Icelandair Group hf.

Prospectus – October 2010

ICELANDAIR GROUP

Íslandsbanki

I.

Summary

NOTICE TO INVESTORS

This Summary should be read as an introduction to the Prospectus, consisting of this Summary, a Registration Document and a Securities Note all dated 28 October 2010.

The Prospectus can be obtained in electronic format on www.icelandairgroup.is. A hard copy can be obtained from Icelandair Group hf. headquarters, Reykjavík Airport, 101 Reykjavík, Iceland. This Summary, Registration Document and Securities Note can be obtained for the next 12 months.

Any investment decision relating to shares in Icelandair Group hf. should be based on a consideration of the Prospectus as a whole by the investor.

Where a claim relating to information contained in the Prospectus is brought before a court, a plaintiff investor may, in accordance with the relevant national legislation of the Contracting Parties to the European Economic Area Agreement, have to bear the costs of translating the Prospectus before legal proceedings are initiated.

Civil liability attaches to those persons who have tabled the Summary, including any translation thereof, and applied for its notification, but only if this Summary is misleading, inaccurate or inconsistent when read together with other parts of the Prospectus.

No person is authorised to give information or to make any representation in connection with the New Shares other than as contained in the Prospectus. If any such information is given or made, it must not be relied upon as having been authorised by the Company or any of the Company's respective affiliates or advisers. Neither the delivery of the Prospectus nor any sale made hereunder shall under any circumstances imply that there has been no change in the Company's affairs or that the information set forth in the Prospectus is correct as of any date subsequent to the date hereof.

REFERENCES

References to "Icelandair Group", "the Issuer", "we", "us", "the Group" and "the Company" in this Summary shall be construed as referring to Icelandair Group hf., Icelandic ID No. 631205-1780, unless otherwise clear from the context.

References to "SPW ehf." in this Summary shall be construed as referring to a special purpose vehicle, incorporated under the laws of Iceland, ID No. 530910-0590 whose registered office is at Sóltún 26, 105 Reykjavík, unless otherwise clear from the context. SPW ehf. common stock is divided between two shareholders: Íslandsbanki with 71.1% and Glitnir Bank which holds the remaining 28.9% share in the company.

References to "the New Shares" in this Summary shall be construed as referring to 2,941,000,000 new shares in Icelandair Group hf., admitted to trading on the Main Market of NASDAQ OMX Iceland and subscribed to by professional investors, unless otherwise clear from the context.

SUMMARY OF THE SHARE OFFERING

This Summary, which forms part of the Prospectus, concerns an Icelandair Group share offering to professional investors of 2,941,000,000 New Shares and the admission to trading on NASDAQ OMX Iceland Main Market.

The Issuer is Icelandair Group hf. ID No. 631205-1780, registered office Reykjavík Airport, 101 Reykjavík Iceland, telephone number: +354 505 0300.

The Listing Advisor is Íslandsbanki hf., ID No. 491008-0160, registered office Kirkjusandur 155, Reykjavík, Iceland, telephone number: +354 440 4000.

Information about the Issue

The New Shares are all of the same class and bear the same rights and are identical to the existing shares in Icelandair Group. The issue of New Shares will be allocated to professional investors and also in the form of debt-to-equity conversions to Íslandsbanki and Glitnir Bank.

Professional investors have subscribed to New Shares in the total of 2,221,000,000 in Icelandair Group at the price of ISK 2.5 per share. Íslandsbanki and Glitnir Bank will convert debt in the amount of ISK 3,600,000,000 into New Shares at the price of ISK 5 per share.

Admission to Trading

An application has been made for the New Shares to be admitted to trading on the regulated market of NASDAQ OMX Iceland, which is an EU regulated market within the meaning of Directive 2004/39/EC on Markets in Financial Instruments ("MiFID"), which has been implemented through the Securities Transaction Act No. 108/2007. NASDAQ OMX Iceland is authorised pursuant to the Act on Stock Exchanges No. 110/2007 to operate a regulated market under the supervision of the Icelandic Financial Supervisory Authority (FME). The FME is a governmental agency responsible for, among other things, supervising Icelandic securities market laws. Furthermore, pursuant to the Act on Stock Exchanges No. 110/2007, NASDAQ OMX Iceland is required to have rules of its own, governing the trading on NASDAQ OMX Iceland.

The New Shares will be delivered electronically through the depository agent, the Icelandic Security Depository, Laugavegur 182, Reykjavík, Iceland. The New Shares will be issued electronically at the ISD no later than 3 November 2010, and they will be admitted to trading no later than on 5 November 2010.

The Company's share capital consists of one class of shares, each share having a nominal value of ISK 1.0. The ISIN number of the shares is IS0000013464. The shares' ticker symbol in the trading system of the NASDAQ OMX Iceland hf. is ICEAIR.

New Issues

At a shareholders' meeting held on the 6 August 2009, the shareholders of the Issuer granted the Board of Directors the authority to increase the Issuer's share capital by up to 4,000,000,000 nominal value for the purpose of strengthening the Company's financial position.

On 9 September 2010, the Board of Directors used the authorisation from the shareholders' meeting on 6 August and approved the issue of New Shares in the amount of 2,941,000,000 in accordance with Article 15 of the Articles of Association. The total share capital of the Company will be 3,941,000,000 after the issue of the New Shares.

No further authorisations or approvals are needed to issue the New Shares

Reasons for the Issue and Use of Proceeds

The Group undertook major cost-cutting measures in the first half of 2008. The cost-cutting measures taken in 2008 are among the main reasons for the Group's ability to shoulder the downturn in 2008 and early 2009.

The balance sheet was not self-sustaining, in particular due to the high level of indebtedness, and it was a major problem for the Group even before the collapse of the banking system in Iceland. It had been evident for some time that the balance sheet needed to be restructured.

The collapse of the banking system in Iceland late in 2008 along with the worldwide recession affected the Group's operational landscape, especially as domestic demand dropped significantly. Strain on cash flows followed due to termination of the Group's banking services coupled with severe outflows of cash to meet an ever-growing demand for cash collateral by international financial institutions to replace bank guarantees.

