale of its technology and fulfillment operations across European markets, and its deep understanding of the digital economy.

The online retail market in Europe reported revenue totaling EUR 55.6bn in 2017, with a CAGR of 12% since 2012.[34] While the online share of retail trade in the United States came to 20% in 2017[35], the online share of retail trade in Zalando's target market, Europe, rose from 13% in 2016 to 15% in 2017[36].

As the online retail market continues to grow, Zalando's focus on providing customers with unique fashion experiences, convenient delivery services, and a leading digital shopping experience puts the group in a favorable position to further expand its revenue and market share. As Zalando

29) European Commission 2017
30) World Bank 2018
31) Euromonitor, Europe excl. Russia
32) Euromonitor, Europe excl. Russia
33) Euromonitor, Europe excl. Russia
34) Euromonitor, Europe excl. Russia
35) Euromonitor, United States of America
36) Euromonitor, 15 countries, in which Zalando operates

further cements its position as a trusted and well-loved fashion companion, we will continue to win new customers and retain existing ones for the long term. Most importantly, the strategic realignment to move towards a platform business model will create new opportunities for growth. It is envisioned that the platform business model brings together different fashion stakeholders, which will in turn help to enhance selection, expand inspiration channels, and improve convenience services. Moreover, Zalando can continue to exploit the high online market potential for European fashion through its presence, which now extends to 15 European countries, and the constant expansion of its own product range.

Mobile Commerce

Mobile commerce provides a significant opportunity. Retail sales generated via mobile devices have risen significantly within Europe, amounting to EUR 85.56bn in 2017 compared to EUR 67.31bn in 2016[37]. Moreover, a further growth at a 13% CAGR is expected in the upcoming years.[38] This growth has been driven by the ubiquity of mobile device usage. Today's customers use their mobile devices on a daily basis to engage in a wide variety of activities ranging from browsing and shopping for products, interacting with brands on social media channels, scheduling deliveries, to tapping their smart assistants for product and sizing recommendations.

As the number of mobile commerce use cases continues to multiply, we see a parallel trend whereby users are starting to rely on a smaller number of apps to power their mobile channel experiences. At Zalando, we are aware that in order to differentiate ourselves and stay relevant, we need to leverage our mobile channels to connect customers with the right information in order to help them make informed shopping decisions. With this goal in mind, Zalando's focus is on designing superior mobile experiences to meet the customer anytime, anywhere: be it on its mobile app, its mobile site, social apps, or other connected devices. As a customer centric-company, Zalando is constantly looking for innovative ways to leverage mobile channels to interact with customers, empower them, and help them discover fashion in new and inspiring ways. During 2017, Zalando set up a dedicated team around mobile apps to gain speed on the development of mobile products, to improve the technical foundation and the ways to market apps on different channels (e.g. Facebook, Google, Snapchat).

General Opportunities Arising from Zalando's Business Activities

Innovative and Scalable Logisitics

Over the past few years, Zalando has made significant investments to expand and automate its pan-European logistics network – now consisting of seven fulfillment centers in four countries – such as implementing and ramping up a bag-sorter in Mönchengladbach, bringing our warehouse operation to a new level of automation. In 2017, a new fulfillment center in France near Paris went live, and another one in Sweden commenced operations but is still under construction. Another new fulfillment center in Poland started initial operations in fall 2017, while two additional new fulfillment center projects have been initiated – one in Poland and another in Italy. All these efforts are aimed on getting closer to Zalando's customers, thus providing an opportunity to further reduce lead times as well as preparing our network for further growth.

zln.do/en-logistics-network

Scalable and innovative logistics provide a source of new growth opportunities for Zalando. They not only enable the company to expand its coverage of convenience benefits, but they also enhance Zalando's attractiveness as an essential and effective logistic partner for fashion brands and retailers.

37) Euromonitor, Europe excl. Russia
38) Euromonitor, Europe excl. Russia

In 2017, Zalando extended the service Zalando Fulfillment Solutions (ZFS), making logistics infrastructure and know-how available to brand partners. Through this new service, partners such as Bestseller can now leverage Zalando's logistic capabilities to scale up their businesses internationally and provide the highest delivery standards for their customers across Europe. Currently, ZFS is supported by one dedicated fulfillment center, but the goal is to roll out this offering to more fulfillment centers. ZFS will play a critical role in supporting the growth of Zalando's Partner Program.

zln.do/en-zfs

Innovative logistics are a crucial component behind Zalando's convenience proposition as they enable the company to meet customers' heightened convenience expectations. Faster deliveries and a growing number of delivery options tailored to customer needs would not be possible without innovative logistics, e.g. new services such as same day delivery and return on demand in selected cities. These initiatives are then also leveraged to bring to life services such as "From Store to Door"– direct deliveries from retail stores of selected brand partners to their customers' homes. Zalando is committed to enhancing its innovative and scalable logistics in order to help brand partners grow and to ensure that customers' shopping experience becomes even easier, faster, and more convenient.

zln.do/en-post-order-experience

Smart Data

Data is at the core of Zalando's platform. By combining data with appropriate technology tools, Zalando is able to effectively play a matchmaking role and facilitate frictionless interactions between supply- and demand-side players in the fashion ecosystem. In this regard, the Zalando platform is geared towards increasing legally compliant data flows between platform stakeholders (e.g. fashion brands, manufacturers, stylists, content creators, logistics, and service providers) in order to unlock new growth opportunities and generate additional value for everyone.

Gaining a good understanding of customer preferences and fashion trends is a prerequisite for effectively connecting platform stakeholders and enabling new ways of consuming and producing fashion. Zalando also leverages data to optimize every aspect of the business through more accurate production forecasts, improved personalization, targeted advertising and smart fulfillment services. The company's overarching objective is to develop scalable solutions that can help both brand partners and customers navigate the digital fashion universe.

zln.do/en-zms

Innovative Technology

Technology forms the backbone of Zalando and drives all workflows – from automating wholesale buying, personalizing customer's' shopping journey, to seamlessly connecting fashion partners' stock to online platforms. Furthermore, technology not only underpins every internal business process and digital solution offered on the platform, but it is also increasingly leveraged to reduce inefficiencies in the broader fashion ecosystem.

Due to the increased complexity of digital infrastructure, fashion brands and retailers need additional support to digitalize their businesses. In this context, Zalando's ability to combine fashion competence with advanced technological capabilities makes it an attractive partner to help brands and retailers accelerate their online growth. Customers also benefit from technological advances. Zalando is currently building the infrastructure needed to move from recommendations to personalized fashion advice across all customer touch points. New solutions, powered by artificial intelligence (AI), are being implemented to help customers find their unique size and fit preferences.

zln.do/en-personalization

Technology is not only a major driver of efficiencies in the fashion ecosystem, but it is also a source of new models and opportunities to produce, consume, and discover fashion. Through continuous investments and strategic acquisitions, Zalando intends to consolidate its position at the forefront of the technological transformation of the fashion ecosystem.

Local Alignment

The European market is extremely heterogeneous, with highly localized needs for fashion styles, payment methods, and delivery options. No other online fashion retailer understands the particularities of all European markets as well as Zalando does. The company is able to adapt its customer and partner proposition to every single market in which it operates. Localization is – and will continue to be – one of Zalando's core differentiators. We will continue building our image of a local fashion specialist through country-specific campaigns and by reflecting local characteristics in our respective sales approach.

At the same time, Zalando uses a central platform and infrastructure to source its merchandise, fulfill orders, and leverage technology solutions across Europe. This approach provides a source of additional competitive advantages since it generates economies of scale that make platform investments possible. These capabilities endow Zalando with first-mover advantages to pursue new opportunities and quickly respond to fast fashion trends emerging across markets in Europe.

Fashion Expertise

zln.do/en-assortment

Consumers tend to move towards those shops offering the best selection and the relevant trends. Meeting this challenge requires fashion competence and the ability to design an exciting and personalized fashion experience. To prevail over the competition, Zalando has systematically developed these skills in a number of different ways.

With its internally designed labels, Zalando offers products whose lifecycle is managed under one umbrella from the design phase right through to sale. Zalando has succeeded in creating popular brands with a loyal customer base and has started to also offer the products through additional external distribution channels.

To remain at the cutting edge, Zalando's trend scouts intensively search the markets and fashion centers to predict and also set the trends for the coming season.

zln.do/en-zalon

Having built up a base of about 500 freelance stylists under the Zalon brand, Zalando has access to a huge pool of fashion experts willing to build a business together with Zalando and bringing in deep fashion knowledge from a vast number of different fashion markets. At Zalon, the stylists are able to offer a highly personalized experience since not one single box they put together resembles another. Adding additional services to our offering, such as most recently subscription and messaging, Zalando is able to leverage stylists' skills even more in the future, contributing to an inspiring and convenient customer journey.

An Attractive Partner

zln.do/en-partner-solutions

Fashion brands and retailers value Zalando as a preferred partner due to its fashion competency and technological capabilities. Zalando supports partners to connect with customers across Europe and helps them tackle some of the most complex and challenging issues that they face across the fashion ecosystem. In this sense, Zalando enables brands and retailers within its Partner Program to sell their merchandise via the Zalando platform and provides tools that are necessary for partners to adjust their digital content across the markets. Zalando's online flagship stores are at the heart of this approach, enabling partners to interact directly with customers and build loyalty for their brand.

In response to the rapid pace of transformation in the fashion ecosystem, Zalando has expanded its partner proposition to help brands stay on top of new developments and technologies. The company has moved beyond providing data insights tools to offering holistic technology solutions tailored to partners' specific needs. This includes, but it is not limited to: Zalando Fulfillment Solutions (ZFS), stock integration technologies, and marketing and advertising services. The overarching goal is to help brands grow their online presence by helping them to simplify their e-commerce operations both on and off the Zalando platform. As Zalando continues to innovate its partner offering, new and interesting opportunities emerge to create new fashion products and services on top of the platform.

Personnel Opportunities

Zalando's successful growth is based on the competencies and motivation of its employees. Due to the considerable growth of its core business, the penetration of new business areas, and the rapid international expansion, Zalando constantly needs to strengthen its team. This is supported by an improved performance and development approach for all employees and by diverse initiatives to foster our culture at Zalando.

Recruiting plays a key role in human resources work. Recruiting highly skilled employees can help boost efficiency and foster innovation and creativity, thus increasing revenue and profitability. The recruiting process therefore was improved by different tools to speed up the process and to support the hiring of desired talents.

2.5 Outlook

- Significant growth is again forecast for internet retailing in Europe and Germany
- For 2018, a 9.7% increase in online fashion sales is forecast for Europe, while 14.8% is forecast for Germany
- Zalando aims to continue its course of profitable growth and capture further market share
- Revenue in 2018 is set to grow by 20% – 25%, adjusted EBIT is expected to be between EUR 220m and EUR 270m

2.5.1 Future Overall Economic and Industry-Specific Situation

European online retail is expected to see continued strong growth. The European retail industry is expected to achieve year-on-year growth of just 1.5% in 2018, while online retail is expected to grow by 13.2%.[39] Similarly, in Germany the retail forecast is 1.9% growth, whereas internet retailing is set to grow by 10.9% in 2018.[40]

The online fashion industry in Europe and Germany is also predicted to enjoy continued growth. Fashion sales in Europe are expected to grow minimally at 0.8%, while fashion sales in Germany are expected to grow even more slowly at 0.3%.[41] In contrast, online fashion sales are expected to grow significantly faster in both regions. Online fashion sales in Europe are expected to increase by approximately 9.7% in 2018, while predictions for Germany anticipate strong growth of 14.8%[42] compared with the previous year.

Due to its wide brand awareness among European consumers, a large customer base, strong supplier relationships, its infrastructure footprint and its fashion and mobile technology capacity, Zalando is certain that it is well positioned to benefit from these favorable market conditions. The high emotional factor that both brands and customers associate with fashion also provides independent and pure-play fashion e-commerce retailers, like Zalando, a considerable advantage over non-specialized e-commerce retailers.

2.5.2 Future Development of the Group

i

End of the Quick Reader Information

The goal is to grow further significantly faster than the online market, thereby strongly growing the company's market share. This growth will be enabled through continued investments in Zalando's customer proposition. Management believes this is the value-maximizing strategy for the company. As such, investments will continue also throughout 2018 into the most important elements of Zalando's customer proposition:

- Digital experience: we focus on building the leading digital experience in fashion e-commerce. A key driver of customers' experience is the level of personalization. With our ever-increasing assortment, it is important that we tailor the offering towards individual customers. As such, Zalando aims to provide every customer with his or her own personalized Zalando store.
- Convenience: Zalando continues to invest heavily in convenience for its customers. In 2018, Zalando will further automate its existing logistics footprint to increase efficiency and speed.

39) Euromonitor, Europe excl. Russia, Germany
40) Euromonitor, Europe excl. Russia
41) Euromonitor, Germany
42) Euromonitor, Europe excl. Russia, Germany

The construction of two fulfillment hubs in Poland and one in Italy as well as a satellite warehouse in Sweden will continue. Additionally, we will build a new fulfillment center for our Lounge business.

- Assortment: Zalando provides customers in 15 European markets with access to more than 300,000 articles from almost 2,000 brands and aims to launch two additional European markets this year. We work towards continued progress through an ongoing expansion of our assortment, including the launch of additional brands, initiation of beauty as a new category, and the further expansion of our Partner Program.
- B2B services: the further build-out of platform initiatives such as Zalando Media Solutions and Zalando Fulfillment Solutions will enable additional growth opportunities.

In short, we will continue to work hard to make our customers' journey even more exciting.

As the European online fashion market is expected to grow at roughly 10% during 2018[43], Zalando targets to grow significantly faster and further build its markets share: the company forecasts revenue growth within a corridor of 20% to 25% in fiscal year 2018 (fiscal year 2017: 23.4%). The strong revenue growth is expected to be primarily driven by an increase of the active customer base as well as an increase in the number of orders per active customer. As in the past, we expect that both drivers contribute in a balanced way.

Zalando expects to continue to grow profitably, showing growth also in its adjusted EBIT in 2018. The company expects adjusted EBIT of EUR 220.0m to EUR 270.0m (EBIT EUR 185.0m to EUR 235.0m) (fiscal year 2017: adjusted EBIT of EUR 215.1m; EBIT of EUR 187.6m).

Due to continued strong logistics investments, the capex volume is expected to stay at an elevated level of around EUR 350m.

2.5.3 Overall Assessment by the Management Board of ZALANDO SE

Overall, the Management Board views the developments in fiscal year 2017 and the economic position of Zalando as positive. The group returned a profit once again at group level in the fiscal year. Zalando showed significant growth, made important long-term investments and achieved a solid level of profitability. The company has grown considerably in all markets and has improved its market position further. In 2018, Zalando expects to be able to continue the strong business performance seen in the past fiscal year.

The comments on future development in this management report are made by the Management Board to the best of their knowledge and belief based on estimates made at the time these financial statements were prepared. The statements are by nature subject to a series of risks and uncertainties. The actual results may therefore deviate from these forecasts should one of these or other uncertainties arise or the assumptions on which the statements are made prove to be inaccurate.

43) Euromonitor, Europe excl. Russia, Germany

2.6 Supplementary Management Report to the Separate Financial Statements of ZALANDO SE

The management report of ZALANDO SE as a separate entity and the group management report have been combined. The following notes are based on the annual financial statements of ZALANDO SE, which were prepared in accordance with the provisions of the German Commercial Code and the AktG ["Aktiengesetz": German Stock Corporation Act] in conjunction with Art. 61 EU CR 2157/2001.

2.6.1 Business Activity

ZALANDO SE is the parent company of the Zalando group. Its registered office is the corporate headquarters in Berlin. Its operating activities mainly include the development, sourcing, marketing and retail sale of various types of goods, in particular clothing and shoes. Other responsibilities include management of the online shops, HR management, IT, finance management and risk management. The country-specific websites of Zalando as well as the websites of Zalando Lounge are part of ZALANDO SE.

GRI 102-3

As the parent company of the group, ZALANDO SE is represented by its Management Board, which sets the direction of the group and defines the corporate strategy.

The financial statements of ZALANDO SE are prepared in accordance with the German Commercial Code. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the EU. This gives rise to differences in recognition and measurement policies. The differences primarily relate to provisions, fixed assets, financial instruments, deferred taxes.

In addition, ZALANDO SE has extensive supply and service relationships with its subsidiaries. The services purchased essentially encompass fulfillment and distribution services, content creation and customer service as well as procurement services.

The services ZALANDO SE provides to its subsidiaries comprise administrative and IT services.

2.6.2 Economic Situation of ZALANDO SE

The results of operations of ZALANDO SE presented in the following condensed income statement broken down by the type of expense reveal revenue growth with solid profitability in the reporting period.

GRI 103-1/-2/-3 MA
Economic Performance
GRI 201-1

Income Statement of ZALANDO SE According to German Commercial Code (Short Version)

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IN EUR M	Jan 1 – Dec 31, 2017	As % of sales	Jan 1 – Dec 31, 2016	As % of sales	Change in percentage points
Revenue	4,479.6	100.0%	3,650.7	100.0%	0.0pp
Own work capitalized	36.5	0.8%	45.2	1.2%	–0.4pp
Other operating income	48.9	1.1%	50.7	1.4%	–0.3pp
Cost of materials	–2,533.9	–56.6%	–2,043.3	–55.9%	–0.7pp
Gross profit	**2,031.1**	**45.3%**	**1,703.3**	**46.7%**	**–1.3pp**
Personnel expenses	–278.8	–6.2%	–227.4	–6.2%	0.0pp
Amortization and depreciation	–37.4	–0.8%	–27.0	–0.7%	–0.1pp
Other operating expenses	–1,545.6	–34.5%	–1,245.9	–34.2%	–0.3pp
Earnings before interest and taxes	**169.4**	**3.8%**	**203.0**	**5.6%**	**–1.8pp**
Financial result	**0.2**	**0.0%**	**–4.4**	**–0.1%**	**0.1pp**
Results from ordinary business activities	**169.6**	**3.8%**	**198.6**	**5.4%**	**–1.7pp**
Income taxes	–64.4	–1.4%	–65.7	–1.8%	0.4pp
Net income for the year	**105.1**	**2.3%**	**132.9**	**3.6%**	**–1.3pp**
EBIT margin	3.8%		5.6%		–1.8pp

In the reporting period, Zalando increased its revenue by EUR 829.0m to EUR 4,479.6m. The 22.7% increase in revenue is the result of the higher number of orders (30.8%) and a larger customer base. Zalando continued its positive development in all markets.