To meet these changes, the Board of Directors of the Group announced its plans to adapt to this new environment. A step in this process was the financial restructuring and binding agreements were signed on 12 August 2010. The Group addressed its refinancing and liquidity needs by entering into a standstill agreement with Íslandsbanki and Glitnir Bank. Further steps to mitigate the refinancing needs are taken with the sale of assets, by the conversion of debt into equity, and by changing the term structure of loans. The proceeds from the equity share issue will be used to increase cash on hand in the Company.

Professional investors have now subscribed for New Shares for a total of ISK 5,552,500,000 at market value in new share capital, which corresponds to 2,221,000,000 New Shares in Icelandair Group. Íslandsbanki and Glitnir Bank have convert debt in the amount of ISK 3,600,000,000 into New Shares at the price of ISK 5 per share, which corresponds to 720,000,0000 New Shares in Icelandair Group.

Private Tender

The New Shares have been subscribed to by professional investors and in the form of debt-to-equity conversion by Íslandsbanki and Glitnir Bank. The tables below show the largest new shareholders.

Item 1. New shareholders that have subscribed for 2,221 million New Shares announced on 12 August 2010

New Shareholders	ID Number	Nominal Value (ISK)	Price	Market Value (ISK)	Holding (% of share capital)
The Enterprise Investment Fund slhf..	651109-0510	1,200,000,000	2.5	3,000,000,000	30.4%
The Pension Fund of Commerce........	430269-4459	400,000,000	2.5	1,000,000,000	10.1%
Lífeyrissjódir Bankastræti 7...............	711297-3919	200,000,000	2.5	500,000,000	5.1%
Virding hf..	561299-3909	137,000,000	2.5	342,500,000	3.5%
Stefnir ÍS-15....................................	470206-8450	85,000,000	2.5	212,500,000	2.2%
Íslensk verdbréf hf...........................	610587-1519	54,000,000	2.5	135,000,000	1.4%
Stefnir ÍS-5......................................	430407-9610	45,000,000	2.5	112,500,000	1.1%
Other new shareholders....................	600390-9619	100,000,000	2.5	250,000,000	2.5%
Total...		**2,221,000,000**		**5,552,500,000**	**56.3%**

Dilution

On the date of this Summary, the total number of shares in Icelandair Group is ISK 1,000,000,000 in nominal value, divided into an equal number of shares, each with a nominal value of ISK 1.0.

The issue of the New Shares increases Icelandair Group’s share capital by 2,941,000,000 shares. The total number of shares in Icelandair Group after the issue of the New Shares will be 3,941,000,000 shares. Assuming that existing shareholders do not take part in the issue of the New Shares at all, the resulting proportional dilution of their shares will be 74.6%.

Expense of the Issuer

The commission for placing 2,941,000,000 new shares is ISK 124,168,750. In addition the cost for preparing the Prospectus, registering the shares, paying stamp duty and other costs is ISK 25,000,000. The charges from NASDAQ OMX Iceland total ISK 2,500,000.

The total cost for the issue of the New Shares will therefore be ISK 151,668,750. All cost of the issue will fall on the Company.

RISK FACTORS

Investing in shares is subject to numerous risks. The following is a summary of those risk factors the management and Board of Directors of Icelandair Group hf. believe are most likely to materially affect the Issuer and any investment made in its shares.

Prior to making any investment decision regarding shares in the Company, please consider all the information in this document and, in particular, the risks and uncertainties described in *Chapter 1 RISK FACTORS* of the Registration Document and *Chapter 1 RISK FACTORS* of the Securities Note, both documents dated 28 October 2010.

These risks and uncertainties may materially affect the Company and any investment made in its shares. If any combination of these events occurs, the trading price of the shares could decline and investors might lose part or all of their investment. Additional risks and uncertainties that do not currently exist, that are not presently considered material, or of which the Company is unaware, may also impair the business and operations of the Company. These risks and uncertainties could have a material adverse impact on the business, income, profits, assets, liquidity and share price of the Company.

Risk relating to Investment in Icelandair Group's Shares:

- General equity risk
- Liquidity risk
- Changes in the regulatory framework for financial and equity markets
- Shareholder structure
- Further capital increase can dilute shareholdings

Icelandair Group's Operational Risks:

- Fluctuations in market prices such as fuel prices, exchange rates, interest rates and possibly carbon prices in the future can materially impact the Company's profitability.
- The company is dependent on external economic factors but the economic risk factors have different effects on individual subsidiaries.
- The Company faces the risk of having insufficient working capital to meet payments, e.g. due to inability or difficulties in liquidating its assets. This risk is mitigated to some extent by maintaining liquid assets.
- Air transportation is subject to intensive regulations. An Air Operator's Certificate (AOC) has been issued to the relevant subsidiaries[1] of Icelandair Group authorising it to conduct its airline operations. There is no guarantee that the Company will be issued such licenses in the future.
- Operating in foreign markets exposes the Company to various risks. There is a risk that its prospects in some markets could diminish due to various factors, including political climate, currency controls and taxation.

[1] Icelandair, Icelandair Cargo and Air Iceland have been issued an AOC.

- The Company is dependent on its key employees and their willingness to continue working for it. The prospects for future cooperation between the key employees and the Company are always uncertain. If any of them should decide to leave, the Company could be adversely affected.
- The airline and tourist industry are inherently labour-intensive industries. The majority of the Company's employees are unionised, and is represented by several unions, each of which has its own contract on salaries and benefits with the Company. Each contract comes up for renegotiation every few years, and every time this happens there is a risk that the parties will not reach an agreement; such situations may end in a strike.
- An increasing proportion of ticket sales take place over the internet. These systems are vulnerable to disruptions that are beyond the Company's control.

Icelandair Group's Risks relating to the Airline and Tourism Industries:

- The Group faces intensive competition in all its fields of activities. The level of competition amongst airlines is high and pricing decisions are heavily dependent on competition from other airlines.
- Airline operators are highly sensitive to jet fuel prices and availability. Increased prices and/or restricted availability of aviation fuel may affect the profitability of Airlines.
- The Company operates in a seasonal industry where there has traditionally been much higher demand for air travel and general tourism in the summer. The high seasonal fluctuation in turnover makes the business riskier than otherwise.
- Many government regulations that are often based on international agreements and concern the environment, have in recent years become a growing issue for the airline industry. Attention should also be paid to varying local restrictions around airports to reduce noise and pollution. As such they can both concern opening hours of airports, availability of slots and the usage of airspace.
- At some airports, an air carrier needs landing and takeoff authorisations (slots) before being able to introduce new services or expand their existing ones. The Company is dependent on such slots in order to be able to compete on the international market.
- Airline operations tend to be burdened with a high level of fixed costs due to the nature of provided services, e.g. operations of expensive equipment and obligations due to leasing and investments. The high proportion of fixed costs to total operation costs can be devastating when demand shocks take place, which inevitably can happen at any given time, e.g. due to external disruptions of some kind.
- The airline and tourism industries are subject to an ever changing environment of taxes, aviation and licence fees and charges, which can have direct effect on ticket pricing and demand.
- The cost of airline insurance can fluctuate and as a result insurance can expose airlines to substantial costs and loss if such developments cannot be met by income sources.
- The airline and tourism industries are dependent on the state of the world's economy. In a depressed economy, consumers are likely to travel less, which could affect load factors, yield, and utilisation of the fleet and hotel rooms.

- Delays and cancelled flights occur for various reasons and impose increased costs on airlines. These events have not only direct added costs for operations but also indirect costs through damage to reputation and the brand name which may take a long time to repair.
- The occurrence of terrorist attacks or an outbreak of a disease that result in a fear of travelling could depress the aviation and tourism industry and affect the Company adversely, both through the airline and tourism operations.
- The airline industry is vulnerable to volcanic ash clouds due to disruptions of flights and cancelled bookings. With the possibility of continued volcanic eruptions, financial outcome could be exposed to uncertainty.
- Security measures have increased internationally in the long term, especially after the terrorist attacks in September 2001 when security surveillance was stepped up, and any suspicious activity is treated with greater intensity than before. Such increased security measures may affect the Company's profitability. Airline operators could be affected adversely if one of their aircraft were to be involved in an accident or crash. This may involve not only the repair or replacement of damaged or lost aircraft and the consequent temporary or permanent loss of services, but also claims from injured passengers and the surviving relatives of deceased passengers.

INFORMATION ABOUT ICELANDAIR GROUP HF.

Business Overview

The Group is an operating company with subsidiaries focused on the international airline and tourism sectors. The operations of the Company are based on two business segments; route network and tourism services. The main focus of the route network is to operate flights based on the *Hub and Spoke* concept between Europe and across the Atlantic to North America via Iceland. The focus of the tourism services business segment is on catering to the growing demand for universal services for tourists in Iceland and on offering a wide variety of support services relating to airline operations. During 2009, the Group employed an average of 2,150 full time employees and the Group generated total revenues of ISK 80.3 billion and carried approximately 1.7 million passengers on its routes.

In addition to passenger flights operated by the airline, the Group has vast interests in most parts of Icelandic tourism and aviation, including hotel chains, travel agencies, domestic airlines, support services, ground handling and technical services, as well as a fledgling ACMI[2] and lease operations.

The future focus of the restructured Group is on the operations of Icelandair ehf., Icelandic Tourism along with the *Hub and Spoke* concept, which is a pivotal part of Icelandair ehf.'s business model.

The Company is adapting to this new environment.

- The Group has simplified its business model to reflect a new strategy.
- In the restructuring process, Icelandair Group was advised by DVB bank.
- From now on, Icelandair Group defines itself as an operating company focusing on route network and tourist services and should not be looked upon as a holding company.
- By placing Travel Service, Bluebird Cargo and SmartLynx under the ownership of Icelandic creditors the size of the Group's balance sheet will be reduced.

[2] Acronym for: Aircraft, Crew, Maintenance and Insurance.

- The new business structure is based on two business segments. As before the support functions will work across both business segments and provide support for the subsidiaries and associate companies.

Item 2. The core Icelandair Group going forward

Item 3. Businesses divested in 2010

The Group's management emphasises the importance of collaboration between its subsidiaries as highlighted in the segmentation of the Group into the Route Network and Tourist Services. The business segmentation stresses the importance for subsidiaries to focus on a Group-wide approach in their daily operations.

Milestones in Icelandair Group‘s History

Icelandair Group traces its roots back to the year 1937 when one of the predecessors of the Group, Flugfélag Akureyrar, was founded in Akureyri. For the sake of brevity the history of the Group is listed below from the year 2006 when the Group took its current form and was listed to OMX ICE Main Market.

- **2006** In February, the current structure of Icelandair Group hf. was formed. On 15 October that year, Icelandair Group Holding hf. was established and on the same day acquired Icelandair Group hf. Icelandair Group Holding was listed on OMX ICE Main Market on 14 December. On 28 December the merger of Icelandair Group Holding and Icelandair Group was approved by the shareholders of Icelandair Group and the following day by the shareholders of Icelandair Group holding. The Merger was effective as of 1 November 2006.
- **2006** In June, the Latvian charter airline Latcharter was acquired.
- **2006** Airline Services Estonia (ASE), Estonian accountancy firm acquired.
- **2007** Icelandair Group Holding was delisted on 9 February and Icelandair Group listed on the OMX ICE Main Market on 12 February.
- **2007** A 50% share of Travel Service, the largest privately owned airline in the Czech Republic was acquired. Travel Service became an associate member of the Group as of November and became a subsidiary and was included in the consolidated interim financial statements as of April 2008.
- **2007** Icelandair Hotels announced a Franchise Agreement with Hilton Hotels Corporations for the 252 room 4-star Nordica Hotel in Reykjavik.
- **2008** Iceland Travel launched the VITA brand to sell a wide variety of leisure tours to Icelanders travelling abroad.
- **2008** A new name and appearance were unveiled in September when Latcharter became Smartlynx.
- **2009** Íslandsbanki hf. acquired 42% of the shares in Icelandair Group hf.