In the current fiscal year, the DACH countries generated more than half of the 24 total revenue. At the same time, revenue recorded in the other European countries climbed significantly, contributing substantially to overall growth.

Revenue of ZALANDO SE by Segment

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IN EUR M	2017		2016		Change	
DACH*	2,350.1	52.5%	1,952.0	53.5%	398.1	20.4%
Rest of Europe**	2,129.5	47.5%	1,698.7	46.5%	430.8	25.4%
Total	**4,479.6**	**100.0%**	**3,650.7**	**100.0%**	**828.9**	**22.7%**

*) As in fiscal 2016, DACH countries include Germany, Austria and Switzerland.
**) As in fiscal 2016, the Rest of Europe comprises the Netherlands, France, Italy, the United Kingdom, Poland, Belgium, Sweden, Finland, Denmark, Spain, Norway and Luxembourg.

Other operating income mainly results from income from foreign currency translation.

The cost of materials rose by EUR 490.6m to EUR 2,533.9m, in line with the expansion of business. The increase of 0.7 percentage points in the ratio of the cost of materials to revenue to 56.6% can be primarily attributed to a higher discount level in fiscal year 2017. Overall, the company generated a gross profit of EUR 2,031.1m in fiscal year 2017 (prior year: EUR 1,703.3m).

Personnel expenses rose by EUR 51.4m to EUR 278.8m, in line with the rise in the number of employees. As of December 31, 2017, the headcount increased by 365 on the prior year from 3,929 to 4,294 employees.

Other operating expenses primarily include marketing expenses as well as shipping and fulfillment costs. The cost ratio as a percentage of revenue (34.5%) is slightly below the previous year. The increase in the fulfillment cost ratio, which is mainly driven by the extension of the logistics network, was not fully compensated for by lower marketing costs resulting from efficiency gains in particular within performance marketing.

The EBIT for the year of EUR 169.4m decreased by 1.8 percentage points mainly due to a lower gross profit margin and a higher fulfillment cost ratio.

The financial result comprises income from profit transfers of EUR 6.6m (prior year: EUR 4.4m) mainly from the profits generated by the outlets in Berlin, Frankfurt and Cologne during the reporting period.

Income taxes include the deferred taxes and current income taxes paid or payable. They comprise trade tax, corporate income tax and the solidarity surcharge. As in the prior year, the statutory corporate income tax rate, including the solidarity surcharge, for the assessment period 2017 was 15.8%. The applicable trade tax rate was 14.8% as in the prior year.

Current and deferred taxes are presented in the following table.

Income Taxes → 35

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Deferred taxes	–21.1	–41.8
Current taxes in Germany	–43.3	–23.9
Total	**–64.4**	**–65.7**

In fiscal year 2017, deferred tax liabilities of EUR 16.5m were recognized mainly due to the capitalization of intangible assets.

Net Assets and Financial Position

The net assets of ZALANDO SE are shown in the following condensed statement of financial position.

Assets → 36

IN EUR M	Dec 31, 2017		Dec 31, 2016		Change
Non-current assets	620.3	21.2%	461.8	17.9%	158.5
Current assets	2,292.8	78.3%	2,091.8	81.3%	201.0
Prepaid expenses	14.3	0.5%	15.4	0.6%	–1.1
Deferred tax assets	0.0	0.0%	4.5	0.2%	–4.5
Total assets	**2,927.4**	**100.0%**	**2,573.5**	**100.0%**	**353.9**

Equity and Liabilities

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IN EUR M	Dec 31, 2017		Dec 31, 2016		Change
Equity	1,569.0	53.6%	1,444.0	56.1%	125.0
Special items for government grants	0.2	0.0%	0.1	0.0%	0.1
Provisions	250.9	8.6%	237.2	9.2%	13.7
Liabilities	1,087.1	37.1%	890.5	34.6%	196.6
Deferred income	3.7	0.1%	1.7	0.1%	2.0
Deferred tax liabilities	16.5	0.6%	0.0	0.0%	16.5
Total equity and liabilities	**2,927.4**	**100.0%**	**2,573.5**	**100.0%**	**353.9**

The total assets of ZALANDO SE rose by around 13.8% as a result of the further increase in business volume. The assets of the company primarily consist of current assets, specifically inventories and cash and cash equivalents. Equity and liabilities exclusively comprise equity and current liabilities and provisions.

In fiscal year 2017, investments focused on intangible assets (EUR 46.4m) and financial assets (EUR 135.2m). Investing activities were financed exclusively from the group's own funds.

In fiscal year 2017, inventories solely comprised merchandise used in the core operational business of ZALANDO SE.

As of December 31, 2017, ZALANDO SE's trade receivables were up EUR 84.0m to EUR 387.2m.

With regard to the liquidity and the financial development of ZALANDO SE, we refer to the financial development of the Zalando group. The financial development of Zalando group essentially reflects the financial development of ZALANDO SE. Furthermore, ZALANDO SE is responsible for the cash management of the Zalando group.

In the past fiscal year, Zalando generated positive cash flow from operating activities of EUR 200.3m (prior year: EUR 252.9m). The cash flow was influenced by lower cash inflow from working capital, cash outflows for VAT liabilities and receivables and lower cash inflows from recognizing reimbursement obligations towards customers.

The cash flow from investing activities in fiscal year 2017 was mainly driven by capital increases in subsidiaries that were used to invest in the fulfillment infrastructure as well as to further expand the respective business segments of the subsidiaries. Cash and cash equivalents consist of cash on hand and bank balances as well as fixed-term deposits due within three months at credit institutions and in disposable money market funds.

The equity ratio stood at 53.6% (prior year: 56.1%).

Provisions and liabilities increased by EUR 210.3m to EUR 1,338.0m, in line with the expansion of the business. As of December 31, 2017, this figure mainly pertains to provisions for expected returns, outstanding invoices for fulfillment and marketing expenses and trade payables.

Reverse factoring agreements are in place with various suppliers and with several financial institutions. Under these agreements, the factor purchases the respective supplier receivables due from Zalando. Supplier claims against Zalando based on these agreements totaling EUR 328.9m had been transferred to the factor as of December 31, 2017 (prior year: EUR 282.3m). This amount is recognized in the balance sheet under trade payables.

2.6.3 Risks and Opportunities

The business development of ZALANDO SE is subject to largely the same risks and opportunities as the group. ZALANDO SE fully participates in the risks of its subsidiaries. Statements made by the Management Board on the overall assessment of the group's risk situation thus also summarize the risk situation of ZALANDO SE. The description of ZALANDO SE's accounting-related internal control system and risk management system stipulated in Section 289 (5) HGB ["Handelsgesetzbuch": German Commercial Code] is provided in the Risk and Opportunity Report of the group.

2.6.4 Outlook

The statements made on market trends and the development of revenue and the results for the group also apply here by virtue of the close ties between ZALANDO SE and the group companies and its weight within the group. The statements also reflect the expectations for the parent company.

Berlin, February 26, 2018

Robert Gentz David Schneider Rubin Ritter

2.7 Report on Equality and Equal Pay for ZALANDO SE[44]

In accordance with Section 21 German Act on Transparency of Pay (Entgelttransparenzgesetz).

2.7.1 Gender Equality

Measures to Promote Equality Between Women and Men

Promoting equality across genders is an important part of our diversity and inclusion efforts. In the first half of 2018, we are revisiting our goals and ambitions regarding inclusion and diversity in an effort to accelerate the agenda. But we already have much to build on having taken a number of measures focused on gender equality in 2017.

We Have Revised Our Promotion Process

Our revised promotion process articulates clearly what the expectations for each role are and defers promotion decisions to a committee instead of the direct leader. These committees of senior leaders are tasked with making consistent decisions across the organization based on facts and well-defined performance and promotion criteria. Additionally, members are trained to be aware of conscious and unconscious biases (in particular around gender) in order to mitigate them. We also track the outcomes of those decisions across genders.

We Have Raised Awareness and Understanding about Equality Across Genders

We have increased our embedded communications to bring the topic of gender equality forward in our internal social media channels.

We have also increased the number of analyses and reports to understand the status quo, e.g., to

- analyze the gender distribution of employees across work fields, roles and seniority levels
- assess potential differences in average pay across genders for comparable roles and grades
- understand whether gender (of an employee or that of their leader) is correlated with the likelihood of promotion or performance rating
- understand cultural health (satisfaction, engagement, sense of purpose, community, inclusion, etc.) across genders
- track the number and reasons for employee attrition out of the company for each gender.

This increased level of insights into the facts allows us to define more relevant and targeted measures to further promote gender equality.

44) The report on equality and equal pay for ZALANDO SE is not part of the audited combined management report.

We Have Taken Ad Hoc Measures as Necessary

While we intend to be proactive on gender equality, we also want to capture opportunities to advance the topic as they arise. To name but two examples: triggered by internal employee initiatives, we have recognized those employees who do not identify either as a woman or man; and in the wake of the #metoo campaign, we have revised and broadcasted our guidelines and routines to prevent and deal with sexual harassment, discrimination and reprisals, reinforcing our zero tolerance principle and our Ask and Tell policy and process.

Measures to Promote Equal Pay

At Zalando, we are committed to pay salaries based on objective criteria and regardless of gender.

The implementation of centralized processes based on defined criteria is aimed to assure fairness for individual pay decisions and to reduce the impact of factors that would lead to any potential bias. The target pay range for each employee is built on a role-based approach and has been consistently applied across Zalando. A new salary band structure was defined in 2017, which has been applied company wide.

In the past year, we also implemented a centralized annual pay review, which is steered by a central team to assure consistency and internal fairness. To increase transparency, our employees are informed in annual feedback and development talks about how their individual salary compares to the internal salary bands.

In addition, we have raised awareness with our leadership teams about the importance of objective pay decisions and a fair salary for both male and female employees.

2.7.2 Employee Statistics for ZALANDO SE

Average Headcount 2017

Male	2,136
Female	2,149

Average Headcount 2017 (Part-Time / Full-Time)

	Full-time	Part-time
Male	2,020	116
Female	1,913	236

Consolidated Financial Statements_

3.1

Consolidated Statement of Comprehensive Income

Further Information
Notes to the Consolidated Statement of Comprehensive Income p. 163

Consolidated Income Statement

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IN EUR M	Notes	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Revenue	(1.)	4,489.0	3,639.0
Cost of sales	(2.)	–2,529.6	–2,029.6
Gross profit		**1,959.4**	**1,609.4**
Selling and distribution costs	(3.)	–1,530.8	–1,223.7
Administrative expenses	(4.)	–242.9	–191.3
Other operating income	(5.)	11.8	16.7
Other operating expenses	(6.)	–9.9	–4.1
Earnings before interest and taxes (EBIT)		**187.6**	**207.0**
Interest and similar income		3.9	2.1
Interest and similar expenses		–14.5	–11.8
Result of investments accounted for using the equity method		0.3	–3.6
Other financial result		–2.2	–0.7
Financial result	(7.)	**–12.4**	**–14.1**
Earnings before taxes (EBT)		**175.2**	**192.9**
Income taxes	(8.)	–73.6	–72.5
Net income for the period		**101.6**	**120.5**
Thereof net income attributable to the shareholders of ZALANDO SE		103.1	120.5
Thereof net income attributable to non-controlling interests		–1.6	0.0
Net income for the period as percentage of revenue		2.3%	3.3%
Basic earnings per share (in EUR)	(9.)	0.42	0.49
Diluted earnings per share (in EUR)	(9.)	0.40	0.47

Consolidated Statement of Comprehensive Income

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IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Net income for the period	**101.6**	**120.5**
Items recycled to profit or loss in subsequent periods		
Effective portion of gains / losses from cash flow hedges, net of tax	8.9	–2.7
Exchange differences on translation of foreign financial statements	3.1	–2.0
Other comprehensive income	**12.0**	**–4.7**
Total comprehensive income	**113.6**	**115.8**
Thereof total comprehensive income attributable to the shareholders of ZALANDO SE	114.8	115.8
Thereof net income attributable to non-controlling interests	–1.6	0.0

3.2 Consolidated Statement of Financial Position

Further Information
Notes to the Consolidated Statement of Financial Position p. 163

Consolidated Statement of Financial Position – Assets

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IN EUR M	Notes	Dec 31, 2017	Dec 31, 2016
Non-current assets			
Intangible assets	(11.)	182.3	100.9
Property, plant and equipment	(12.)	350.5	243.0
Financial assets	(13.)	25.9	29.2
Deferred tax assets	(8.), (27.)	1.4	1.6
Non-financial assets	(13.)	3.5	3.0
Investments accounted for using the equity method	(14.)	5.9	14.8
		569.6	*392.6*
Current assets			
Inventories	(15.)	778.9	576.9
Prepayments	(15.)	2.6	1.1
Trade and other receivables	(16.)	278.7	216.0
Other financial assets	(17.)	80.7	245.8
Other non-financial assets	(17.)	152.7	133.1
Cash and cash equivalents	(18.)	1,065.5	972.6
Assets held for sale	(12.)	51.5	0.0
		2,410.7	*2,145.6*
Total assets		**2,980.3**	**2,538.2**

Consolidated Statement of Financial Position – Equity and Liabilities

→ 41

IN EUR M	Notes	Dec 31, 2017	Dec 31, 2016
Equity			
Issued capital		247.2	247.2
Capital reserves		1,182.4	1,161.0
Other reserves		8.7	–3.3
Accumulated profit		100.7	2.5
Equity of shareholders of ZALANDO SE		1,539.0	1,407.5
Non-controlling interest		–0.1	0.0
	(19.)	*1,538.9*	*1,407.5*
Non-current liabilities			
Provisions	(21.)	15.8	12.6
Borrowings	(24.)	8.4	11.2
Other financial liabilities		4.5	2.3
Other non-financial liabilities		7.9	3.3
Deferred tax liabilities	(8.), (26.)	35.4	3.1
		71.9	*32.5*
Current liabilities			
Provisions	(21.)	0.3	1.7
Borrowings	(25.)	2.8	3.2
Trade payables and similar liabilities	(22.)	1,120.0	920.5
Prepayments received	(22.)	32.0	8.1
Income tax liabilities		6.4	8.9
Other financial liabilities	(23.)	84.0	69.0
Other non-financial liabilities	(23.)	123.9	86.7
		1,369.5	*1,098.2*
Total equity and liabilities		**2,980.3**	**2,538.2**

3.3

Consolidated Statement of Changes in Equity

Consolidated Statement of Changes in Equity 2017

IN EUR M	Notes	Issued capital	Capital reserves
As of Jan 1, 2017		**247.2**	**1,161.0**
Net income for the period		0.0	0.0
Other comprehensive income		0.0	0.0
Total comprehensive income		**0.0**	**0.0**
Capital increase	(19.)	0.1	0.5
Repurchase of treasury shares	(19.)	–0.2	–6.6
Share-based payments	(20.)	0.0	27.5
Equity transactions with changes of stake	(19.)	0.0	0.0
As of Dec 31, 2017		**247.2**	**1,182.4**

Consolidated Statement of Changes in Equity 2016

IN EUR M	Notes	Issued capital	Capital reserves
As of Jan 1, 2016		**247.0**	**1,140.9**
Net income for the period		0.0	0.0
Other comprehensive income		0.0	0.0
Total comprehensive income		**0.0**	**0.0**
Capital increase	(19.)	0.2	0.9
Repurchase of treasury shares	(19.)	0.0	–0.7
Share-based payments	(20.)	0.0	19.9
As of Dec 31, 2016		**247.2**	**1,161.0**

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Other reserves					
Cash flow hedges	Currency translation	Accumulated profit	Shareholders of ZALANDO SE	Non-controlling interest	Total
–1.3	**–1.9**	**2.5**	**1,407.5**	**0.0**	**1,407.5**
0.0	0.0	103.1	103.1	–1.6	101.6
8.9	3.1	0.0	12.0	0.0	12.0
8.9	**3.1**	**103.1**	**115.1**	**–1.6**	**113.6**
0.0	0.0	0.0	0.6	0.0	0.6
0.0	0.0	0.0	–6.7	0.0	–6.7
0.0	0.0	0.0	27.5	0.0	27.5
0.0	0.0	–4.9	–4.9	1.5	–3.5
7.6	**1.2**	**100.7**	**1,539.0**	**–0.1**	**1,538.9**

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Other reserves					
Cash flow hedges	Currency translation	Accumulated profit/losses	Shareholders of ZALANDO SE	Non-controlling interest	Total
1.4	**0.0**	**–118.0**	**1,271.4**	**0.0**	**1,271.4**
0.0	0.0	120.5	120.5	0.0	120.5
–2.7	–2.0	0.0	–4.7	0.0	–4.7
–2.7	**–2.0**	**120.5**	**115.8**	**0.0**	**115.8**
0.0	0.0	0.0	1.1	0.0	1.1
0.0	0.0	0.0	–0.7	0.0	–0.7
0.0	0.0	0.0	19.9	0.0	19.9
–1.3	**–1.9**	**2.5**	**1,407.5**	**0.0**	**1,407.5**

3.4 Consolidated Statement of Cash Flows

Consolidated Statement of Cash Flows

→ 44

IN EUR M			Notes	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
1.		Net income for the period		101.6	120.5
2.	+	Non-cash expenses from share-based payments	(20.)	27.5	19.9
3.	+	Depreciation of property, plant and equipment and amortization of intangible assets	(11.), (12.)	58.7	48.2
4.	+/–	Income taxes	(8.)	73.6	72.5
5.	–	Income taxes paid, less refunds		–49.4	–33.8
6.	+/–	Increase/decrease in provisions	(21.)	–1.5	0.1
7.	–/+	Other non-cash income/expenses		6.5	1.2
8.	+/–	Decrease/increase in inventories	(15.)	–189.4	–83.4
9.	+/–	Decrease/increase in trade and other receivables	(16.)	–61.6	–64.0
10.	+/–	Increase/decrease in trade payables and similar liabilities	(22.)	198.4	264.3
11.	+/–	Increase/decrease in other assets/liabilities	(13.), (17.), (23.)	29.2	–69.7
12.	**=**	**Cash flow from operating activities**	**(25.)**	**193.7**	**275.8**
13.	–	Cash paid for investments in property, plant and equipment	(12.)	–189.1	–122.1
14.	–	Cash paid for investments in intangible assets	(11.)	–54.8	–59.6
15.	–	Cash paid for acquisitions of shares in associated companies and acquisition of companies and prepayments for such acquisitions	(14.)	–34.9	–30.4
16.	+/–	Cash received/paid for investments in term deposits	(17.)	180.0	–65.0
17.	+/–	Change in restricted cash	(13.)	10.4	0.0
18.	**=**	**Cash flow from investing activities**	**(25.)**	**–88.3**	**–277.1**
19.	+	Cash received from capital increases by the shareholders less transaction costs	(19.)	3.9	1.1
20.	–	Repurchase of treasury shares	(19.)	–6.7	–0.7
21.	–	Payments for shares in other entities without change in control	(19.)	–4.6	0.0
22.	–	Cash repayments of loans	(24.), (25.)	–3.2	–3.2
23.	**=**	**Cash flow from financing activities**	**(25.)**	**–10.6**	**–2.9**
24.	=	Net change in cash and cash equivalents from cash relevant transactions		94.8	–4.1
25.	+/–	Change in cash and cash equivalents due to exchange rate movements		–1.9	0.5
26.	+	Cash and cash equivalents at the beginning of the period		972.6	976.2
27.	**=**	**Cash and cash equivalents as of Dec 31**		**1,065.5**	**972.6**

Interest paid and received included in cash flow from operating activities:

Cash-Relevant Interest

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IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Interest paid	–13.5	–4.0
Interest received	2.0	0.0
Total	**–11.5**	**–4.0**

The table below shows the calculation of the free cash flow based on the cash flow from operating activities.