- **2009** A share capital increase in Travel Service diluted Icelandair Group's share in Travel Service to 50.1% from the previous 66%. The Company sold a 20.1% share in Travel Service in November and holds a 30.0% share in Travel Service.
- **2009** A shareholders' meeting gave the Board of Directors authorisation to increase the share capital of the Company by up to ISK 4 billion - by means of subscriptions to new shares.
- **2010** At the end of March 2010 Icelandair Group hf. and its largest lenders, Íslandsbanki and the Resolution Committee of Glitnir Bank, announced that they had reached an agreement on the best way to finalise the financial restructuring of Icelandair Group.
- **2010** On 14 April 2010 a volcanic eruption commenced in the glacier Eyjafjallajökull in Iceland. The volcanic ash from the eruption had a severe impact on flight schedules around the world.
- **2010** On 14 June, the Enterprise Investment Fund (EIF – Icelandic: Framtakssjódur Islands), an investment company owned by 16 Icelandic pension funds, entered into a binding agreement with Icelandair Group on an ISK 3 billion investment in the Group. The agreement was concluded with normal reservations regarding the results of due diligence, which the Fund performed. The EIF has subscribed to New Shares in the nominal amount of ISK 1.2 billion at the price of ISK 2.5, for a total of ISK 3 billion.
- **2010** On 15 June, The Pension Fund of Commerce (PCF – Icelandic: Lífeyrissjódur Verslunarmanna) entered into a binding agreement with Icelandair Group hf. on investing ISK 1 billion in the Group in return for a 10.1% share in the Company. The PCF has subscribed to New Shares in the nominal amount of ISK 400 million at a price of ISK 2.5, for a total of ISK 1 billion.
- **2010** On 21 October the Company announces that the financial restructuring is completed and the documentation process finalised.

ORGANISATIONAL STRUCTURE

The management team of Icelandair Group is lead by the Executive Board. The Executive Board is comprised of Björgólfur Jóhannsson, Chief Executive Officer, Bogi Nils Bogason, Chief Financial Officer and Sigthor Einarsson Deputy CEO.

The Executive Board leads a team of specialists whose task is to harness the potential synergy effects, organise the overall operational network and ensure efficient financial management of Icelandair Group and its subsidiaries. In addition, the Executive Board has direct access to the day-to-day operations of each subsidiary, with the focus on strategy, finance, and business development enhancing Group synergies. The management team also formulates and ensures compliance by all subsidiaries with the overall strategy of the Group. All operational companies of the Group have their individual management, with executives in charge of the daily business, supported by the Group management. This team of subsidiary managers is at all times in close liaison with the Group-level management and contributes greatly to the overall insight and functionality of the organisation.

BUSINESS SEGMENTS

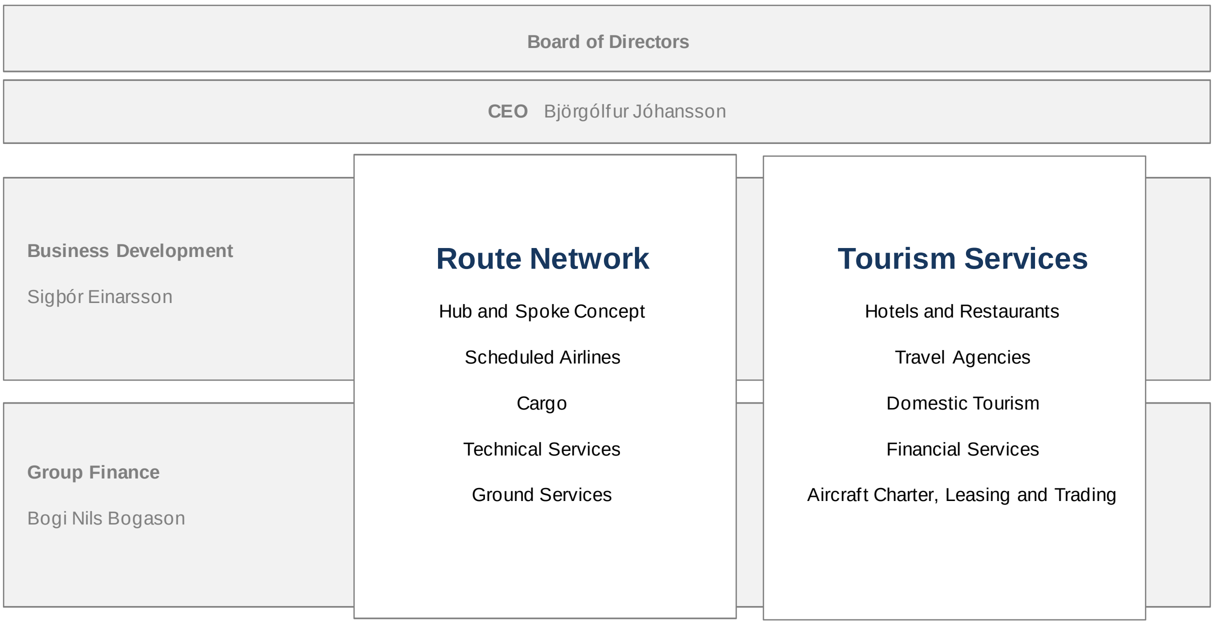
Route Network

This business segment is focused on the well-established international route networks based on the *Hub and Spoke* concept that the Group has developed for the last decades. Three companies are categorised as being part of the Route Network business segment:

- Icelandair ehf., the international, full-service airline with a hub in Iceland;
- Icelandair Cargo, a full-service air freight company;
- Icelandair Ground Services, which handles airlines and passenger services at Keflavík Airport;

These companies work closely together and have long historical ties. The main common task of the focus group is to run a profitable airline network operation with growth potential while supporting local tourism in Iceland. This is done through sales and marketing activity on behalf of all companies, as well as through placing emphasis on revenue management and cost control throughout the operation.

Item 4. Corporate Structure



Tourism Services

The business segment Tourism Services comprises the following subsidiaries:

- Air Iceland, a turboprop operator which operates both domestically and internationally to Greenland. The company is in cooperation with the Faroese airline Atlantic Airways and sells seats to the Faroe Islands on flights operated by Atlantic Airways.
- Loftleidir-Icelandic, the capacity solution provider.
- Icelandair Hotels, the domestic hotel chain.
- Iceland Travel travel agency, tour operator and destination management company in Iceland.
- Icelease, the aircraft trading arrangement company.
- Icelandair Shared Services (Fjárvakur-fjármálathjónusta ehf.), the accounting and financial support company of the Group.