Free Cash Flow

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IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Cash flow from operating activities	193.7	275.8
Cash paid for investments in property, plant and equipment	–189.1	–122.1
Cash paid for investments in intangible assets	–54.8	–59.6
Cash paid for acquisitions of shares in associated companies and acquisition of companies and prepayments for such acquisitions	–34.9	–30.4
Free cash flow	**–85.0**	**63.7**

3.5 Notes to the Consolidated Financial Statements

3.5.1 Company Information

Company Name, Registered Office

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

Nature of Operating Activities

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

Zalando's assortment of almost 2,000 international brands ranges from popular global brands, fast-fashion and local brands, and is complemented by private label products. Zalando's localized offering addresses the distinct preferences of its customers in each of the 15 European markets being served: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Poland, Spain, Sweden, Switzerland and the United Kingdom. The logistics network with five centrally located fulfillment centers allows Zalando to efficiently serve its customers throughout Europe, supported by fulfillment centers in Northern Italy, France and Sweden with a focus on local customer needs. Zalando's offering has been extended and enhanced with the Zalando Lounge, which offers registered members special articles at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt am Main and Cologne serve as additional sales channels for remaining stock. Zalando was founded in 2008 and has its registered offices in Berlin.

3.5.2 General Principles

Application of IFRS

The consolidated financial statements of ZALANDO SE for the fiscal year from January 1 to December 31, 2017, were compiled in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU as of the reporting date. In addition, the provisions of Section 315a (1) HGB have been taken into account. The consolidated financial statements give a true and fair view of the group's financial performance and position.

General Information

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

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

3.5.3 New Accounting Standards

Effects of New or Amended IFRS Relevant for Fiscal Year 2017

The consolidated financial statements take into account all IFRS endorsed as of the reporting date and whose adoption is mandatory in the European Union.

The changes in IFRS relate to IAS 7, IAS 12 and IFRS 12. Application has been mandatory since January 1, 2017. For Zalando, the amendments to IAS 7 require an extension of the disclosures with regard to changes in respect of liabilities arising from financing activities (see section 3.5.7. (25.)).

All other standards subject to first-time application in fiscal year 2017 have not had any material impact on Zalando's financial performance, position or disclosure.

New or Amended IFRS Not yet Applied

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

Standard / interpretation		Impending change
Improvements to International Financial Reporting Standards 2016 (Annual Improvements 2014 – 2016)		Minor amendments to a large number of IFRS (IFRS 1, IFRS 12, IAS 28).
Amendments to IFRS 2	Share-based payments	The clarifications relate to the effect of vesting conditions on the measurement of a cash-settled share-based payment, changes in the classification of a transaction from cash-settled to equity-settled and the classification of share-based payment transactions with net settlement features.
IFRS 9	Financial instruments	IFRS 9 introduces a uniform approach for classifying and measuring financial assets. IFRS 9 relates to the characteristics of the contractual cash flows and the business model by which these cash flows are managed. The standard also provides a new risk provision model that now also accounts for anticipated losses for the calculation of the risk provision. Moreover, IFRS 9 contains new regulations on hedge accounting in order to better present the risk management activities of an entity, in particular with regard to the management of non-financial risks.
Amendments to IFRS 9	Prepayment features with negative compensation	The amendment clarifies that the previous designation of a financial asset or liability can be revoked if there is a change in specific conditions regarding an accounting mismatch.

IASB effective date	Endorsed by the EU	Anticipated effects
January 1, 2018, (January 1, 2017 for amendments to IFRS 12 see below), early adoption on a case-by-case basis permitted	Yes	Application has no significant impact on the consolidated financial statements.
January 1, 2018, early adoption permitted	No	Application has a minor impact on the consolidated financial statements.
January 1, 2018, early adoption permitted	Yes	Zalando will apply the new classification and measurement requirements of IFRS 9 from January 1, 2018. The new classification model results in minor changes that will not have any material effect on the consolidated financial statements. The changes mainly relate to equity instruments held by the entity that are no longer allocated to available-for-sale financial assets but are now measured at fair value through profit and loss. Zalando will not voluntarily designate instruments to fair value through other comprehensive income. Likewise, it will not voluntarily designate financial assets to fair value through profit or loss. This is in accordance with the accounting treatment practiced by Zalando to date. The measurement of impairment losses on trade receivables considers the risk of default for customers in line with industry practices from the point of recognizing the revenue. Such an approach already corresponds with the lifetime ECL (expected credit losses) approach of IFRS 9. The measurement of cash and cash equivalents and term deposits will lead to the recognition of an insignificant loss allowance due to the 12-month ECL. The impairment loss will not exceed EUR 3.0m and will be considered directly under equity in accumulated profit as an effect of initial application. The amendments relating to hedge accounting will lead to reporting relief in the assessment of the effectiveness of hedging relationships and the designation of the underlying and the hedging instruments. Zalando will apply the new requirements on hedge accounting prospectively from January 1, 2018. Existing hedging relationships will be maintained beyond the date of initial application as they also qualify for hedge accounting under IFRS 9. A need for a rebalancing is not expected.
January 1, 2019, early adoption permitted	No	Application has no significant effect on the consolidated financial statements.

Standard / interpretation		Impending change
IFRS 15	Revenue from contracts with customers	The core principle of IFRS 15 is that an entity recognizes revenue to reflect the transfer of goods or services to customers at an amount that represents the consideration the entity expects to receive. Revenue is recognized when the customer obtains control over the goods or services. IFRS 15 also contains guidance on the presentation of contract assets or contract liabilities. The standard also requires additional disclosures, including a disaggregation of total revenue, on performance obligations, on reconciliations of opening and closing balances of net contract assets and contract liabilities as well as on significant judgments and estimates.
Amendments to IFRS 15	Clarifications	The clarifications relate to identifying performance obligations, principal versus agent considerations, and licensing of intellectual property as well as the exceptions to the application of sales-based and usage-based royalties and the transitional relief to IFRS 15.
IFRS 16	Leases	IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. For the lessee, IFRS 16 introduces a single accounting model in contrast to IAS 17. The new model requires the lessee to recognize assets and liabilities from all leases in the statement of financial position except for leases with a lease term of 12 months or less or leases of low-value assets (option). There will also be changes within the statement of profit or loss. First, there is an interest expense on the outstanding lease liability. Secondly, depreciation of the right-of-use asset has to be shown instead of lease expenses. Thirdly, the cost burden at the beginning of a lease will be higher than at the end due to the frontloading effect. Furthermore, the majority of lease payments will no longer be shown in cash flow from operating activities, but in cash flow from financing activities. For lessors, IFRS 16 continues to distinguish between finance leases and operating leases for accounting purposes. Zalando acts exclusively as a lessee and not as a lessor. It is currently not intended to change this in the future.

IASB effective date	Endorsed by the EU	Anticipated effects
January 1, 2018, early adoption permitted	Yes	The application of IFRS 15 will not have any significant effects on the consolidated financial statements of Zalando. Due to Zalando's fraud prevention measures, only those contracts are entered into where it is probable that Zalando will receive consideration. The structure of the ordering process and the obligation to acknowledge the general terms and conditions makes it apparent to both contracting parties that they are entering into a contract from which various rights and obligations arise. The same applies for the terms of payment, which vary depending on the mode of payment chosen by the customer. Consequently, there is always a contract with a customer. The goods or services promised by Zalando (goods, free delivery and returns with a return policy of up to 100 days, free customer care) create a bundle that is distinct, i.e. the identified performance obligation. The services cannot be separated from the goods promised. Merely the "express delivery" option represents an independent service commitment. This is billed separately. With regard to revenue recognition, Zalando already makes a distinction between two types of promises. In our wholesale business, the performance obligation of Zalando consists of transferring control over its own goods to the customer. Zalando, as the principal, therefore recognizes the revenue in full. By contrast, in the Partner Program, Zalando's performance obligation consists of arrange for a third party (partner) to provide those goods to the customer. In this case, Zalando acts as an agent and merely recognizes revenue at the amount of the commission that is expected to be received from the business partner. The right of return extended by Zalando to all goods, which can be exercised for each individual item, constitutes variable consideration. The transaction price is therefore determined after considering the expected returns. This is estimated on the basis of past experience and is adjusted continuously. Moreover, the ratio of returns is determined on a country-specific and payment option basis. As in the past, revenue is therefore recognized only at the amount for which no returns are expected. A refund obligation is recognized under liabilities for the returns expected on customer payments already received. At the same time, a right to repossess goods is recognized under assets and deducted from the cost of sales at the amount of the expected returns. The right to repossess goods is reduced by the expected costs of returns. This accounting treatment already complies with IFRS 15.B21 et seq. Due to the fact that the transaction price comprises the sum of the individual prices of the goods in a shipment – and the prices listed in the shop constitute the stand-alone selling prices of the transaction in the sense of IFRS 15.77 – the revenue to be recognized for each item corresponds to the respective stand-alone price. Any rebates granted on the total order are allocated proportionately to the respective goods making up the order. Rebates that are granted on specific articles are allocated only to these articles. The performance obligations that Zalando must fulfill within the framework of the Fashion Store business do not meet the criteria for recognizing revenue over time because the customer does not simultaneously receive the benefits over time, nor is there any transfer of control to the goods over time. In addition, there is an alternative use to the entity for each of the goods since they could be equally assigned to any other customer. Consequently, revenue is recognized by Zalando at a point in time. The point in time for revenue recognition corresponds to the time at which the customer obtains control over the goods, i.e. the goods are handed over to the customer. Zalando already considers that partial deliveries may arrive at the customer at different times. Consequently, the revenue of an order can be recognized at different times. There are no significant financing components or contractual costs for Zalando. The new standard will be adopted by Zalando from January 1, 2018. Zalando will apply the modified retrospective method by which the prior-year figures will not be adjusted and any required adjustment is posted to equity. However, no such adjustment is expected at Zalando.
January 1, 2018, early adoption permitted	Yes	Application has no significant impact on the consolidated financial statements.
January 1, 2019, early adoption permitted	Yes	The new standard will have a material effect on the consolidated financial statements. The recognition of a right-of-use asset and a lease liability for leases previously recognized as operating leases under IAS 17 will increase the sum of total assets and the sum of total equity and liabilities. The increase is expected to be lower than EUR 400.0m at the transition date (January 1, 2019). This will have a non-recurring impact on certain financial indicators upon transition, particularly the equity ratio is expected to fall to around 50.0%. Moreover, the recognition of interest expenses will burden the financial result (effect expected to be less than EUR 15.0m for the financial year beginning on January 1, 2019). EBITDA will increase significantly (effect expected by up to EUR 85.0m) due to the depreciation of the right-of-use asset instead of the recognition of lease expenses. By contrast, EBIT will improve due to a lower depreciation expense for the right-of-use asset in comparison to the previous lease expenses. The increase in EBIT will be less than EUR 10.0m. Bottomline, net income of the period will only be minimally negatively affected (front loading effect to be lower than EUR 5.0m). In addition, lease payments will no longer be reported in cash flow from operating activities but in cash flow from financing activities, and the disclosures required in the notes will be extended. The effect of the reclassification within the consolidated statement of cash flows will be less than EUR 85.0m. Zalando plans to apply the standard retrospectively with no restatement of comparative information. We will measure the right-of-use asset with an amount equal to the lease liability at the date of initial application. Zalando elects to use the exemptions where permitted. These primarily relate to the separation of non-lease components, low-value and short-term leases as well as the licensing of software. Early adoption is not planned.

Standard / interpretation		Impending change
IFRS 17	Insurance contracts	IFRS 17 contains a consistent model to account for insurance contracts. The standard establishes principles for the recognition, measurement, presentation and disclosures of insurance contracts and eliminates differences in accounting practices. IFRS 17 supersedes the interim standard IFRS 4.
Amendments to IAS 28	Long-term interests in associates and joint ventures	Clarification to the application of IFRS 9 for specific long-term interests outside the scope of IAS 28.
Improvements to International Financial Reporting Standards 2017 (Annual Improvements 2015 – 2017)		Minor amendments to a large number of IFRS (IFRS 3, IFRS 11, IAS 12, IAS 23).

The IASB has issued other amendments of accounting standards that are not listed above (IFRS 4, IAS 19, IAS 40) and are not applied and do not have any material impact on Zalando’s financial performance and position.

Additionally, the IASB issued the IFRIC Interpretations 22 (Foreign Currency Transactions and Advance Consideration) and 23 (Uncertainty over Income Tax Treatments). The Interpretations shall be applied on or after January 1, 2018 and 2019, respectively. Both were not endorsed by the EU by the reporting date and do not have any material impact on Zalando’s financial performance and position.

3.5.4 Principles of Consolidation

Basis of Consolidation

The number of subsidiaries included in the basis of consolidation increased from 32 (prior year) to 40 on account of entities founded and acquired in fiscal year 2017.

Reporting Date of the Consolidated Financial Statements

The consolidated financial statements cover fiscal year 2017 on the basis of the reporting period from January 1 to December 31, 2017. Apart from abbreviated reporting periods due to the establishment or acquisition of entities, the fiscal year of the consolidated entities also corresponds to the calendar year.

Accounting Policies

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

The consolidated financial statement comprise ZALANDO SE and its subsidiaries over which the company has control within the meaning of IFRS 10.

	IASB effective date	Endorsed by the EU	Anticipated effects
	January 1, 2021, early adoption permitted	No	Zalando has no transactions within the scope of the new standard. Therefore, Zalando does not need to apply IFRS 17.
	January 1, 2019, early adoption permitted	No	Zalando does not have interests in an associate or joint venture to which the equity method is not applied. Hence, there will be no effect.
	January 1, 2019, early adoption permitted	No	Application has no significant impact on the consolidated financial statements.

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

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

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

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

Currency Translation

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

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

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

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

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

Foreign Exchange Rates → 47

		Closing rate		Annual average rate	
	ISO Code	Dec 31, 2017	Dec 31, 2016	2017	2016
British pound	GBP	0.8872	0.8562	0.8767	0.8195
Danish krone	DKK	7.4449	7.4344	7.4386	7.4452
Norwegian krone	NOK	9.8403	9.0863	9.3270	9.2906
Polish zloty	PLN	4.1770	4.4103	4.2570	4.3632
Swedish krona	SEK	9.8438	9.5525	9.6351	9.4689
Swiss franc	CHF	1.1702	1.0739	1.1117	1.0902
US dollar	USD	1.1993	1.0541	1.1297	1.1069

3.5.5 Accounting Policies

Intangible Assets

Intangible assets are measured at amortized cost. All intangible assets, except for brands and domain rights, have a finite useful life. These are amortized over their useful life of three to eight years on a straight-line basis. The carrying amounts of brands and domain rights are immaterial from the group's perspective. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the residual values or the respective useful lives are taken into consideration prospectively when measuring amortization. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. In 2017 no indication that an asset may be impaired exists.

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

Capitalized development costs are amortized over an anticipated useful life of an average of about three years. Amortization of the asset begins when development is complete and the asset is available for use. Research costs are expensed in the period in which they arise. An impairment test is performed once a year as long as the asset is under development regardless of any indications of impairment. The same applies to goodwill acquired and intangible assets with indefinite useful lives.

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

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

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

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

From the perspective of the group, intangible assets under development and goodwill acquired in business combinations are material. They are tested for impairment on the cash-generating unit level once a year. All other assets being tested are immaterial and concern units outside of the core business of Zalando. The total amount of the impairment losses arising from impairment testing is immaterial from a group perspective.

Property, Plant and Equipment

Property, plant and equipment are recognized at cost and depreciated in accordance with their expected useful life using the straight-line method. Depreciation is charged over the following useful lives.

Useful Lives → 48

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

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

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

Impairment of Non-Financial Assets

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

Current Versus Non-Current Classification

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

An asset is classified as current when:

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

All other assets are classified as non-current.

A liability is classified as current if:

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

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

Assets Held for Sale

Non-current assets are classified as held for sale and therefore presented separately within the balance sheet if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This is the case if:

- the asset is available for sale and
- the sale is highly probable.

Non-current assets classified as held for sale are measured at the lower of their carrying amount or their fair value less costs to sell. Such assets are not depreciated or amortized.

Leases – The Group as Lessee

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

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

Assets leased under operating leases are not recognized. Instead, the lease payments are expensed on a straight-line basis over the term of the lease. Significant operating leases pertain to leases of office space and logistic premises in the group.