The main focus of this business segment is international and domestic tourism as well as support functions thereof.

PROFIT FORECAST

On 21 October 2010 the Company revised its profit forecast and made public a press release that, among other, stated:

- "The operations of Icelandair Group have been strong this year and the company has outperformed its original financial forecast for the year. To reflect that, Icelandair Group has revised its EBITDA forecast for the year from ISK 8.5 billion to 9.5 billion for the full year. "

Therefore the current EBITDA projection for the year 2010 has been revised upwards from ISK 8.5 to ISK 9.5 billion for the full year.

EMPLOYEES

The Company believes that one of its principal strengths lies in its employees. Its operations require a wide range of knowledge and specialised personnel within aviation technology, international marketing, finance and management. The average positions for the full years 2007–09 and the first six months of 2010 are presented below.

In the year 2009 a significant reduction was made in the number of employees within the Group. Redundancies were made to meet the changed market conditions and to lower costs going forward. Icelandair and IGS reduced the number of their employees by 15% and 25% respectively, and other subsidiaries reduced their number of employees significantly as is depicted in the table below. It must be noted that SmartLynx and Travel Service increased the number of employees significantly from 2008 to 2009 mainly through hiring's of new cabin crew members. Both companies, SmartLynx and Travel Service, are categorised as discontinued operations.

Item 5. Average number of employees – Continuing Operations

	2007	2008	2009	1H 2010
Icelandair	1,464	1,368	1,163	1,150
IGS	601	530	400	382
Icelandair Cargo	67	58	52	40
Icelandair Hotels	276	289	249	290
Iceland Travel	92	101	99	99
Loftleidir-Icelandic	9	9	10	11
Air Iceland	316	306	259	250
Icelandair Shared Services	102	97	95	95
Icelandair Group	15	15	15	15
BlueBird	66	75	70	67
Total	**3,007**	**2,848**	**2,412**	**2,399**

Icelandair ehf. plans to increase its flight operations by 17% in 2011 and expects that the increase will create around 200 new jobs in Icelandair ehf.

BOARD OF DIRECTORS AND EXECUTIVE BOARD

A shareholders' meeting was held on 15 September 2010. A new Board of Directors was elected during the meeting. The following were elected to the Board of Directors of Icelandair Group:

Audur Finnbogadóttir, ID No.: 200767 3739
No. of votes: 466,559,586
Finnbogi Jónsson, ID No.: 180150-2429
No. of votes: 466,559,586
Katrín Olga Jóhannesdóttir, ID No.: 010862-7369
No. of votes: 466,542,492
Sigurdur Helgason, ID No.: 010546-2069
No. of votes: 466,709,586
Úlfar Steindórsson, ID No.: 030756-2829
No. of votes: 597,754,244

Alternate Board members, chosen without election:
Herdís Dröfn Fjeldsted, ID No.: 210971-4329
Magnús Magnússon, ID No.: 160965-4799
Vilborg Lofts, ID No.: 121256-3129

Remuneration and Benefits

The table below sets forth a breakdown of the remuneration that the Group paid to certain members of the management and Board of Directors in 2009. It also provides information regarding holdings in the Group's shares by these individuals at December 31, 2009. The table includes the Members of the Board of Directors, Chief Executive Officer and the members of the Executive Board. There is no pension liability regarding Members of the Board of Directors, Chief Executive Officer or Executive Board.

Item 6. The table depicts salaries and benefits for the year ended 31 December 2009.

Board of Directors:	Salaries and benefits (million ISK)	Share options (million)	Shares held at year-end 2009 (million)	Shares held by related parties (million)
Sigurdur Helgason, Chairman of the Board	1.6 *			
Katrín Olga Jóhannesdóttir	0.8			
Magnús Magnússon, alternative board member	0.1			238.3
Gunnlaugur M. Sigmundsson, former Chairman	4.9			
Ásgeir Baldurs, former board member	1.8			
Einar Sveinsson, former board member	2.3			12.8
Finnur Reyr Stefánsson, former board member	3.0			38.2
Jón Ármann Gudjónsson, former board member	0.8			111.7
Ómar Benediktsson, former board member	1.1			
Pétur J. Eiríksson, former board member	19.1			
Jón Benediktsson, former alt. board member	0.7		0.4	12.8
Kristín Einarsdóttir, former alt. board member	0.2			
Martha Eiríksdóttir, former alt. board member	2.1		0.1	
Sigurdur Atli Jónsson, fomer alt. board member	0.9			
Tómas Kristjánsson, former alt. board member	0.5			20.0
CEOs:				
Björgólfur Jóhannsson, CEO of Icelandair Group hf.	38.7			
Sigthór Einarsson, Deputy CEO of Icelandair Group hf.	25.5	1.0	0.1	
Bogi Nils Bogason, CFO of Icelandair Group	26.3			
Birkir Hólm Gudnason, CEO of Icelandair ehf.	33.2	0.1		
Gudni Hreinsson, CEO of Loftleidir-Icelandic ehf.	25.3			
Gunnar Már Sigurfinnsson, CEO of Icelandair Cargo	21.5			
Managing directors:				
Eight MDs of Group companies	152.4	6.2		

Included in the above mentioned list of shares held by management and directors are shares held by companies controlled by them.

*The Chairman of the Board has forgone his right to a salary so instead the Board agreed to pay the same amount to a charity —the Special Children's Travel Fund.

Audur Finnbogadóttir, Finnbogi Jónsson (CEO), Herdís Dröfn Fjelsted and Vilborg Lofts are all employed by the Enterprise Investment Fund. Magnús Magnússon is employed by Landsbanki Íslands hf.

STATUTORY AUDITORS

Icelandair Group hf. elected KPMG hf., Icelandic ID No. 590975-0449, Borgartún 27, 105 Reykjavík, Iceland, as the Company's Statutory Auditor at the Annual General Meeting held on 21 May 2010. KPMG was Icelandair Group's Statutory Auditor for the financial periods 2007, 2008 and 2009.

On behalf of KPMG hf. State-authorised accountants and members of The Institute of State Authorized Public Accountants in Iceland Jón S. Helgason Icelandic ID No. 050269-3619 and Gudný Helga Gudmundsdottir Icelandic ID No. 221168-4029 have audited the Company's financial information for the years ended 31 December 2007, 2008 and 2009 and reviewed the half year interim accounts ended 30 June 2009 and 2010.

FINANCIAL INFORMATION

The financial statements of Icelandair Group are prepared in accordance with International Financial Reporting Standards and comprise the consolidated accounts of the parent company and its subsidiaries.

The following tables show the Income Statement from Icelandair Group's financial statements. The information covers the years 2007, 2008, 2009 and the first six months of 2010 and 2009.

Item 7. Income Statement FY2007–FY2009

(mISK)	2007	2008**	2009
Transport revenue	35,949	41,885	47,139
Aircraft and aircrew lease	15,510	16,951	19,425
Other	12,018	13,363	13,757
Operating Income	**63,477**	**72,199**	**80,321**
Salaries and related expenses	20,008	20,275	18,652
Aircraft fuel	9,769	15,703	13,250
Aircraft and aircrew lease	7,353	8,921	12,797
Aircraft servicing, handling and communication	4,367	5,060	5,881
Aircraft maintenance	5,128	5,499	6,825
Other	11,375	13,688	14,782
Operating Expenses	**58,000**	**69,146**	**72,185**
EBITDA	**5,477**	**3,053**	**8,136**
Impairment and Depreciation	-3,141	-10,404	-6,652
EBIT	**2,336**	**-7,351**	**1,483**
EBT	**128**	**-8,985**	**-4,468**
Net Profit/Loss from continuing operations	**257**	**-8,905**	**-3,983**
Net Profit (Loss) from discontinuing operations	0	1,437	-6,681
Net Profit/Loss for the year / quarter	**257**	**-7,468**	**-10,665**
EBITDAR	**11,056**	**8,821**	**16,332**

** Re-presented

Item 8. Income Statement 1H 2009 and 1H 2010

(mISK)	1H 2009**	1H 2010
Transport revenue	18,763	22,016
Aircraft and aircrew lease	9,064	9,719
Other operating revenue	5,756	6,433
Operating Income	**33,583**	**38,168**
Salaries and related expenses	8,994	9,841
Aircraft fuel	5,549	6,644
Aircraft and aircrew lease	5,649	5,941
Aircraft handling, landing and communication	2,545	2,783
Aircraft maintenance	2,855	3,400
Other operating expenses	6,526	7,232
Operating Expenses	**32,118**	**35,841**
EBITDA	**1,465**	**2,327**
Depreciation and amortisation	-2,427	-2,647
EBIT	**-962**	**-320**
EBT	**-2,630**	**-2,043**
Net Profit/Loss from continuing operations	**-2,232**	**-1,646**
Net Profit (Loss) from discontinuing operations	-2,747	-400
Net Profit/Loss for the year / quarter	**-4,979**	**-2,046**
EBITDAR	**5,779**	**6,629**

** Re-presented

WORKING CAPITAL, CAPITALISATION AND INDEBTEDNESS

The Chairman of the Board of Directors and the CEO on behalf of the Issuer declare that in their opinion the Issuer's working capital is sufficient for the next 12 months.

The following table sets forth the Group's capitalisation and indebtedness as of 30 June 2010. The following table does not reflect the issue of new shares.

Item 9. Capitalisation and indebtedness of Icelandair Group as of 30 June 2010

Capitalization and Indebtedness (mISK)		**30 June 2010**
Total current liabilities		**65,713**
Guaranteed*	18,686	
Secured**	5,890	
Unguaranteed/unsecured	41,137	
Total non-current liabilities		**18,976**
Guaranteed*	0	
Secured**	10,532	
Unguaranteed/unsecured	8,444	
Shareholders' equity		**13,128**
Share capital	975	
Share premium	25,450	
Fair value and other reserves	7,368	
Retained earnings	-20,695	
Minority interest	30	
Total capitalization on 30 June 2010		**97,817**

**** Represents a general pledge in unpledged assets of the Group***

***** Represents a direct pledge in certain real estates and aircraft***

The table above does not reflect the issue of approximately ISK 2.2 billion New Shares in Icelandair Group in the share offering at the subscription price indicated in this Summary and the intended application of the estimated net proceeds of approximately ISK 5.5 billion. Following the completion of the share offering of the New Shares, the share capital will increase by ISK 2,941,000,000.

The table on capitalisation represents the current portion of long-term loans, plus short-term liabilities excluding aircraft leases. Total non-current liabilities include long-term interest-bearing debt which amounts to approximately ISK 12.5 billion. The remainder consists of prepayments (ISK 2.3 billion) and long term payables (ISK 4.1 billion). Total current liabilities consist of interest bearing loans and borrowings (ISK 26.3 billion), trade and other payables (ISK 16.7 billion), liabilities held for sale (ISK 6.7 billion) and deferred income (ISK 16.1 billion). Aircraft financing constitutes 40% of the total interest-bearing debt and is solely of a long-term nature and financed by foreign banks. Apart from that source of financing, the interest-bearing debt stems from domestic bank borrowing. Further details of the breakdown of loans can be found in the table below.

Item 10. Net indebtedness of Icelandair Group as of 30 June 2010

Net indebtedness (mISK)		**30 June 2010**
a) Cash	7,471	
b) Cash equivalents	0	
c) Trading securities	0	
d) Liquidity (a) + (b) + (c)		**7,471**
e) Current financial receivables		0
f) Current bank debt	19,271	
g) Current portion of long term debt	5,821	
h) Other current financial debt	1,160	
i) Current financial debt (f) + (g) + (h)		**26,252**
j) Net current financial indebtedness (i) - (e) - (d)		**18,781**
K) Non-current bank debt	10,552	
l) Non-current bonds issued	1,971	
m) Other non-current loans	18	
n) Non-current financial indebtedness (k) + (l) + (m)		**12,541**
Net financial indebtedness (j) + (n)		**31,322**

The cash represents the net figure derived from the consolidated cash flow statement of the Group as published on 13 August 2010.