Income Taxes

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

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

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

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

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

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

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

Inventories

Merchandise accounted for as inventories is recognized at cost pursuant to IAS 2. Cost is calculated on the basis of an item-by-item measurement, either based on goods market prices or moving average prices. Supplier payments that are to be classified as a reduction of cost reduce the carrying amount of inventories.

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

Financial Instruments

General Information

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

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

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

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

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

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

Financial Assets

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

- loans and receivables,
- held-to-maturity investments (n/a during the reporting and comparative period),
- financial assets at fair value through profit or loss, or
- available-for-sale financial assets.

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

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

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

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

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

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

Impairment of Financial Assets

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

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

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

Financial Liabilities

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

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

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

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

Derivative Financial Instruments and Hedge Accounting

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

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

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

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

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

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

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

Fair Value Hedges

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

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

Cash Flow Hedges

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

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

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

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

Fair Value Measurement

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

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs have a significant effect on measurement are observable, either directly or indirectly
- Level 3: unobservable inputs for the assets and liabilities

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

Provisions

General Information

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

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

Restoration Obligations

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

Share-Based Payments

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

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

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

No expense is recognized for awards that do not ultimately vest due to a service or performance condition not being fulfilled. Equity-settled payment models with market-related performance conditions and other non-vesting conditions affect the fair value of the payment on the grant date only.

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

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

Revenue Recognition

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

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

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

Expected Returns

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

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

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

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

Government Grants

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

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

3.5.6 Use of Estimates and Assumptions

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

- identification and determination of write-downs of merchandise and receivables; see comments under notes 3.5.7 (15.) and 3.5.7 (16.),
- setting the expected rate of returns, see comments under note 3.5.7 (23.),
- the determination of the fair value of obligations from financial liabilities and share-based payments; see comments under 3.5.7 (20.) as well as note 3.5.8 (1.),
- the determination of the recoverability of deferred tax assets on unused tax losses; see comments under notes 3.5.7 (8.) and 3.5.7 (26.),
- impairment test for goodwill and intangible assets under development, see comments under note 3.5.7 (11.),
- identification and determination of anticipated effects from the application of new or amended IFRS not yet applied, see comments under note 3.5.3.

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

3.5.7 Notes to the Consolidated Statement of Comprehensive Income and Statement of Financial Position

Further Information Consolidated Statement of Comprehensive Income p. 135

(1.) Revenue

Revenue

→ 49

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Revenue from the sale of merchandise	4,358.9	3,553.1
Revenue from other services	130.1	85.9
Total	**4,489.0**	**3,639.0**

Zalando was able to significantly increase its revenue in all market segments. Revenue rose by 23.4%.

The rise in revenue is mainly attributable to a larger customer base and an increase in number of orders. As of December 31, 2017, the group had 23.1 million active customers. This corresponds to an increase of 16.2% compared to the prior year. The larger customer base ordered more frequently compared to the prior year with the average number of orders per active customer rising by 12.6%. The higher number of customer orders, which increased by 30.8%, was driven in particular by a 28.7% increase in site visits. The higher traffic also relates to a significant increase in the share of visitors who access our shops on mobile devices. Compared to the prior year, the share of site visits via mobile devices rose by 5.1 percentage points to 70.7% in 2017.

The considerable rise in these revenue drivers was enabled through our continued focus on investing in the consumer and brand proposition as well as in our technology and operations infrastructure.

(2.) Cost of Sales

Cost of Sales

→ 50

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Non-personnel costs	2,444.8	1,964.3
Personnel costs	84.8	65.2
Total	**2,529.6**	**2,029.6**

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

Cost of sales rose by 24.6% year on year from EUR 2,029.6m to EUR 2,529.6m, roughly in line with the expansion of business. For 2017, the gross margin decreased slightly by 0.6 percentage points from 44.2% to 43.6% due to a slightly higher group discount rate. Furthermore, the growing share of the Rest of Europe segment in Zalando’s business contributes to this effect as the Rest of Europe segment shows higher discounting. In 2017, we continued our conscious management of the trade-off between sales promoting measures and margin and invested in customer acquisition around cyber days and during the end-of-season sale. Furthermore, Zalando attracts a growing number of younger customers who prefer to shop for fast fashion articles at lower prices, which also impacts gross margin. Economies of scale from continued negotiation successes with brand partners partially offset the aforementioned effects.

The cost of materials in the group totals EUR 2,250.9m (prior year: EUR 1,823.4m).

Zalando generated a gross profit of EUR 1,959.4m in fiscal year 2017 (prior year: EUR 1,609.4m).

(3.) Selling and Distribution Costs

Selling and Distribution Costs → 51

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Non-personnel costs	1,212.4	1,005.2
Personnel costs	318.4	218.4
Total	**1,530.8**	**1,223.7**

In 2017, selling and distribution costs rose by EUR 307.1m to EUR 1,530.8m and pertain to fulfillment costs of EUR 1,168.2m (prior year: EUR 847.8m) and marketing costs of EUR 362.5m (prior year: EUR 375.9m). The fulfillment cost ratio as a percentage of revenue increased by 2.7% percentage points from 23.3% in 2016 to 26.0% in 2017. The increase in the fulfillment cost ratio is primarily attributable to higher logistic costs as Zalando is building up a diverse logistic network and continues its investments in the customer and brand proposition. Noteworthy developments include the ramp-up of new fulfillment centers in southern Germany, France, Italy, Sweden and Poland, continued investments in convenience to enhance our customer experience like same day delivery, and the ramp-up of our Zalando Fulfillment Solutions service for brand partners, where we take on the fulfillment services for brands that are selling in our Partner Program.

(4.) Administrative Expenses

Administrative Expenses → 52

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Non-personnel costs	80.1	71.8
Personnel costs	162.8	119.5
Total	**242.9**	**191.3**

The non-personnel costs primarily contain office expenses, depreciation and legal and advisory expenses. The increase in personnel costs mainly results from the higher headcount in administration to strengthen the Zalando platform and from the integration of newly acquired companies in 2017.

(5.) Other Operating Income

Zalando recognized changes in the fair value of a derivative resulting from the interest in the proceeds from the sale of developed land owned by third parties (see section 3.5.7 (13.)). Income recognized in that context amounted to EUR 1.0m (prior year: EUR 10.6m). Therefore, decrease totaling EUR –4.9m in other operating income to EUR 11.8m (prior year: EUR 16.7m) mainly stems from the prior year.

(6.) Other Operating Expenses

Other operating expenses of EUR 9.9m (prior year: EUR 4.1m) mainly stem from expenses relating to other periods as well as Supervisory Board remuneration.

(7.) Financial Result

Financial Result

→ 53

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Interest and similar income	3.9	2.1
thereof from hedging derivatives	4.3	3.2
thereof from trade and other receivables	0.2	0.3
thereof from other financial instruments	–2.2	–1.4
thereof from unwinding the discount on non-current assets	1.6	0.0
Interest and similar expenses	–14.5	–11.8
thereof from financial liabilities at amortized cost	–7.5	–6.5
thereof from hedging derivatives	–4.1	–2.6
thereof other interest and similar expenses	–2.6	–2.5
thereof from unwinding the discount on non-current provisions	–0.2	–0.1
Result of investments accounted for using the equity method	0.3	–3.6
Other financial result	–2.2	–0.7
thereof from hedging transactions	1.7	–0.6
thereof from ineffective hedging transactions	–1.6	0.0
thereof from currency effects	–2.2	–0.2
Financial result	**–12.4**	**–14.1**

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

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

(8.) Income Taxes

Income taxes include deferred taxes and current income taxes paid or payable in the respective countries. They comprise trade tax, corporate income tax, solidarity surcharge and the equivalent foreign tax charges. As in the prior year, the statutory corporate income tax rate, including solidarity surcharge, for the 2017 assessment period in Germany was 15.8%. The applicable trade tax rate was also unchanged in comparison to the prior year at 14.7%. This results in an effective tax rate for the group of 30.5% (prior year: 30.5%).

Current and deferred taxes are presented in the following table.

Income Taxes → 54

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Deferred taxes	–27.0	–47.9
Current taxes	–46.6	–24.5
Total	**–73.6**	**–72.5**

As of the reporting date, the Zalando group maintains unused corporate income tax losses of EUR 60.8m (prior year: EUR 98.0m) and unused trade tax losses of EUR 25.0m (prior year: EUR 75.5m). Currently, loss carry forwards are mainly attributable to foreign companies (prior year to ZALANDO SE). The amount of these unused tax losses depends on the final assessment by the applicable tax office.

The utilization of unused tax losses for which no deferred tax assets have been recognized in the past did not affect the tax result in the reporting year (prior year: EUR 0.3m).

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

Tax Rate Reconciliation

→ 55

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Earnings before taxes	175.2	192.9
Income tax rate for the group	30.5%	30.5%
Expected tax expense (–) / tax income (+)	–53.4	–58.8
Share of taxes for:		
Non-deductible expenses	–8.8	–6.8
Recognition of previously unrecognized unused tax losses	–0.2	0.0
Unrecognized unused tax losses	–7.8	–3.8
Entities included using the equity method	0.1	–1.1
Tax expenses (–) / tax income (+) relating to other periods	–0.2	–0.2
Tax rate differences	–3.2	–1.5
thereof share of subsidiaries with higher tax rates	0.1	0.0
thereof share of subsidiaries with lower tax rates	–3.3	–1.5
Other	0.0	–0.2
Income tax expense according to the consolidated statement of comprehensive income	**–73.6**	**–72.5**
Effective tax rate	*42.0%*	*37.6%*

(9.) Earnings per Share

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

The basic earnings per share decreased in comparison to the prior year due to lower net income for the period.

Basic Earnings per Share (EPS)

→ 56

	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Net income for the period attributable to the shareholders of ZALANDO SE (in EUR m)	103.1	120.5
Basic weighted average number of shares (in millions)	247.3	247.2
Total (in EUR)	**0.42**	**0.49**

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

Diluted Earnings per Share (EPS)

→ 57

	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Net income for the period attributable to the shareholders of ZALANDO SE (in EUR m)	103.1	120.5
Weighted average number of diluted shares (in millions)	259.5	256.3
Total (in EUR)	**0.40**	**0.47**

Employee options and contracts, which can be equity-settled, were also taken into account in the calculation of the diluted earnings per share in fiscal year 2017, except for those equity-settled share-based payments, which include performance conditions that had not yet been met as of the reporting date. As a result, the options granted within the scope of VSOP 2017 and EIP in fiscal year 2017 were not taken into account in the calculation of diluted earnings.

(10.) Personnel Expenses

Personnel Expenses

→ 58

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Wages and salaries	523.4	390.5
Social security, pensions and other benefit costs	91.2	67.2
thereof pension costs	0.2	0.3
Total	**614.6**	**457.7**

The average number of salaried employees in the group was 13,940 in fiscal year 2017 (prior year: 11,036). Contributions to the statutory pension insurance scheme rose by EUR 11.0m to EUR 41.2m (prior year: EUR 30.2m).

(11.) Intangible Assets

Intangible assets developed as follows:

Statement of Movements of Intangible Assets 2017 → 59

IN EUR M	Capitalized development costs	Industrial rights, similar rights and assets as well as licenses	Goodwill	Prepayments and assets under development	Total
Historical costs					
As of Jan 1, 2017	**79.1**	**42.1**	**13.9**	**38.4**	**173.5**
Additions	14.4	20.9	36.6	36.8	108.7
thereof from business combinations	0.0	17.3	36.6	0.0	53.9
Disposals	0.0	0.1	0.1	0.0	0.2
Reclassifications	17.1	–0.9	0.0	–16.4	–0.2
As of Dec 31, 2017	**110.6**	**62.0**	**50.4**	**58.8**	**281.8**
Amortization					
As of Jan 1, 2017	**48.0**	**24.6**	**0.0**	**0.0**	**72.6**
Additions	20.0	6.9	0.0	0.0	26.9
As of Dec 31, 2017	**68.0**	**31.5**	**0.0**	**0.0**	**99.5**
Carrying amounts					
As of Dec 31, 2016	**31.1**	**17.5**	**13.9**	**38.4**	**100.9**
As of Dec 31, 2017	**42.6**	**30.5**	**50.4**	**58.8**	**182.3**

Statement of Movements of Intangible Assets 2016

→ 60

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

Additions mainly relate to capitalized development costs of EUR 51.2m (prior year: EUR 57.7m), of which EUR 36.8m is contained in prepayments and assets under development (prior year: EUR 36.4m). These mainly concern production costs for internally developed software.

Research costs were recognized directly in profit and loss.

Apart from goodwill (see below), brand names and domain rights of EUR 4.7m (prior year: EUR 1.3m) were assigned an unlimited useful life since there are no legal, regulatory, contractual, competition-related, economic or other factors that would limit the useful life.

Amortization of EUR 26.9m was recorded in the reporting period (prior year: EUR 27.8m). Of this amount, EUR 4.4m (prior year: EUR 4.2m) is recognized in cost of sales, EUR 18.5m (prior year: EUR 19.5m) in selling and distribution costs, and EUR 4.1m (prior year: EUR 4.1m) in administrative expenses.

Impairment Test for Goodwill

Zalando recognized goodwill totaling EUR 50.4m as of December 31, 2017. This amount is not deemed to be material for the group, so we refrain from providing information beyond the following.

The goodwill is allocated to four units (substantially to DACH and RoE), being either individual cash-generating units or a group of cash-generating units (see 3.5.8 (5.)).

The annual impairment testing was carried out in the fourth quarter of the reporting year at the level of such cash-generating units. Recoverable amounts were calculated using value-in-use concept. At Zalando, the value in use is calculated based on reconciled planned financial statements, which have been approved by the Management Board. Thereafter, an additional period is added to reflect the strong growth of the Zalando businesses combined with the transition to a steady state situation. Beyond that, a terminal value is added as a perpetual annuity. The underlying planned financial statements reflect current performance and management's best possible estimates on the future development of individual parameters, such as market prices and profit margins. Market assumptions, such as economic development and market growth, are included based on external macroeconomic sources as well as sources specific to the business.

Zalando calculated the discount rate before taxes using the capital asset pricing model. Consequently, a risk-free rate, a market risk premium and a spread for credit risk based on the respective business-specific peer group were determined. In addition, the calculations include capital structure and the beta factor of the respective peer group as well as the average tax rate of each cash-generating unit. The resulting discount rates before taxes lie in the range of 11.8% to 12.8%.

The annual impairment testing did not uncover any goodwill impairment losses. Beyond this, it has been tested whether reasonably possible changes in the key assumptions could lead to the carrying amount of the units exceeding their respective recoverable amounts. Such situation did not exist as of December 31, 2017.

(12.) Property, Plant and Equipment

Property, plant and equipment were as follows:

Statement of Movements of Property, Plant and Equipment 2017

→ 61

IN EUR M	Plant and machinery	Other equipment, furniture and fixtures	Land and buildings and buildings on third-party land	Prepayments and assets under construction	Total
Historical cost					
As of Jan 1, 2017	**137.4**	**75.8**	**4.5**	**84.3**	**302.0**
Additions	35.6	31.9	35.9	86.3	189.7
thereof from business combinations	0.0	1.2	0.0	0.0	1.3
Disposals	–0.1	–3.8	0.0	–0.5	–4.4
Reclassifications	40.6	1.9	0.2	–42.5	0.2
Reclassified to held for sale	0.0	0.0	–39.5	–12.5	–52.0
Currency translation differences	0.0	0.0	0.2	1.0	1.2
As of Dec 31, 2017	**213.5**	**105.8**	**1.3**	**116.1**	**436.7**
Depreciation					
As of Jan 1, 2017	**25.2**	**33.5**	**0.3**	**0.0**	**59.0**
Additions	13.9	17.3	0.6	0.0	31.8
Disposals	–0.1	–4.0	0.0	0.0	–4.1
Reclassifications	0.0	0.0	0.0	0.0	0.0
Reclassified to held for sale	0.0	0.0	–0.5	0.0	–0.5
As of Dec 31, 2017	**39.0**	**46.8**	**0.4**	**0.0**	**86.2**
Carrying amounts					
As of Dec 31, 2016	**112.2**	**42.3**	**4.2**	**84.3**	**243.0**
As of Dec 31, 2017	**174.5**	**59.0**	**0.9**	**116.1**	**350.5**

Statement of Movements of Property, Plant and Equipment 2016

→ 62

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

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

The assets held for sale contain the warehouse set up in Szczecin, Poland, consisting of the land and building. The warehouse set up is available for immediate sale as of December 31, 2017. According to an agreement signed in November 2017, the property is to be sold in the first quarter of 2018. The transaction will be expected as an asset deal. Subsequently, the fulfillment center will be leased back by Zalando. The rental arrangement will qualify as an operating lease in accordance with the criteria set forth in IAS 17.

Depreciation of property, plant and equipment was EUR 31.8m (prior year: EUR 20.4m). Of this total, an amount of EUR 4.1m (prior year: EUR 2.6m) is recognized in cost of sales, EUR 21.2m (prior year: EUR 14.2m) in selling and distribution costs and EUR 6.4m (prior year: EUR 3.6m) in administrative expenses.

(13.) Non-Current Financial and Non-Financial Assets

As of the reporting date, non-current financial assets and non-current non-financial assets comprise the following components.

Non-Current Financial and Non-Financial Assets → 63

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
Other non-current financial assets	**25.9**	**29.2**	**–3.3**
thereof derivative financial instruments	17.2	11.2	6.0
thereof restricted cash	2.5	12.9	–10.4
thereof other	6.2	5.1	1.1
Other non-current non-financial assets	**3.5**	**3.0**	**0.5**
thereof deferred items	3.5	3.0	0.5

Derivative financial instruments include the long term fair value of a derivative resulting from the interest in the proceeds from the sale of developed land owned by third parties (EUR 15.4m; prior year: EUR 10.9m).

(14.) Investments Accounted for Using the Equity Method

As of the reporting date, investments accounted for using the equity method comprise the following entities:

Investments Accounted for Using the Equity Method → 64

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
FashionTrade.com B.V.	4.1	0.0	4.1
Le New Black SAS	1.8	0.0	1.8
Anatwine Ltd.	0.0	14.8	–14.8
Total	**5.9**	**14.8**	**–8.9**

During 2017, Zalando acquired additional shares of Anatwine and obtained control. Consequently, Anatwine is now fully consolidated and no longer presented in the investments accounted for using the equity method (see section 3.5.8 (5.)).

(15.) Inventories and Prepayments

Inventories of merchandise, mainly consisting of shoes and textiles, are recognized in an amount of EUR 778.9m (prior year: EUR 576.9m). The EUR 201.9m increase in inventories resulted from the increased business volume and from holding larger amounts of inventory in stock in order to increase availability and thus customer satisfaction.

Allowances of EUR 98.9m were recognized on inventories and the right to repossess goods associated with expected returns (prior year: EUR 82.9m). Expenses for allowances recorded on inventories was EUR 127.6m in the reporting year (prior year: EUR 95.3m).

(16.) Trade and Other Receivables

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

On aggregate, the bad debt allowances developed as follows:

Development of Bad Debt Allowances

→ 65

IN EUR M	Dec 31, 2017	Dec 31, 2016
Accumulated bad debt allowances as of Jan 1	**71.7**	**132.9**
Additions to portfolio-based specific bad debt allowance	38.0	28.1
Utilizations	–34.4	–82.1
Reversals	–9.0	–7.0
Exchange rate effects and other changes	–1.0	–0.2
Accumulated bad debt allowances as of Dec 31	**65.4**	**71.7**

Additions to bad debt allowances totaled EUR 38.0m in the reporting year (prior year: EUR 28.1m). Of the bad debt allowances recognized as of December 31 of the prior year, EUR 34.4m was utilized (prior year: EUR 82.1m) and EUR 9.0m reversed (prior year: EUR 7.0m). Bad debt losses for uncollectible receivables amounted to EUR 43.9m in the fiscal year (prior year: EUR 89.4m).

Bad debt allowances are in line with prior year's allowances. Zalando continues to optimize and improves its steering of payment options and works with a solvency score provider for better monitoring of fraudulent activities, resulting in a low level of bad debt allowances.

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

(17.) Other Current Financial Assets and Other Non-Financial Assets

As of the reporting date, current financial assets and current non-financial assets comprise the following components:

Other Current Financial Assets and Other Non-Financial Assets

→ 66

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
Other current financial assets	**80.7**	**245.8**	**–165.1**
thereof term deposits	40.0	220.0	–180.0
thereof derivative financial instruments	20.7	8.9	11.7
thereof receivables from suppliers	14.5	5.0	9.5
thereof other financial instruments	5.6	11.9	–6.3
Other current non-financial assets	**152.7**	**133.1**	**19.6**
thereof VAT receivables	67.4	59.6	7.8
thereof right to repossess goods	62.5	46.7	15.8
thereof deferred items	13.0	13.5	–0.4
thereof other	9.7	13.3	–3.6

Zalando did not continue the investments in term deposits because the interest conditions for term deposits are currently not favorable.

(18.) Cash and Cash Equivalents

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

Cash and Cash Equivalents

→ 67

IN EUR M	Dec 31, 2017	Dec 31, 2016
Money market funds	475.5	477.9
Cash in bank	529.8	439.6
Short-term bank deposits	60.0	55.0
Cash on hand	0.2	0.1
Total	**1,065.5**	**972.6**

(19.) Equity

The parent company issued 247,384,898 ordinary bearer no-par value shares (Stückaktien auf den Inhaber) as of the reporting date (prior year: 247,255,868). Each share represents an imputed share of issued capital of EUR 1.00 and entitles the bearer to one vote at the company's annual general meeting.

During fiscal year 2017, the issued capital of the parent company was increased by a total of EUR 0.1m to EUR 247.4m by making partial use of the authorized capital 2013. The capital contribution for the newly issued shares has been paid in in full.

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

Authorized and Conditional Capital

→ 68

	Amount in EUR m	Number of no-par value shares	Purpose
Authorized capital 2013	2.7	2,736,745	Servicing of subscription rights from COPs and SOP 2011 until October 28, 2018
Authorized capital 2015	94.7	94,694,847	Cash or non-cash capital increases until June 1, 2020
Conditional capital 2013	9.8	9,817,500	Servicing of subscription rights from SOP 2013
Conditional capital 2014	6.7	6,732,000	Servicing of subscription rights from SOP 2014
Conditional capital 2015	73.9	73,889,248	Issue of convertible bonds and / or bonds with warrants until June 1, 2020
Conditional capital 2016	5.1	5,098,440	Servicing of subscription rights from EIP

The use of authorized capital 2013 and the authorized capital 2015 requires the approval of the Supervisory Board. Authorized capital 2015 was not used in fiscal year 2017. No subscription rights from conditional capital 2013, conditional capital 2014 or conditional capital 2016 were exercised in the fiscal year.

The capital reserve amounts to EUR 1,182.4m (prior year: EUR 1,161.0m). In the reporting year, contributions were made under the share-based payment plans in accordance with IFRS 2 of EUR 27.5m (prior year: EUR 19.9m).

Other reserves include effects from cash flow hedging of EUR 10.9m (prior year: EUR −2.3m) and deferred taxes on the resulting measurement differences of EUR −3.3m (prior year: EUR 1.0m). Due to cash flow hedging in the reporting year, income of EUR 15.3m (prior year: EUR 3.6m) was recycled from other reserves to revenue, and expense of EUR 4.2m (prior year: EUR 0.1m) to cost of sales. Moreover, expenses of EUR 0.1m (prior year: EUR 0.2m) from interest rate hedging were recycled to the financial result in the reporting year.

In July 2017, ZALANDO SE repurchased 17,000 treasury shares at an average price of EUR 43.53, which corresponds to a notional share in share capital of EUR 17,000 and thus 0.01% of share capital. In November 2017, ZALANDO SE repurchased 143,773 treasury shares at an average price of EUR 41.73, which corresponds to a notional share in share capital of EUR 143,773 and thus 0.06% of share capital. Total repurchased shares per December 31, 2017, amount to a notional share in share capital of EUR 230,773 (prior year: 70,000) and thus to 0.09% (prior year: 0.03%) of share capital.

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

In 2017, ZALANDO SE purchased additional shares in Anatwine Ltd. after first-time full consolidation (see section 3.5.8 Other Notes (5.)). The difference between acquisition cost and proportional equity acquired was recognized in accumulated profit (EUR 4.9m).

Non-controlling interest arose from the acquisition and first-time full consolidation of Anatwine Ltd. in 2017. Minority shareholders hold 2.5% of the Anatwine shares per December 31, 2017; the non-controlling interest amounted to EUR –0.1m (prior year: EUR 0.0m).

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

(20.) Share-Based Payments

The share-based payment awards granted by Zalando are primarily designed as equity-settled plans.

Equity-Settled Plans

Overview

Various share-based equity-settled payment awards were in place as of the reporting date. For reporting purposes, plans with similarities are grouped together. Zalando makes a distinction between six kinds of payment awards: First, the Call Option Programs (“COPs”); second, the Stock Option Program 2011 (“SOP 2011”); third, the Stock Option Program 2013 (“SOP 2013”); fourth, the Stock Option Program 2014 (“SOP 2014”); fifth, the Equity Incentive Program (“EIP”) and sixth, the Virtual Stock Option Program 2017 (“VSOP 2017”). The following section includes the explanation of significant programs.

The goal of share-based payments is to reward the recipients’ contribution to the value of the business and foster the long-term success of the company. These variable compensation packages, with their long-term incentive and risk-based character, are a useful way of tying together the interests of the shareholders and recipients.

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

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

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

Furthermore, Zalando has decided to implement a Top Performance Options Plan (“TPOP”) for employees of the company and its subsidiaries. The TPOP only applies to the granting of a bonus for the performance period from July 1, 2017, to June 30, 2018. The purpose of the plan is to reward employees for excellent performance and to give them an opportunity to participate in the future development of the company.

The grant for the performance year amounts to no more than 1/12 of the comprehensive annual target compensation of the respective participant. One top performance option entitles the participant to receive one share and has a term of two years from the valuation date. Any grant under this plan is voluntary. Therefore, the status or possible status of an employee as a participant or the fact that a participant was granted a bonus under this plan cannot be interpreted as an obligation of the company. In particular, no operational practice is constituted by the granting of Top Performance Options.

SOP 2011

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

The options granted to the recipients vest in tranches. They vest if the recipient is employed at Zalando for the entire vesting period of the respective sub-tranche. The last sub-tranche of SOP 2011 can be exercised in October 2018. The options are forfeited if the recipient leaves the group before the end of the vesting period. The recipients have no claim to cash payment.

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

Development of Options (SOP 2011)

→ 69

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**2,730,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	187,000	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**2,543,200**	**5.65**
Options vested as of Dec 31, 2016	**1,870,000**	**5.65**
Outstanding options as of Jan 1, 2017	**2,543,200**	**5.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	691,900	5.65
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**1,851,300**	**5.65**
Options vested as of Dec 31, 2017	**1,486,650**	**5.65**

The options granted by the company can be exercised as of the vesting date. The recipients can exercise vested options for an unlimited period. The weighted average share value on the date of exercise of an option exercised in the reporting period amounts to EUR 41.39 (prior year: EUR 30.93).

SOP 2013

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

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

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

Development of Options (SOP 2013)

→ 70

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**9,817,500**	**15.63**
Options vested as of Dec 31, 2016	**5,856,840**	**15.63**
Outstanding options as of Jan 1, 2017	**9,817,500**	**15.63**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**9,817,500**	**15.63**
Options vested as of Dec 31, 2017	**7,809,120**	**15.63**

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

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

SOP 2014

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

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

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

Development of Options (SOP 2014)

→ 71

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**6,468,554**	**19.13**
Options granted during the reporting period	342,450	31.60
Options forfeited during the reporting period	215,485	22.91
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**6,595,520**	**19.65**
Options vested as of Dec 31, 2016	**3,450,009**	**18.90**
Outstanding options as of Jan 1, 2017	**6,595,520**	**19.65**
Options granted during the reporting period	0	–
Options forfeited during the reporting period	298,608	**21.22**
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**6,296,912**	**19.58**
Options vested as of Dec 31, 2017	**4,826,377**	**19.13**

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

The weighted average fair value of a new option last granted in fiscal year 2016 within the scope of the SOP 2014 was EUR 7.10. The fair value of the options comprises the intrinsic value and the fair value multiplied by the probability that the performance target will be reached. The fair value of the options was calculated using the Black-Scholes option price model. In fiscal year 2017, no new options were granted under SOP 2014. The input parameters included in the calculation of the last granted options in 2016 are summarized in the following table:

Parameters SOP 2014

→ 72

IN EUR M	Jan 1 – Dec 31, 2016
Weighted average share price (EUR)	29.2
Weighted average exercise price (EUR)	31.6
Expected volatility (%)	36.2
Expected life of option (years)	4.0
Expected dividends (%)	0.0
Risk-free interest rate for equivalent maturities (%)	0.0
Probability of reaching the performance target (%)	95.2

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

VSOP 2017

The VSOP 2017 entitles selected senior members of the management team to subscribe to virtual stock options in order to be remunerated for any sustained increase in the value of ZALANDO SE. The virtual stock options were issued at an exercise price of EUR 25.00 (Type A options) or at EUR 50.00 (Type B options). In fiscal year 2017, a total of 270,000 A options and 600,000 B options were issued. For each option that is exercised, the holder receives a cash settlement of an amount equal to the closing price of the share of the company listed on the Frankfurt Stock Exchange on the date on which notification is received that the option is being exercised less the exercise price of EUR 25.00 for Type A options and EUR 50.00 for Type B options. The company has the right to fulfill the cash settlement obligations towards the holder of the option by delivering shares instead.

The options vest provided that (i) the recipients have worked for the company for the period specified within a tranche, (ii) the performance target defined in the VSOP 2017 has been fulfilled, and (iii) the waiting period has elapsed.

The options granted to the recipients vest in 12 tranches over a period of three years. Generally, over the three years starting with the grant date, 1/12th of the options granted are deemed to have vested in each three-month period in which the option holder is employed at ZALANDO SE (or a group company).

The performance target stipulates that Zalando must achieve a certain level of contractually agreed revenue growth over a period of three years, starting on the grant date. If the contractual revenue target is not achieved, the options are forfeited without replacement.

The waiting period of three years commences on the date on which the options are granted. At the end of the waiting period, the holders of exercisable options can exercise them at any time over the following two years, except during black-out-periods.

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

Development of Options (VSOP 2017) → 73

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2017	**0**	**–**
Options granted during the reporting period	870,000	42.24
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**870,000**	**42.24**
Options vested as of Dec 31, 2017	**72,498**	**42.24**

The weighted average of the remaining contractual term of the outstanding options (meaning the period until the options’ expiry date) as of the reporting date is four years and six months.

The weighted average fair value of a new option granted within the scope of the VSOP 2017 was EUR 17.76 for Type A options and EUR 8.79 for Type B options in the reporting period. The fair value of the options comprises the intrinsic value and the market value multiplied by the probability that the performance target will be reached. The fair value of the options was calculated using a binomial model. The input parameters included in the calculation of the newly granted options are summarized in the following table:

Parameters VSOP 2017

→ 74

	Jan 1 – Dec 31, 2017
Weighted average share price (EUR)	40.0
Weighted average exercise price Type A (EUR)	25.0
Weighted average exercise price Type B (EUR)	50.0
Expected volatility (%)	36.0
Expected dividends (%)	0.0
Risk-free interest rate for equivalent maturities (%)	–0.2
Probability of reaching the performance target (%)	93.1

The parameters used in the valuation were determined as follows: The share price was set with reference to the trading price of the Zalando share. The estimated volatility used in the model is primarily based on the historical share price of the Zalando share. The risk-free interest rate for equivalent maturities was calculated using the Svensson method. Where possible, the probability that the performance target will be reached was determined based on market assumptions.

EIP

The first EIP tranche was granted in fiscal year 2016 to the members of the Management Boards of affiliated companies and managerial staff members as well as selected key employees of the company and affiliated companies. In fiscal year 2017, the second tranche was granted.

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

The performance options provide a payout only in case of an increase of the value of ZALANDO SE. The management of Zalando aims to settle performance shares and performance options by issuing shares.

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

The ability to exercise the portfolio is tied to a number of conditions. First, the recipient has to be employed by the company during the vesting period. Second, the terms and conditions of the EIP must be met, and third, the waiting period must have expired.

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

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

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

Development of Options (EIP 2016 and 2017)

→ 75

	Number	Weighted average exercise price (EUR)
Outstanding options as of Jan 1, 2016	**0**	**–**
Options granted during the reporting period	879,721	24.77
Options forfeited during the reporting period	0	–
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2016	**879,721**	**24.77**
Options vested as of Dec 31, 2016	**219,731**	**24.78**
Outstanding options as of Jan 1, 2017	**879,721**	**24.77**
Options granted during the reporting period	1,232,955	36.45
Options forfeited during the reporting period	188,899	31.17
Options exercised during the reporting period	0	–
Options expired during the reporting period	0	–
Outstanding options as of Dec 31, 2017	**1,923,777**	**31.65**
Options vested as of Dec 31, 2017	**1,155,365**	**28.15**

The weighted average fair value of performance shares within the scope of the EIP was EUR 35.76 in the reporting period. The weighted average fair value of ATM performance options was EUR 9.79, and of OTM performance options was EUR 7.20.

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

Parameters EIP 2016 and 2017

→ 76

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Weighted average share price (EUR)	39.3	24.6
Weighted average exercise price Performance Share (EUR)	1.0	1.0
Weighted average exercise price ATM Performance Option (EUR)	40.2	27.1
Weighted average exercise price OTM Performance Option (EUR)	48.2	32.5
Expected volatility (%)	36.0	36.0
Expected life of option (years)	4.0	4.0
Expected dividends (%)	0.0	0.0
Risk-free interest rate for equivalent maturities (%)	–0.4	–0.6
Probability of reaching the performance target (%)	93.5	95.1

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

Total Expenses Recognized for Share-Based Payment Awards

The following table shows the expenses recognized for share-based payments awards in fiscal years 2017 and 2016:

Expenses from Share-Based Payments

→ 77

IN EUR M	Jan 1 – Dec 31, 2017	Jan 1 – Dec 31, 2016
Equity-settled	27.5	19.9
Total expenses recognized	**27.5**	**19.9**

(21.) Provisions

Provisions developed as follows in the reporting year:

Development of Provisions

→ 78

IN EUR M	Jan 1, 2017	Usage	Addition	Interest expense	Dec 31, 2017
Restoration obligations	11.8	0.1	2.9	0.3	14.9
Other provisions	2.6	1.9	0.5	0.0	1.2
Total	**14.4**	**2.0**	**3.4**	**0.3**	**16.1**

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

The following table shows the maturities of the provisions at the end of fiscal year 2017:

Maturity of Provisions

→ 79

	Due in			
IN EUR M	Less than 1 year	1–5 years	More than 5 years	Total
Restoration obligations	0.0	1.0	13.9	14.9
Other provisions	0.4	0.7	0.1	1.2
Total	**0.4**	**1.7**	**14,0**	**16.1**

(22.) Trade Payables and Similar Liabilities and Prepayments Received

Trade payables and similar liabilities rose by EUR 199.5m to EUR 1,120.0m. The increase is largely due to deliveries of merchandise in light of the higher business volume and longer payment terms.

Under reverse factoring agreements, suppliers' claims against Zalando totaling EUR 328.9m were transferred to various factors as of December 31, 2017 (December 31, 2016: EUR 282.3m). These are recognized in the statement of financial position under trade payables and similar liabilities.

Trade payables contain liabilities denominated in foreign currency equivalent to EUR 23.4m as of the reporting date (prior year: EUR 31.1m).