The capital profile above is based on Icelandair Group's Financial Statements as of 30 June 2010 and before the financial restructuring of the balance sheet. A part of the completion of the financial restructuring will be a share capital increase of approximately ISK 9.2 billion (ISK 2,941 million in share capital and ISK 6,212 in share premiums) where approximately ISK 5.5 billion will be paid with cash and approximately ISK 3.6 billion will be debt-to-equity conversion. Additionally, most of the Group's interest-bearing loans will be restructured.

The Group has a total of approximately ISK 31.4 billion in contingent indebtedness in the form of lease obligations due to aircraft financing. The lease obligations are off-balance-sheet items that are not reflected in the balance sheet, but are directly payable through an amortisation schedule, and they are not reflected in the maturity profile of the Group. Furthermore, the Group has a contingent liability stemming from the commitment to acquire four 787-800 Dreamliner aircraft, see note 46 in the consolidated financial statement on 31 December 2009 for further information.

The Group had a total of ISK 6.7 billion in indirect indebtedness at year end 2009, through off-balance-sheet items such as lease obligations and financial guarantees. The only financial guarantee for third parties is the USD 19.6 million guarantees to SmartLynx as of 30 June 2010.

After the divestment of SmartLynx, Icelandair Group will continue to guarantee USD 19.6 million to SmartLynx. The guarantee will gradually expire until 1 January 2014. The guarantees for SmartLynx are in regard of lease payments on aircraft. If SmartLynx cannot pay its lessors, the guarantee will fall on Icelandair Group. That could happen if SmartLynx could not lease its unused aircraft to another company. Loftleidir has a contract with SmartLynx regarding the lease of two aircraft, where Loftleidir leases two aircraft from SmartLynx. The contracts are on an arm's length basis and they will not be affected by the divestment of SmartLynx from the Group.

The expected net indebtedness after the restructuring is shown in the following table. Please note that the financial information on net indebtedness after the financial restructuring is not audited and is based on information from the management of Icelandair Group.

Item 11. The table shows net indebtedness after financial restructuring

Net indebtedness (mISK)		30 June 2010
a) Cash	13.175	
b) Cash equivalents	0	
c) Trading securities	0	
d) Liquidity (a) + (b) + (c)		**13.175**
e) Current financial receivables		0
f) Current bank debt	0	
g) Current portion of long term debt	3.181	
h) Other current financial debt	0	
i) Current financial debt (f) + (g) + (h)		**3.181**
j) Net current financial indebtedness (i) - (e) - (d)		**-9.994**
K) Non-current bank debt	22.370	
l) Non-current bonds issued	1.971	
m) Other non-current loans	18	
n) Non-current financial indebtedness (k) + (l) + (m)		**24.359**
Net financial indebtedness (j) + (n)		**14.365**

Item 11 shows the effects of the restructuring on the Company‘s net indebtedness after financial restructuring as of 30 June 2010.

The information provided in this chapter is derived from the last published financial information of the Issuer and information related to the financial restructuring which have not been audited and is based on information from the management of Icelandair Group. As of the date of this Summary the Issuer declares that there have been no material changes since the last published financial information.

MAJOR SHAREHOLDERS.

Item 12. 20 Largest shareholders as of 21 October 2010

Shareholder	Number of shares	Percentage of shares	Percentage of votes*
Íslandsbanki hf.	469,772,387	46.98%	29.99%
Landsbanki Íslands hf.	238,348,350	23.84%	30.37%
Sparisjódabanki Íslands hf.	93,572,562	9.36%	11.92%
Alnus ehf.	32,992,831	3.30%	4.20%
Icelandair Group hf.	25,460,000	2.55%	0.00%
Glitnir Bank hf.	20,925,000	2.09%	2.66%
Sigla ehf.	20,000,000	2.00%	2.55%
Saga Capital Fjárfestingarbanki	18,104,159	1.92%	2.45%
Arkur ehf.	17,500,000	1.75%	2.23%
N1 hf.	12,844,611	1.28%	1.63%
Stafir lífeyrissjódur	8,656,512	0.93%	1.18%
Almenni lífeyrissjódurinn	6,571,047	0.66%	0.84%
Kaupfélag Sudurnesja	3,375,000	0.34%	0.43%
Landsbanki Luxembourg S.A.	2,870,961	0.29%	0.37%
DnB NOR Bank ASA	2,000,000	0.20%	0.25%
Landssjódur hf úrvalsbréfadeild	1,924,512	0.20%	0.25%
Jafet Ólafsson	1,843,300	0.20%	0.25%
Íslandssjódir hf, sjódur 6	1,652,712	0.20%	0.25%
Lífeyrissjódur Vestfirdinga	1,561,736	0.20%	0.25%
Hagur eignarhaldsfélag ehf.	1,111,111	0.10%	0.13%
Total		**98.39%**	**92.23%**

*Íslandsbanki is not allowed to utilise more than 23.5% of outstanding share capital as its voting powers are capped at 29.99% of total votes.

The table above lists the holdings and voting rights of the 20 largest shareholders in the Company as of 21 October 2010. Certain relationships between the parties listed above should be noted: (i) according to publicly available information, 95% of the common stock of Íslandsbanki is held by foreign creditors of the Resolution Committee of Glitnir Bank hf. and (ii) Magnús Magnússon is Managing Director of Corporate Banking for Landsbanki Íslands hf., which owns 23.84% stake in the Company.

SHARE CAPITAL

The total issued share capital, as of the date of this Summary, is ISK 1,000,000,000 in nominal value, divided into an equal number of shares, each with a nominal value of ISK 1.0. The Group's share capital consists of one class of shares, and each issued share carries one vote. The Group holds, as of the date of this Summary, 25,460,000 shares in itself (2.55% of the total shares) and 974,540,000 shares are outstanding. All of the Group's shares are fully paid and non-assessable.

RELATED PARTY TRANSACTIONS

When Group companies deliver products or provide services to other Group companies, any such agreement or arrangement is performed at a market price and on market terms. All intra-Group transactions, balance sheet items, revenues and expenses are eliminated upon consolidation of the Group's financial statements and are therefore not included in the Group's consolidated balance sheet or results of operations.