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

(23.) Other Current Non-Financial Liabilities and Other Financial Liabilities

As of the reporting date, current financial liabilities and current non-financial liabilities comprise the following components:

Other Current Financial Liabilities and Other Current Non-Financial Liabilities

→ 80

IN EUR M	Dec 31, 2017	Dec 31, 2016	Change
Other current financial liabilities	**84.0**	**69.0**	**15.0**
thereof obligations to reimburse customers for returns	53.2	34.9	18.3
thereof debtors with credit balances	12.2	22.8	–10.6
thereof cash contribution for capital increase	3.3	0.0	3.3
thereof others	15.3	11.3	4.0
Other current non-financial liabilities	**123.9**	**86.7**	**37.2**
thereof VAT liabilities	66.1	43.3	22.8
thereof liabilities from gift vouchers	24.2	17.3	6.9
thereof liabilities from wage and salary	25.6	19.0	6.6
thereof others	8.0	7.1	0.9

The increases in VAT liabilities and liabilities from gift vouchers are largely due to the higher business volume. Liabilities from the sale of gift vouchers are recognized at the value of the anticipated utilization. The changes in liabilities from wage and salary are mainly impacted by the increase in the number of employees (see section 3.5.8 (6.))

(24.) Borrowings

Borrowings are due to banks and relate to the financing of fulfillment centers. For more information, please refer to section 3.5.8 Other Notes (1.).

(25.) Notes to the Statement of Cash Flows

In fiscal year 2017, Zalando generated a positive cash flow from operating activities of EUR 193.7m (prior year: EUR 275.8m). Further to a decrease in pre-tax income (which decreased from EUR 192.9m in the prior year to EUR 175.2m in the reporting year), cash flow from operating activities decreased largely due to a higher cash outflow from working capital. This was partly offset by the increase in cash inflows for VAT receivables and VAT payables and prepayments received.

The capital employed in net working capital increased compared to the prior year and thus negatively impacted the cash flow. Net working capital, consisting of inventories and trade and other receivables less trade payables and similar liabilities increased from a very low level of EUR –127.6m in the prior year to EUR –62.4m as of December 31, 2017.

The cash outflow from investing activities mainly results from investments in the logistics infrastructure relating primarily to the fulfillment centers in Mönchengladbach, Lahr and Szczecin and capital expenditures on internally developed software as well as furniture and fixtures. Capex, being the sum of the payments for investments in fixed and intangible assets, amounted to EUR 243.9m (prior year: EUR 181.7m). In 2017, an amount of EUR 34.9m was invested in corporate acquisitions (prior year: EUR 30.4m). Cash flow from investing activities further consists of cash disinvested in term deposits with an original term of more than three months and is therefore presented in cash flow from investing activities. As of December 31, 2017, an amount of EUR 40.0m was still invested in such term deposits (December 31, 2016: EUR 220.0m).

Changes in borrowings impacted the statement of cash flows and the statement of financial position as follows.

Reconciliation of Liabilities Arising from Financing Activities

→ 81

IN EUR M	Carrying amount as of Dec 31, 2016	Cash flows	Non-cash flow changes	Carrying amount as of Dec 31, 2017
Non-current borrowings	11.2	0.0	–2.8	8.4
Current borrowings	3.2	–3.2	2.8	2.8

As a result, cash and cash equivalents increased by EUR 92.9m during the year, resulting in Zalando carrying cash and cash equivalents of EUR 1,065.5m as of December 31, 2017.

Free cash flow decreased by EUR 153.3m from EUR 63.7m to EUR –85.0m compared to the prior year. The main factor for the decrease is the lower cash inflow from operating activities and higher capex.

Zalando’s liquidity position – as the sum of cash and cash equivalents plus term deposits with an original term of more than three months but less than twelve months – slightly declined in 2017 by EUR 87.1m to EUR 1,105.5m.

(26.) Deferred Taxes

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

Deferred Tax Assets and Liabilities

→ 82

IN EUR M	Deferred tax assets		Deferred tax liabilities		Net balance	
	Dec 31, 2017	Dec 31, 2016	Dec 31, 2017	Dec 31, 2016	Dec 31, 2017	Dec 31, 2016
Intangible assets	2.1	1.9	–27.9	–20.6	–25.8	–18.7
Property, plant and equipment	0.1	0.0	–3.5	–3.4	–3.4	–3.4
Inventories	0.6	0.0	–5.3	–2.5	–4.7	–2.5
Trade and other receivables	1.2	0.2	–11.9	–6.7	–10.7	–6.6
Provisions	3.8	3.2	0.0	0.0	3.8	3.2
Other financial and non-financial liabilities	6.6	5.0	0.0	–0.2	6.6	4.8
Unused tax losses	0.2	21.7	0.0	0.0	0.2	21.7
Total	**14.7**	**31.9**	**–48.7**	**–33.5**	**–34.0**	**–1.5**
Netting	**–13.2**	**–30.3**	**13.2**	**30.3**	**0.0**	**0.0**
Total recognized deferred tax assets and liabilities	**1.4**	**1.6**	**–35.4**	**–3.1**	**–34.0**	**–1.5**

The increase of net deferred tax liabilities is mainly impacted by the usage of loss carry forwards in 2017, which were mainly attributable to ZALANDO SE and zLabels (EUR –21.7m) and due to an increase in deferred tax liability on capitalized development costs totaling EUR –6.2m. Furthermore, market values of hedging derivatives and other derivatives also increased net deferred tax liabilities (EUR –7.7m; prior year: EUR –3.1m).

Changes in the fair values of hedging derivatives (cash flow hedges) in equity had an equity-decrease effect from deferred taxes of EUR –3.3m (prior year: EUR +0.9m), which are included in other comprehensive income.

Deferred tax assets on unused tax losses in the 2017 reporting year pertain primarily to foreign subsidiaries (EUR 0.2m; prior year mainly to ZALANDO SE: EUR 21.4m). The amounts recognized are based on the tax results expected in the planning period.

(27.) Financial Instruments

Carrying Amounts of Financial Assets / Liabilities and Their Fair Values 2017

→ 83

IN EUR M	Category pursuant to IAS 39*	Carrying amount as of Dec 31, 2017	Amount recognized in the balance sheet pursuant to IAS 39			Fair value as of Dec 31, 2017**
			Amortized cost	Fair value not through profit or loss	Fair value through profit or loss	
Assets						
Cash and cash equivalents	LaR	1,065.5	1,065.5	–	–	–
Trade receivables	LaR	278.7	278.7	–	–	–
Other financial assets	LaR	64.7	64.7	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	17.2	–	17.2		17.2
Other derivative financial instruments	FVtPL	20.6			20.6	20.6
Investments in equity instruments	Afs	4.1	4.1***			
Liabilities						
Trade payables and similar liabilities	FLAC	1,120.0	1,120.0	–	–	–
Financial liabilities	FLAC	11.2	11.2	–	–	11.9
Other financial liabilities	FLAC	78.3	78.3	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	5.7	–	5.7		5.7
Other derivative financial instruments	FVtPL	2.1			2.1	2.1

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

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

***) Zalando used the exception in accordance with IAS 39.46 (c).

Carrying Amounts of Financial Assets / Liabilities and Their Fair Values 2016

→ 84

IN EUR M	Category pursuant to IAS 39*	Carrying amount as of Dec 31, 2016	Amount recognized in the balance sheet pursuant to IAS 39: Amortized cost	Fair value not through profit or loss	Fair value through profit or loss	Fair value as of Dec 31, 2016**
Assets						
Cash and cash equivalents	LaR	972.6	972.6	–	–	–
Trade receivables	LaR	216.0	216.0	–	–	–
Other financial assets	LaR	254.9	254.9	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	7.3	–	6.2	1.1	7.3
Other derivative financial instruments	FVtPL	12.8			12.8	12.8
Liabilities						
Trade payables	FLAC	920.5	920.5	–	–	–
Financial liabilities	FLAC	14.4	14.4	–	–	15.5
Other financial liabilities	FLAC	61.8	61.8	–	–	–
Derivative financial instruments designated as hedging instruments	n.a.	9.5	–	9.3	0.2	9.5

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

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

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

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

Nominal Amounts and Market Values of Derivative Financial Instruments

→ 85

IN EUR M	Nominal value	Market value: Assets	Market value: Liabilities	Market value: Total	Nominal value	Market value
	Dec 31, 2017	Dec 31, 2017	Dec 31, 2017	Dec 31, 2017	Dec 31, 2016	Dec 31, 2016
Forward exchange contracts	1,288.1	22.5	7.6	14.8	1,104.4	–1.9
Interest rate swaps	6.7	0.0	0.2	–0.2	8.8	–0.3
Total	**1,294.8**	**22.5**	**7.8**	**14.7**	**1,113.3**	**–2.2**

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

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

The market values of forward exchange contracts designated to a hedging relationship as well as forward exchange contracts that are not designated to a hedging relationship are reported in the statement of financial position under other current or non-current financial assets and liabilities.

In the event that all contractual partners fail to meet their obligations from the forward exchange contracts, the credit risk for the group amounts to EUR 15.0m as of the reporting date (prior year: EUR 0.2m).

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

In the reporting period, income from fair value measurement of financial instruments designated as a cash flow hedge of EUR 11.5m (prior year: EUR –3.1m) was recognized directly in equity.

Net Gains and Losses from Financial Assets and Financial Liabilities

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

Net Gains and Losses from Financial Instruments 2017

→ 86

IN EUR M	From interest affecting profit or loss	From subsequent measurement affecting profit or loss			From disposal affecting profit or loss	Total 2017
		At fair value	Currency translation	Allowances		
Loans and receivables	–2.2	0.0	–3.8	–38.0	–3.8	–47.8
Fair value through profit or loss	1.6	1.0	0.0	0.0	0.0	2.6
Liabilities in the category measured at amortized cost	–7.5	0.0	0.5	0.0	0.0	–7.1
Total	**–8.2**	**1.0**	**–3.3**	**–38.0**	**–3.8**	**–52.3**

Net Gains and Losses from Financial Instruments 2016

→ 87

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

Fair Value Hierarchy

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

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

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

Other financial assets include an interest in the proceeds from the sale of developed land owned by third parties. This is measured at fair value through profit or loss using the income approach and level 3 inputs of the fair value hierarchy (observable sales price). As of December 31, 2017, it amounted to EUR 15.6m (prior year: EUR 12.8m).

Offsetting

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

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

Netting of Financial Instruments 2017

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IN EUR M	Gross amount	Amount netted in the statement of financial position	Net amount shown in the statement of the financial position	Associated amounts not netted in the statement of financial position	Net amount as of Dec 31, 2017
Financial assets					
Derivative financial assets	22.5	0.0	22.5	7.5	15.0
Financial liabilities					
Derivative financial liabilities	7.6	0.0	7.6	7.5	0.2

Netting of Financial Instruments 2016

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

3.5.8 Other Notes

(1.) Risks Relating to Financial Instruments and Financial Risk Management

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

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

Market Risk

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

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

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

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

If the euro had appreciated by 5% against the foreign currencies as of December 31, 2017, earnings before taxes would have been EUR 5.0m lower (prior year: EUR 7.3m). If the euro had depreciated 5% compared with the exchange rate as of December 31, 2017, earnings before taxes would have been EUR 5.6m higher (prior year: EUR 8.1m).

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

Foreign Currency Sensitivity on Profit or Loss 2017

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	Impacts on profit or loss							
IN EUR M	CHF	DKK	GBP	NOK	PLN	SEK	USD	Total
FX rate as Dec 31, 2017	**1.1702**	**7.4449**	**0.8872**	**9.8403**	**4.1770**	**9.8438**	**1.1993**	
5% increase in FX rate	–1.2	–0.4	0.0	–0.3	–1.9	–0.2	–0.9	–5.0
5% decrease in FX rate	1.3	0.5	0.0	0.3	2.1	0.2	1.0	5.6

The reserve for derivatives in group equity would have been EUR 38.8m higher (prior year: EUR 34.6m higher) if the euro had appreciated 5% compared with the exchange rate as of December 31, 2017. This reserve would have been EUR 42.9m lower (prior year: EUR 38.2m lower) if the euro had depreciated 5%.

The impact on other comprehensive income by currency breaks down as follows.

Foreign Currency Sensitivity on Other Comprehensive Income 2017

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	Impact on other comprehensive income							
IN EUR M	CHF	DKK	GBP	NOK	PLN	SEK	USD	Total
FX rate as Dec 31, 2017	**1.1702**	**7.4449**	**0.8872**	**9.8403**	**4.1770**	**9.8438**	**1.1993**	
5% increase in FX rate	26.4	0.0	–0.8	5.1	8.0	7.0	–6.9	38.8
5% decrease in FX rate	–29.2	0.0	0.9	–5.7	–8.9	–7.8	7.7	–42.9

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

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

Credit Risk

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

There is no significant concentration of credit risk.

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

Liquidity Risk

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

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

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

The tables below show the contractually agreed (undiscounted) interest and principal payments for primary financial liabilities and for derivative financial instruments with their negative fair value. All instruments in the portfolio as of December 31, 2017, and December 31, 2016, and for which payments had already been contractually agreed were included. Planned figures for new future liabilities were not included. The floating-rate interest payments from the financial instruments were determined based on the interest rates most recently fixed before December 31, 2017, and December 31, 2016, respectively. All on-call financial liabilities are always allocated to the earliest possible date.

Payments for Financial Liabilities and Derivative Financial Instruments 2017

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	Carrying amount	Cash flows 2018		Cash flows 2019–2022	
IN EUR M	Dec 31, 2017	Interest	Repay-ments	Interest	Repay-ments
Borrowings	11.2	0.3	2.8	0.4	8.4
Trade payables and similar liabilities	1,120.0	1.6	1,120.0	0.0	0.0
Other financial liabilities	88.5	0.1	84.0	0.1	4.5
thereof from derivatives	7.8	0.1	7.6	0.1	0.0
Total	**1,219.6**	**2.0**	**1,206.8**	**0.6**	**12.8**

Payments for Financial Liabilities and Derivative Financial Instruments 2016

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

Capital Management

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

Capital management and its objectives and definition are based on key performance indicators derived from the consolidated financial statements in accordance with IFRS. Zalando defines the equity ratio key performance indicator as the ratio of equity to total assets and the net working capital key performance indicator as the sum of inventories and trade receivables less trade payables and similar liabilities. The equity ratio stood at 51.6% as of the reporting date (prior year: 55.5%) and net working capital came to EUR –62.4m as of the reporting date (prior year: EUR –127.6m). The company achieved the key performance indicator targets set by management during both the 2017 year and in the prior year.

Collateral

Zalando pledged financial assets of EUR 2.5m as collateral in the reporting period (prior year: EUR 12.9m). They mainly relate to collateral in connection with lease. The collateral provided may be drawn upon by the beneficiaries should the group not be able to fulfill its payment obligations.

(2.) Information about Related Parties

Zalando identified the related parties of ZALANDO SE in accordance with IAS 24. Zalando had transactions with related parties in the reporting period in the ordinary course of business. The transactions were carried out in accordance with the arm's length principle.

Goods and services from related parties give rise to liabilities of EUR 67.3m as of the reporting date (prior year: EUR 59.2m). Of this amount, EUR 65.4m (prior year: EUR 59.2m) is due to a reverse factoring provider on account of reverse factoring agreements between Zalando and related parties. As a result, there were trade payables or similar liabilities due directly to related parties totaling EUR 1.9m (prior year: EUR 0.0m). Furthermore, trade receivables from related parties amount to EUR 0.3m (prior year: EUR 0.4m).

Merchandise of EUR 161.2m was ordered from related parties in the reporting period. The order volume totaled EUR 122.7m in the comparative period of the prior year. In addition, goods totaling EUR 2.7m were sold to related parties. The cost of services received from related parties came to EUR 3.5m in the reporting period (prior year: EUR 0.3m).

Furthermore, there are no loan receivables due from a related party (prior year: EUR 3.5m).

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

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

Members of the Management Board

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

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Members of the Supervisory Board

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Supervisory Board	Profession held	Member of the Supervisory Board since
Alexander Samwer	Independent internet entrepreneur, Munich, Germany	Dec 12, 2013
Anders Holch Povlsen (Vice chairperson)	CEO Bestseller A / S, Brande, Denmark	Dec 12, 2013
Beate Siert	Talent Acquisition Specialist ZALANDO SE, Berlin, Germany	Jun 2, 2015
Dominik Asam	CFO Infineon Technologies AG, Munich, Germany	May 31, 2017
Dylan Ross	Category Management / Men Textile Fashion ZALANDO SE, Berlin, Germany	Jun 2, 2015
Jørgen Madsen Lindemann	CEO & President Modern Times Group MTG AB, Klampenborg, Denmark	May 31, 2016
Konrad Schäfers	Digital Experience ZALANDO SE, Berlin, Germany	Jun 2, 2015
Lothar Lanz (Chairperson of the Supervisory Board)	Member of Supervisory Boards, including Axel Springer SE and TAG Immobilien AG as well as of the Board of Directors of Kinnevik AB	Feb 10, 2014
Shanna Prevé	Managing Director Business Development for Google Consumer Hardware Group, San Francisco, USA (California)	May 31, 2017

Further Information
Report of the Supervisory Board p. 42

The term of office of Kai-Uwe Ricke and Lorenzo Grabau expired on May 31, 2017. Furthermore, Dylan Ross stepped down from the Supervisory Board in January 2018.

The members of the Management Board and Supervisory Board only receive remuneration relating to their function as persons in key positions. In fiscal year 2017, expenses of EUR 4.3m were recorded for the members of management who hold key positions in the group (prior year: EUR 5.9m). Of this amount, EUR 3.7m is attributable to share-based payment awards in fiscal year 2017 (prior year: EUR 5.3m). The expenses for share-based payment awards are calculated using graded vesting, which means that the periodical expense gradually decreases over the course of the vesting period. All other remuneration is classified as short-term benefits.

The share-based payments were granted in fiscal years 2011 and 2013. They can vest over a certain period of time and will be included in the total remuneration over this time period based on the service rendered in the respective fiscal year. The share-based payment awards granted to key management personnel are included in the plans explained in section 3.5.7 (20.) of the notes to the consolidated financial statements.

(3.) Remuneration of the Management Board and Supervisory Board of ZALANDO SE

Total remuneration of the Management Board totaled EUR 0.6m in fiscal year 2017 (prior year: EUR 0.6m). No new option rights were granted to the Management Board in fiscal year 2017 (prior year: 0 options). Further information regarding Section 314 (1) No. 6a HGB can be found in the remuneration report, which is presented in the corporate governance report and is part of the combined management report.

The members of the Supervisory Board received remuneration of EUR 0.8m in fiscal year 2017 (prior year: EUR 0.6m). The Management Board and Supervisory Board propose to the annual general meeting the granting of remuneration in accordance with the provision contained in Art. 15 of ZALANDO SE's Articles of Association.

(4.) Corporate Governance Declaration

The declaration by the Management Board and the Supervisory Board regarding the Corporate Governance Code pursuant to Section 161 AktG of December 2017 is published on the company's website.

(5.) Business Combinations

During 2017, Zalando invested in corporate acquisitions totaling EUR 26.7m. These acquisitions closed in June 2017 include KICKZ Never Not Ballin' GmbH, Munich, Germany ("KICKZ"), and Anatwine Ltd, Cheltenham, United Kingdom ("Anatwine"). Resulting from this, Zalando acquired 100% and 78.4% of the voting equity interests in KICKZ and Anatwine respectively.

zln.do/en-kickz

KICKZ is a leading multi-channel basketball retailer. With the addition of KICKZ, Zalando will further strengthen its sports and lifestyle segment, especially in basketball.

Furthermore, Zalando acquired additional shares of Anatwine in order to effectively obtain control of the company. Anatwine provides marketplace supply-side integration solutions for retailers and brands, especially in the fashion and lifestyle sectors. With this acquisition, Zalando will strengthen its ability to digitalize partner stock and connect it to retail channels. Consequently, the majority of the purchased goodwill was allocated to DACH and RoE.

Both acquisitions impacted additions to intangible assets totaling EUR 53.9m, including goodwill of EUR 36.6m and additions to property, plant and equipment totaling EUR 1.3m. Furthermore, Zalando acquired inventories totaling EUR 12.5m. In addition, Zalando remeasured its previously held equity interest in Anatwine at its acquisition-date fair value and recognized the resulting gain in the financial result totaling EUR 3.2m.

(6.) Average Number of Employees

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

Average Number of Employees → 96

	2017	2016
Commercial	1,939	1,347
Operations	8,445	6,620
Technology	1,852	1,439
Other	1,704	1,630
Total	**13,940**	**11,036**

(7.) Operating Leases

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

The expenses recognized from operating leases came to EUR 45.3m in the reporting period (prior year: EUR 34.5m). Future minimum lease payments under non-cancelable operating leases are shown in the following table:

Future Minimum Lease Payments

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IN EUR M	Less than 1 year	1–5 years	More than 5 years	Total
Dec 31, 2017	**64.5**	**190.7**	**55.4**	**310.6**
Dec 31, 2016	42.8	97.0	49.2	189.0

There are no future minimum receipts from non-cancelable operating sub-leases.

(8.) Information Regarding the Auditor

The consolidated financial statements and the annual financial statements of ZALANDO SE for the fiscal year from January 1 to December 31, 2017, were audited by Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart. The lead auditors were Dr. Ingo Röders (since 2013) and Mr. Sebastian Haas (since 2016). Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, may audit the financial statements of the company until 2023, after which the audit has to be put out for tender.

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

— EUR 0.7m for the audit (separate and consolidated financial statements) (prior year: EUR 0.5m) and
— EUR 0.1m for other assurance services (prior year: EUR 0.3m).

(9.) Shareholdings

ZALANDO SE's direct and indirect shareholdings in its subsidiaries as of December 31, 2017, can be summarized as follows:

List of Shareholdings

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No.	Company	Company domicile	Currency	Share of equity held by*	Share in capital in % 2017
Subsidiaries					
1	zLabels GmbH	Berlin	EUR	Directly	100.0
2	Zalando Operations GmbH	Berlin	EUR	Directly	100.0
3	Zalando Logistics SE & Co. KG	Brieselang	EUR	Directly 2	99.0 1.0
4	Zalando Logistics Mönchengladbach SE & Co. KG	Mönchen-gladbach	EUR	Directly 2	99.0 1.0
5	Zalando Logistics Süd SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
6	Zalando S.A.S.	Paris, France	EUR	Directly	100.0
7	Zalando Customer Care DACH SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
8	Zalando Customer Care International SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
9	Zalando Content Creation SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
10	Zalando Fashion Entrepreneurs GmbH	Berlin	EUR	Directly	100.0
11	Zalando Lounge Service GmbH	Berlin	EUR	Directly	100.0
12	Zalando Outlets GmbH	Berlin	EUR	Directly	100.0
13	Zalando Ireland Ltd.	Dublin, Ireland	EUR	Directly	100.0
14	Zalando Finland Oy	Helsinki, Finland	EUR	Directly	100.0
15	Bread & Butter GmbH & Co. KG	Berlin	EUR	Directly	100.0
16	Portokali Property Development III SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
17	Fashion Connectivity Technologies GmbH	Berlin	EUR	Directly	100.0
18	Mobile Fashion Discovery GmbH	Berlin	EUR	Directly	100.0
19	Zalando Media Solutions GmbH	Berlin	EUR	Directly	100.0
20	Bread & Butter Tradeshow Verwaltungs GmbH	Berlin	EUR	15	100.0

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No.	Company	Company domicile	Currency	Share of equity held by*	Share in capital in % 2017
21	zLabels Trading Ltd.	Hong Kong, Hong Kong	HKD	1	100.0
22	zLabels China Trading Co. Ltd.	Dongguan, China	CNY	21	100.0
23	ifansho Holding GmbH	Berlin	EUR	Directly	100.0
24	nugg.ad GmbH	Berlin	EUR	19	100.0
25	Zalando Logistics Operations Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
26	Tradebyte Software GmbH	Ansbach	EUR	Directly	100.0
27	Zalando Logistics Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
28	Zalando Lounge Logistics SE & Co. KG	Berlin	EUR	Directly 2	99.0 1.0
29	zLabels Trading Southern Europe S.L.U	Elche, Spain	EUR	1	100.0
30	zLabels LP GmbH	Berlin	EUR	1	100.0
31	Zalando Payments GmbH	Berlin	EUR	Directly	100.0
32	Ifansho Portugal, Unipessoal Lda	Lisbon, Portugal	EUR	Directly	100.0
33	KICKZ Never Not Ballin' GmbH	Munich	EUR	Directly	100.0
34	Lindentor 308. V V GmbH	Berlin	EUR	Directly	100.0
35	Terrehill Investments sp. z o.o.	Warsaw, Poland	PLN	Directly	100.0
36	Anatwine Ltd.	Cheltenham, United Kingdom	GBP	Directly	97.5
37	Anatwine, Inc.	New Castle, Delaware, USA	USD	36	100.0
38	Zalando OpCo Polska sp. z o.o.	Warsaw, Poland	PLN	2	100.0
39	zLabels Creation & Sales GmbH & Co. KG	Berlin	EUR	1 30	99.0 1.0
40	zLabels Platform Services GmbH & Co. KG	Berlin	EUR	1 30	99.0 1.0
Associated companies					
41	Le New Black S.A.S.	Paris, France	EUR	23	33.9
42	FashionTrade.com B.V.	Amsterdam, Netherlands	EUR	23	50.0

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

(10.) Disclosure Exemptions

In accordance with Section 264b HGB, the partnerships[45] listed as shareholdings are exempt from the requirement to disclose their financial statements and to prepare notes to the financial statements and a management report. In accordance with the provisions of Section 264 (3) HGB, Zalando Lounge Service GmbH, Zalando Outlets GmbH, Zalando Fashion Entrepreneurs GmbH, Tradebyte Software GmbH and Zalando Media Solutions GmbH are exempt from the requirement to disclose their financial statements and to prepare notes to the financial statements and a management report.

(11.) Segment Reporting

Reporting on the business segments is in line with the internal reporting. The reporting to the top body of management of ZALANDO SE for purposes of internal control fundamentally corresponds to the principles of financial reporting described in section 3.5.3 in accordance with IFRS.

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

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

45) Partnerships, which are exempt from the requirement to disclose their financial statements are presented with the following numbers in the shareholding table above: 3, 4, 5, 7, 8, 9, 16, 28, 39, 40.

Segment Reporting 2017

→ 100

IN EUR M	DACH	Rest of Europe	Other	Total 2017
Revenue	2,145.6	1,973.6	369.9	4,489.0
Cost of sales	–1,131.4	–1,200.0	–198.2	–2,529.6
Gross profit	**1,014.2**	**773.6**	**171.7**	**1,959.4**
Selling and distribution costs	–736.2	–666.2	–128.4	–1,530.8
Administrative expenses	–104.9	–98.0	–40.0	–242.9
Other operating income	7.2	3.8	0.7	11.8
Other operating expenses	–4.7	–3.6	–1.6	–9.9
Earnings before interest and taxes (EBIT)	**175.6**	**9.6**	**2.5**	**187.6**

Segment Reporting 2016

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

Of the total revenue generated in the DACH region, Germany accounts for 60.2% (prior year: 61.9%). In the Other reporting segment, Germany accounts for 33.8% of total revenue (prior year: 39.2%). The non-current assets of the group are mainly located in Germany. Cost of sales include valuation allowances of inventories for the DACH segment of EUR 51.8m (prior year: EUR 41.5m), for the Rest of Europe segment of EUR 63.9m (prior year: EUR 42.2m) and for the Other segment of EUR 12.0m (prior year: EUR 11.6m).

The selling and distribution costs contain valuation allowances of trade receivables and write-downs due to uncollectible receivables for the DACH segment of EUR 25.8m (prior year: EUR 14.1m), for the Rest of Europe segment of EUR 14.6m (prior year: EUR 7.6m) and for the Other segment of EUR 1.4m (prior year: EUR 1.1m).

Total expenses include depreciation and amortization of property, plant and equipment and intangible assets for the DACH segment of EUR 28.5m (prior year: EUR 21.5m), for the Rest of Europe segment of EUR 23.8m (prior year: EUR 17.3m and for the Other segment of EUR 6.4m (prior year: EUR 9.5m).

Other operating income in the prior year included non-operating one-time effects of EUR 4.9m in the DACH segment, EUR 5.3m in the Rest of Europe segment and EUR 0.4m in the Other segment.

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

(12.) Subsequent Events

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

(13.) Authorization of the Financial Statements for Issue

The consolidated financial statements and group management report of ZALANDO SE are published in the Bundesanzeiger [German Federal Gazette]. The consolidated financial statements and the group management report were authorized for issue by the Management Board on February 26, 2018.

Berlin, February 26, 2018

The Management Board

Robert Gentz David Schneider Rubin Ritter

3.6 Responsibility Statement by the Management Board

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

Berlin, February 26, 2018

The Management Board

Robert Gentz   David Schneider   Rubin Ritter

3.7 Independent Auditor's Report

To ZALANDO SE

Report on the Audit of the Consolidated Financial Statements and of the Combined Management Report

Opinions

We have audited the consolidated financial statements of ZALANDO SE, Berlin, its subsidiaries (the group), which comprise the consolidated statement of comprehensive income for the fiscal year from January 1 to December 31, 2017, the consolidated statement of financial position as at December 31, 2017, the consolidated statement of changes in equity and the consolidated statement of cash flows for the fiscal year from January 1 to December 31, 2017, and the notes to the consolidated financial statements, including a summary of significant accounting policies. We have also audited the combined management report of ZALANDO SE, which is combined with the management report of the company, for the fiscal year from January 1 to December 31, 2017. In accordance with the German legal requirements, we have not audited the information included in the statement on corporate governance contained in the corporate governance report in the combined management report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with IFRS as adopted by the EU and the supplementary provisions of German law pursuant to Section 315e (1) HGB ["Handelsgesetzbuch": German Commercial Code] and give a true and fair view of the assets and liabilities and financial position of the group as at December 31, 2017 and its financial performance for the fiscal year from January 1 to December 31, 2017 in accordance with these requirements, and
- the accompanying combined management report as a whole provides an appropriate view of the group's position. In all material respects, this combined management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the combined management report does not cover the content of the statement on corporate governance contained in the corporate governance report.

Pursuant to Section 322 (3) Sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the combined management report.

Basis for the Opinions

We conducted our audit of the consolidated financial statements and of the combined management report in accordance with Section 317 HGB and the EU Audit Regulation (No 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Combined Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the consolidated financial statements and on the combined management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the fiscal year from January 1, 2017 to December 31, 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon; we do not provide a separate opinion on these matters.

Below, we describe what we consider to be the key audit matters:

1) Occurrence and Measurement of Revenue from the Delivery of Merchandise Taking into Account Expected Returns

Reasons Why the Matter Was Determined to Be a Key Audit Matter
As part of selling merchandise to customers, Zalando typically satifies its performance obligation when the merchandise is delivered, i.e., the date on which the significant risks and rewards of ownership and control of the merchandise are transferred to the customer. Zalando customers have the option to return merchandise within the revocation period stipulated by law and, in addition to that period, the return periods granted by Zalando. Zalando's executive directors calculate expected returns, for which no revenue is recognized. Their assumptions and judgments are based primarily on country-specific and month-specific rates of returns, taking seasonal influences into account. Revenue has a significant influence on the net income of the group and is one of the most important performance indicators for the Zalando group.

We consider the existence and measurement of revenue from the delivery of merchandise to be a key audit matter due to the large volume of transactions from the sale of merchandise as well as the risk of fictitious revenue and the degree of uncertainty associated with expected returns.

Auditor's Response
In the course of our audit, we traced the process of revenue recognition from the order through to payment receipt on the basis of the documentation provided to us. Furthermore, we tested the effectiveness of the internal controls in place. This approach includes in particular the operating effectiveness of IT-supported controls. In order to identify anomalies regarding revenue and the development of revenue, we developed a forecast of country-specific revenue from the sale of merchandise based on historical daily, weekly and monthly revenue and compared it with the revenue recognized in the current fiscal year. In addition, we examined the posting ledger for any revenue entries that were entered manually and analyzed the respective contra accounts.

Moreover, as part of the substantive audit procedures, we obtained documentation (delivery slips, invoices, payment receipts) for a test of sales based on mathematical-statistical assumptions regarding the existence of revenue in order to determine whether the revenue recognized was based on a corresponding delivery of merchandise. We also verified the clerical accuracy of the expected returns as determined by Zalando. We obtained documentation of past annual and monthly returns and documentation of seasonal factors, among other things, for the assumed country-specific rate of returns. In order to evaluate the assumed country-specific rate of returns, we also compared this to the merchandise actually returned by the time we concluded our audit.

Our procedures did not lead to any reservations relating to the occurrence of revenue or the measurement of revenue from the sale of merchandise inventory.

Reference to Related Disclosures
With regard to the accounting policies applied for the recognition of merchandise revenue, we refer to the company's disclosures in Notes 3.5.5 (Accounting and Valuation Methods) and 3.5.7 (1.) (Revenue) in the Notes to the Consolidated Financial Statements.

2) Measurement of Trade Receivables from Distance Retail

Reasons Why the Matter Was Determined to Be a Key Audit Matter
Trade receivables from distance retail are characterized by a high number of individual receivables typical to distance retail. Within trade receivables, impairment risks are accounted for by portfolio-based specific allowances. These are determined according to payment type and country based on their age and taking into account expected risks of default, how long they are past due as well as historical bad debts. Zalando's executive directors are responsible for selecting the valuation model as well as the underlying assumptions used in calculating impairment from the valuation model, which is subject to judgment.

We consider the measurement of trade receivables from distance retail to be a key audit matter due to the large number of individual receivables, the complexity of the valuation models as well as the use of judgment in the assumptions of the executive directors.

Auditor's Response
We analyzed the trade receivables measurement process and tested the effectiveness of the internal controls in place including the relevant IT-supported controls.

Furthermore, we considered bad debts recorded in the past as well as payments on open receivables received between the reporting date and the end of our audit according to payment type and country in order to evaluate the incoming payments accepted in the model. In addition, we verified the assumptions regarding expected future incoming payments on open receivables. In this context, we substantiated this using estimates obtained by Zalando's executive directors from the external service providers responsible for the collection of open receivables. We also analyzed whether the valuation model applied provides a suitable basis to measure the recoverability of trade receivables.

Our procedures did not lead to any reservations relating to the measurement of trade receivables from distance retail.

Reference to Related Disclosures
With regard to the accounting policies applied for trade receivables, we refer to the company's disclosures in Notes 3.5.5. (Accounting and Valuation Methods) and 3.5.7 (16.) (Trade and Other Receivables) in the Notes to the Consolidated Financial Statements.

3) Subsequent Measurement of Merchandise Inventory

Reasons Why the Matter Was Determined to Be a Key Audit Matter
Zalando's merchandise inventory is continuously subject to risks associated with existing and potential future excess stocks, which are sold with high discounts through distance retail or are disposed of outside of distance retail. Write-downs on estimated future excess stocks as well as existing excess stocks are calculated at the end of the reporting period and recognized in the consolidated financial statements.

Zalando's executive directors calculate excess stocks based on the expected future sell-through for various sales channels and seasons. Future sell-through and the resulting estimated net realizable value are based on planning assumptions subject to judgment, which are determined using figures observed in the past.

We consider the subsequent measurement of merchandise inventory to be a key audit matter due to the high volume and heterogeneity of merchandise as well as the judgment used in calculating excess stocks and estimating the future net realizable value.

Auditor's Response
We evaluated the compliance of the accounting policies Zalando applied in calculating the merchandise inventory and the timely recognition of write-downs with the IFRS Framework and the relevant IFRSs.

We also analyzed the process used by Zalando's executive directors regarding the subsequent measurement of merchandise and gained an understanding of the process steps and the internal controls in place.

Within the scope of the valuation process, the executive directors consider the expected sell-through of merchandise for various sales channels and seasons. We analyzed the timing of the sell-through using past data compared with actual sales and examined any significant deviations or irregularities in detail. In addition, we considered the allocation to seasons and valuation groups as well as the classification of articles always available in the valuation model.

The valuation model also incorporates the expected proceeds from excess stocks. We examined the assumptions associated with expected proceeds considering proceeds actually generated in the past from merchandise sold with high discounts as well as merchandise for disposal outside of distance retail. In this context, we considered lower-quality features (BCD merchandise) separately. We developed expectations regarding potential future excess stocks based on this and compared them with valuation model assumptions and the write-downs recorded. Furthermore, we verified the clerical accuracy of the valuation model.

Our procedures did not lead to any reservations relating to the subsequent measurement of merchandise inventory.

Reference to Related Disclosures
With regard to the accounting policies applied for the subsequent measurement of merchandise inventory, we refer to the company's disclosures in Notes 3.5.5 (Accounting and Valuation Methods) and 3.5.7 (15.) (Inventories and Prepayments) in the Notes to the Consolidated Financial Statements.

Other Information

The Supervisory Board is responsible for the Report of the Supervisory Board. In all other respects, the executive directors are responsible for the other information. Other information comprises the information included in the statement on corporate governance contained in the corporate governance report in the combined management report as well as the remaining components of the annual report, with the exception of the audited consolidated financial statements and combined management report as well as our independent auditor's report, in particular:

- the responsibility statement contained in the responsibility statement by the Management Board pursuant to Section 297 (2) Sentence 4 HGB and Section 315 (1) Sentence 5 HGB
- the combined non-financial report contained in the "Corporate Responsibility" section pursuant to Section 315b HGB
- the "Report of the Supervisory Board" section and
- the "Report on Equality and Equal Pay for ZALANDO SE" section.

We received a version of this other information prior to issuing this independent auditor's report.

Our opinions on the consolidated financial statements and the combined management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, the combined management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Executive Directors and the Supervisory Board for the Consolidated Financial Statements and the Combined Management Report

Management is responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted in the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB and for the preparation of the consolidated financial statements that, in compliance with these requirements, give a true and fair view of the assets and liabilities, financial position and financial performance of the group. In addition, the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the combined management report that, as a whole, provides an appropriate view of the group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a combined management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the combined management report.

The Supervisory Board is responsible for overseeing the group's financial reporting process for the preparation of the consolidated financial statements and of the combined management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Combined Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the combined management report as a whole provides an appropriate view of the group's position and is, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the consolidated financial statements and on the combined management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this combined management report.

We exercise professional judgment and maintain professional skepticism throughout the audit.
We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the combined management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the combined management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the combined management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the group to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express opinions on the consolidated financial statements and on the combined management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.
- Evaluate the consistency of the combined management report with the consolidated financial statements, its conformity with [German] law, and the view of the group's position it provides.
- Perform audit procedures on the prospective information presented by the executive directors in the combined management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information Pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on May 31, 2017. We were engaged by the audit committee and the Supervisory Board on August 8, 2017. We have been the group auditor of ZALANDO SE without interruption since fiscal year 2010. ZALANDO SE has been a corporation geared to the capital market pursuant to Section 264d HGB since 2014.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

In addition to the financial statement audit, we have provided to the company or entities controlled by it the following services that are not disclosed in the consolidated financial statements or in the combined management report:

- services associated with the voluntary audit of financial statements for subsidiaries
- review of the company's voluntarily prepared half-year financial statements as of June 30, 2017
- audit of the system to comply with the requirements pursuant to Section 20 (1) WpHG ["Wertpapierhandelsgesetz": German Securities Trading Act]
- performance of agreed-upon procedures
- audit of financial statements or their individual elements in accordance with IDW AuS 490
- audit to obtain limited assurance of the non-financial statement pursuant to Section 289b et seq. and Section 315b et seq. HGB
- translation services

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Dr. Ingo Röders.

Berlin, February 26, 2018

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

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

4

Service_

4.1 Glossary

Active Customers

We define active customers as the number of customers who have placed at least one order in the last 12 months during the reporting period, irrespective of cancellations or returns.

Adjusted EBIT

We define adjusted EBIT as EBIT before equity-settled share-based payment expense and other non-operating one-time effects.

Adjusted EBITDA

We define adjusted EBITDA as EBITDA before equity-settled share-based payment expense and other non-operating one-time effects.

Adjusted Fulfillment Cost Ratio

We define the adjusted fulfillment cost ratio as fulfillment costs before equity-settled share-based payments divided by the revenue during the reporting period. Fulfillment costs include expenditures for shipment processing, content creation, customer service and payment processing, as well as allocated overhead costs and write-downs on trade receivables. Fulfillment costs thus include all selling and distribution costs with the exception of marketing costs.

Adjusted Marketing Cost Ratio

We define the adjusted marketing cost ratio as marketing costs before equity-settled share-based payment expense divided by the revenue during the reporting period. Marketing costs consist of expenses for advertising, including search engine marketing and advertising on television, online and other marketing channels, as well as allocated overhead costs.

Apps

Applications that were developed to optimize internet use for a specific task with a mobile device or smartphone.

Average Basket Size

We define the average basket size as the gross merchandise volume (including the gross merchandise volume from our Partner Program) after cancellations and returns divided by the number of orders delivered during the reporting period. The gross merchandise volume is defined as the total amount spent by our customers (including VAT) less cancellations and returns during the reporting period.

Average Orders per Active Customer

We define the average orders per active customer as the number of orders in the last 12 months of the reporting period divided by the number of active customers.

Capex

The sum of the payments for investments in fixed assets and intangible assets excluding payments for the acquisition of companies.

Content Creation

We define content creation as the production of photos and text for the sale of products on our websites.

Content Creator

We define content creators as opinion leaders that have a certain reach and contacts within the relevant target groups and therefore function as multipliers.

Corporate Responsibility

Corporate responsibility (CR) is a business approach that takes responsibility for social and environmental impacts resulting out of company activity. The goal is to create long-term value for shareholders, other stakeholders and communities by embracing the opportunities associated with economic, environmental and social developments.

Customer Service

We define customer services as the service we offer our customers via our hotline or email.

EBIT

EBIT is short for "earnings before interest and taxes."

EBITDA

EBITDA is short for EBIT before depreciation and amortization of property, plant and equipment and intangible assets.

EBIT Margin

The EBIT margin is defined as EBIT as a percentage of revenue.

Fast Fashion

Fast fashion refers to affordable fashion or clothing that quickly transfers from the catwalk to stores in order to capture the most recent fashion trends.

Flagship Store

A flagship store refers to company retail locations that are characterized by exclusive features and therefore serves as a retailer's showcase location.

Free Cash Flow

Cash flow from operating activities plus cash flow from investment activities (excluding investments in term deposits and restricted cash).

GRC Cycle

The GRC cycle is a standardized process to support decision makers with consistent, comparable and transparent information via standardized procedures to identify, assess, monitor, document and report on risks and the measures implemented.

Integrated Risk and Opportunity Management System

Successful risk and opportunity management depends on group-wide standards for systematically handling risks and opportunities. For this purpose, Zalando created the Governance, Risk & Compliance (GRC) Department, which identifies risks and opportunities at an early stage. The GRC function continuously refines the implemented risk management instruments and methodology, and coordinates the defined core process (GRC cycle).

Mobile Commerce

We define mobile commerce as retail via mobile devices such as smartphones or tablet computers.

Mobile Visit Share (As % of Site Visits)

We define the mobile visit share (as % of site visits) as the number of page views via m.sites, t.sites or apps divided by the total number of page views during the period in question.

M.Sites

Websites designed to be accessed via smartphones or mobile devices that offer users internet access.

Net Promoter Score (NPS)

The NPS reflects a customer satisfaction index. Customers are asked: "How likely it is that you will recommend the product/service to friends and family." The range is from −100 to +100.

Net Working Capital

We calculate net working capital as the sum of inventories and trade receivables less trade payables and similar liabilities.

Number of Orders

We define the number of orders as the number of orders placed by customers during the reporting period, irrespective of cancelations or returns. An order is counted on the day the customer places the order. The number of orders placed may differ from the number of orders delivered because the orders at the end of the reporting period may still be in transit or may have been canceled.

POP

POP stands for Persistent Organic Pollutants. It is a group of substances, such as pesticides, solvents, pharmaceuticals and industrial chemicals, that can cause adverse effect on human health and the environment and were restricted as an effect of the Stockholm Convention on Persistent Organic Pollutants.

Private Labels

For us, private labels (zLabels) are Zalando's own labels. The product assortment comprises shoes, apparel and accessories for women, men and children.

Purpose

Our shared purpose is what unites us all – it lies at the core of everything we do: reimagine fashion for the good of all. The shared purpose sets the course for the company and explains why Zalando exists and what influence we want to have on the world around us.

RAPEX

RAPEX is the Rapid Alert System of the European Commission for consumer protection.

REACH

REACH (Registration, evaluation, authorization and restriction of chemicals) is a European regulation on safe handling of chemical substances.

Site Visits

We define site visits as the number of series of page views from the same device and the same source (via websites, m.sites, t.sites or apps) during the relevant period. The series is considered ended when a page view is not recorded for longer than 30 minutes.

Smart Data

Smart data is the result of processing and analyzing collected data to create added value.

Social Media

Social media encompasses digital media and technologies that allow social interaction between users and content creation.

T.Sites

Websites designed to be accessed via tablets, such as the Apple iPad or the Samsung Galaxy tablets.

TENCEL® / Lyocell

Lyocell (also commonly known by the brand name Tencel®) is a third-generation cellulosic fabric manufactured in an environmentally-friendly “closed loop” process. It is made from wood pulp sourced from sustainably managed forests or fast growing renewable materials such as bamboo and eucalyptus and is 100% biodegradable.

Zalon

Zalon is our curated shopping service in which professional stylists in Germany, Austria and Switzerland compile an individual look that is tailored to our customers.

4.2

GRI Index

GRI G4 Index

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GRI 102: General disclosures			
	1. Organizational Profile		
102-1	Name of the organization	79	
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102-3	Location of headquarters	79, 125	
102-4	Location of operations	26, 79, 85	
102-5	Ownership and legal form	75, 79	
102-6	Markets served	79	
102-7	Scale of the organization	17, 79	
102-8	Employee statistics	17	Temporary staff helps us to manage especially high workloads. Those peak-times vary throughout the year, and the number of workers varies accordingly.
102-9	Supply chain	25, 26	
102-10	Significant changes to the organization and its supply chain during the reporting period	26, 85	
102-11	Precautionary principles and approaches	14, 54, 107	
102-12	Support for external initiatives	15, 20, 21, 28, 30	
102-13	Membership of associations / initiatives	15, 21, 27, 28, 30	
	2. Strategy		
102-14	Statement from senior decision-maker	12	
	3. Ethics and Integrity		
102-16	Values, principles, standards, and norms of behavior	22, 23, 28, 55	
	4. Governance		
102-18	Governance structure	14, 79	
	5. Stakeholder Engagement		
102-40	List of stakeholder groups	15	
102-41	Collective bargaining agreements		We currently have no existing collective bargaining agreements.
102-42	Identifying and selecting stakeholders	15	
102-43	Approach to stakeholder engagement	15	
102-44	Key topics and concerns raised	15	

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Number	Disclosures	Page	Notes in case of omissions / further explanations
	6. Reporting Practice		
102-45	Entities included in the consolidated financial statements	79	
102-46	Defining report content and topic boundaries	13	
102-47	List of material topics	13	
102-48	Restatements of information		No restatements required.
102-49	Changes in reporting		No changes have occurred.
102-50	Reporting period		Jan 1–Dec 31, 2017
102-51	Date of most recent report	13	March 1, 2017
102-52	Reporting cycle	13	Annual
102-53	Contact point for questions regarding the report	237	
102-54	Disclosures on reporting in accordance with the GRI Standards	13	
102-55	GRI content index	13	
102-56	External assurance		Our non-financial statement, including relevant KPIs in human rights, climate protection and working conditions, was audited by Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart.
GRI 200: Economic Topics			
GRI 201: Economic Performance			
103-1 / -2 / -3	Management approach	91, 126	
201-1	Direct economic value generated and distributed	91, 126	
GRI 205: Anti-Corruption			
103-1 / -2 / -3	Management approach	54	
205-1	Operations assessed for risks related to corruption	54	
GRI 300: Environmental Topics			
GRI 301: Materials			
103-1 / -2 / -3	Management approach	28, 37, 38	
301-1	Materials used by weight or volume	37	The information is limited to packaging materials.
301-2	Recycled input materials used	37	The information is limited to packaging materials.
301-3	Reclaimed products and their packaging materials	38	The information is limited to packaging materials.

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Number	Disclosures	Page	Notes in case of omissions / further explanations
GRI 302: Energy			
103-1 / -2 / -3	Management approach	36	
302-1	Energy consumption (within the organization)	37	
GRI 303: Water			
103-1 / -2 / -3	Management approach	27	
303-1	Water withdrawal by source		We are aware that water, an increasingly scarce natural resource, is used while making our goods, from fibre-production to dyeing and washing. In 2017, we started using the HIGG Index in order to measure the sustainability performance of our sourcing partners and their factories.
GRI 305: Emissions			
103-1 / -2 / -3	Management approach	33, 35	
305-1	Direct (Scope 1) GHG emissions	33	
305-2	Energy indirect (Scope 2) GHG emissions	33	
305-3	Other indirect (Scope 3) GHG emissions	33, 35	
305-4	GHG emissions intensity	34	We chose the number of orders as the denominator of the intensity ratio.
GRI 306: Effluents and Waste			
103-1 / -2 / -3	Management approach	38	
306-2	Waste by disposal method	38	
GRI 308: Supplier Environmental Assessment			
103-1 / -2 / -3	Management approach	27	
308-1	Percentage of new suppliers that were screened using environmental criteria	29	
GRI 400: Social Topics			
GRI 401: Employment			
103-1 / -2 / -3	Management approach	22	
401-1	New employee hires and employee turnover by age, gender, and region	17	We do not consider regional aspects to be material and therefore do not track this dimension.
401-2	Benefits provided to full-time employees	22	

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Number	Disclosures	Page	Notes in case of omissions / further explanations
GRI 402: Labor / Management Relations			
103-1 / -2 / -3	Management approach	20	
402-1	Minimum notice periods regarding operational changes	23	We respect all legal requirements for minimum notice periods and endeavor to inform employees as soon as possible before operational changes. The works councils are involved in decision-making processes that lead to operational changes. In order to discuss changes with works councils in good times, a sufficient notice period needs to be scheduled.
GRI 403: Occupational Health and Safety			
103-1 / -2 / -3	Management approach	23	
403-2	Types of injury and rates of injury, occupational diseases, lost days and absenteeism, and number of work-related fatalities	24	We further improve our data collection processes in order to comply with all requirements of this indicator.
GRI 404: Training and Education			
103-1 / -2 / -3	Management approach	18	
404-2	Training programs	18	
GRI 405: Diversity and Equal Opportunity			
103-1 / -2 / -3	Management approach	20, 57, 58, 61	
405-1	Diversity of governance bodies and employees	21, 57, 58, 61	
GRI 406: Non-Discrimination			
103-1 / -2 / -3	Management approach	22	
406-1	Incidents of discrimination and corrective actions taken	22	In order to protect the privacy of our employees, the number of cases is handled confidentially.
GRI 407: Freedom of Association and Collective Bargaining			
103-1 / -2 / -3	Management approach	29	
407-1	Operations and suppliers in which the right to freedom of association and collective bargaining may be at risk	29	Information given on this disclosure refers to suppliers of our private label brands.

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Number	Disclosures	Page	Notes in case of omissions / further explanations
GRI 408: Child Labor			
103-1 / -2 / -3	Management approach	29	
408-1	Operations and suppliers at significant risk for incidents of child labor	29	Information given on this disclosure refers to suppliers of our private label brands.
GRI 409: Forced or Compulsory Labor			
103-1 / -2 / -3	Management approach	29	
409-1	Operations and suppliers at significant risk for incidents of forced or compulsory labor	29	Information given on this disclosure refers to suppliers of our private label brands.
GRI 412: Human Rights Assessment			
103-1 / -2 / -3	Management approach	29	
412-1	Operations that have been subject to human rights reviews	29	We consider this disclosure to be especially relevant for suppliers of our private label brands and therefore provide information in this context.
GRI 413: Local Communities			
103-1 / -2 / -3	Management approach	39	
413-1	Operations with local community engagement	39	We have implemented local community engagement programs but we have not yet developed methodologies for impact assessment.
GRI 414: Supplier Social Assessment			
103-1 / -2 / -3	Management approach	29	
414-1	New suppliers that were screened using social criteria	29	
GRI 416: Customer Health and Safety			
103-1 / -2 / -3	Management approach	31	
416-1	Assessment of the health and safety impacts of product and service categories	32	100% of product categories are assessed for risks and improvement possibilities e.g. regarding health and safety impacts by our Product Safety Teams.
416-2	Incidents of non-compliance concerning the health and safety impacts of products and services	32	
GRI 418: Customer Privacy			
103-1 / -2 / -3	Management approach	55	
418-1	Substantiated complaints regarding breaches of customer privacy and losses of customer data	55	Our Legal Department maintains close contacts with the data protection authorities in Berlin concerning the processing of personal data. We received five inquiries from government agencies in 2017 for the entire Zalando group. Complaints involve, for example, technical aspects related to data processing such as the use of cookies on our website. German authorities are required by law to investigate customer complaints.

4.3 List of Charts and Tables

4.3.1 Charts

Company

Combined Management Report

4.3.2 Tables

Company

Combined Management Report

Consolidated Financial Statements

Service

4.4 Financial Calendar 2018

Financial Calendar

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Date	Event
Tuesday, May 8	Publication of the first quarter results 2018
Wednesday, May 23	Annual General Meeting 2018
Tuesday, June 5	Capital Markets Day 2018
Tuesday, August 7	Publication of the second quarter results 2018
Tuesday, November 6	Publication of the third quarter results 2018

4.5 Imprint

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Statement Relating to the Future
This annual report contains statements that relate to the future and are based on assumptions and estimates made by the management of ZALANDO SE. Even if the management is of the opinion that these assumptions and estimates are appropriate, the actual development and the actual future results may vary from these assumptions and estimates as a result of a variety of factors. These factors include, for example, changes to the overall economic environment, the statutory and regulatory conditions in Germany and the EU and changes in the industry. ZALANDO SE makes no guarantee and accepts no liability for future development and the actual results achieved in the future matching the assumptions and estimates stated in this annual report. It is neither the intention of ZALANDO SE nor does ZALANDO SE accept a special obligation to update statements related to the future in order to align them with events or developments that take place after this report is published.

The annual report is available in English. If there are variances, the German version has priority over the English translation. It is available for download in both languages at corporate.zalando.com/en/investor-relations.