The Board of Directors of the Group believes that the Group's related party transactions described below are conducted on an arm's length basis. Íslandsbanki holds 46.98% of the shares in the Group, however, Íslandsbanki is only authorised to apply up to 30% of its effective voting rights in the Group. Íslandsbanki is the primary commercial bank of the Group, acts as Listing Advisor in respect of this Summary and was mandated by the Group to act as the advisor in respect of the New Shares. All transactions with Íslandsbanki have been concluded on an arm's length basis.

No Members of the Board of Directors, nor any member of Group Management, currently, or during the period that is covered in the historical financial information in this Summary has participated directly or indirectly in any transaction with the Group that is, or would have been, unusual or made under unusual conditions. The Group has not granted any loans, provided any guarantees or entered into a guarantee undertaking, to or for the benefit of any member of the Board of Directors.

ARTICLES OF ASSOCIATION

The object of the Company is to own and run airlines and tourism companies, purchase and sell of shares, especially shares in other companies working in the field of aviation, travel industry and transport, purchase and sellf real estate, lend and other related business. This can be found in the first chapter of the Company's Articles of Association.

Summary of Provisions with Respect to the Board of Directors, CEO and Management

The Company's Board of Directors consist of five members and three alternate members, elected at the Annual General Meeting for a term of one year. Those who intend to run for the Board of Directors shall notify the Board of Directors of their candidacy at least 5 days before a shareholders' meeting. The notification shall list the name, identification number and address of the candidate along with information about his main employment, other board memberships, education, experience and shareholding in the Company. Candidates shall furthermore list any interest connected to main clients and competitors of the Company and shareholders controlling more than 10% of the Company. Information about candidates for the Board of Directors shall be available for shareholders' review at the Company's offices no later than 2 days before the shareholders' meeting.

The Company’s Board of Directors is the supreme authority in the Company’s affairs between shareholders’ meetings and ensures that the organisation and activities of the Company‘s operation are generally in correct and good order. The Board of Directors appoints a Managing Director for the Company and decides the terms of his or hers employment. The Board of Directors and the Managing Director are responsible for the management of the Company. The Company’s Board of Directors ensures that there is adequate supervision of the Company’s accounts and the disposal of its assets and adopts working procedures in compliance with Act No. 2/1995 on Public Limited Companies. Only the Board of Directors grants power of procuration. The signatures of the majority of the members of the Board bind the Company.

The Board of Directors elects a Chairman from among its members, and otherwise allocates its obligations among its members as needed. The Chairman calls board meetings. A meeting shall also be held if requested by a member of the Board of Directors or the Managing Director. Meetings of the board are valid if attended by a majority of the members of the Board. However, important decisions shall not be taken unless all members of the Board have had the opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote and in the event of an equality of votes the issue is regarded as rejected. The Managing Director attends meetings of the Board of Directors, even though he or she is not a member of the Board, and has the right to debate and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings of the Board and is to be signed by participants in the meeting. A board member, or the Managing Director, who is not in agreement with a decision by the Board of Directors is entitled to have his or her dissenting opinion entered in the book of minutes. A board meeting is able to make decisions when a majority of board members participate in meetings. If possible, an important decision should not be taken without all members of the Board of Directors having had a chance to discuss the matter.

The Managing Director has charge of the day-to-day operations of the Company and observes the policy and instructions set out by the Company’s Board of Directors. Day-to-day operations do not include measures which are unusual or extraordinary. Such arrangements can only be made by the Managing Director in accordance with special authority from the Board, unless it is impossible to await the decision of the Board without seriously damaging the operation of the Company. In such an event, the Managing Director consults with the Chairman, if possible, after which the Board of Directors is immediately notified of the measures. The Managing Director ensures that the accounts and finances of the Company conform to the law and accepted practices and that the disposal of the property of the Company is secure. The Managing Director provides the members of the Board of Directors and Company auditors with any information pertaining to the operation of the Company which they may request, as required by law.

Rights, Preferences and Restrictions of Shares

All shares in the company that carry votes have equal rights and no privileges are attached to shares in the Company. The Company´s own shares are restricted in a way that no voting rights are attached to the shares. All the shares are freely transferable, unless otherwise provided for by law. No restrictions are placed on shareholders’ rights to sell their shares. The provisions of the Act on Electronic Registration of Title to Securities No. 131/1997, and rules based on the Act shall govern the change of ownership. Sale of shares to foreign parties shall be governed by Icelandic law as it reads at the relevant time.

The Board of Directors of the Company is authorised to increase the share capital of the Company in accordance with Article 15.1of the Articles of Association. The share capital of the Company may be increased by up to ISK 4,000,000,000 (four billion Icelandic kronur) nominal value with the subscription of New Shares. This authorisation is valid until 31 December 2010. The nominal value of the shares to which the shareholders may subscribe is one Icelandic krona. The subscription rate may be decided by means of a public invitation to tender for new shares in the meaning of section 1 of Article 43 of the Securities Transactions Act No. 108/2007. Shareholders shall have a pre-emptive right to purchase new shares in proportion to their registered holdings. Exemptions from this are authorised; cf. paragraph 3 of Article 34 of Act No. 2/1995 on Public Limited Companies.

Provisions

- There are no provisions in the Company's incorporation agreement or its Articles of Association that could delay, postpone or prevent a change in the control of the company.
- There are no provisions in the Company's incorporation agreement or its Articles of Association that include limits on the disclosure of shareholder ownership other than Icelandic law.
- There are no provisions in the Company's incorporation agreement or its Articles of Association regarding changes of share capital that are stricter than is required by law.

Actions Necessary to Change Shareholders' Rights

According to Article 93 of Act No. 2/1995 on Public Limited Companies, the Articles of Association may only be amended at a lawful Annual General Meeting or extraordinary shareholders' meeting, provided that the notice of the meeting clearly indicates that such an amendment is proposed and outlines the main substance of the amendment. A decision is valid only if it has the support of at least 2/3 of the votes cast and the support of shareholders controlling at least 2/3 of the share capital represented at the meeting, provided always that no other force of vote is required by the Articles of Association or statutory law.

Shareholders' Meetings

The supreme power of the Company's affairs, within the boundaries set in the Articles of Association and Icelandic legislation is in the hands of lawful shareholders' meetings. Shareholders, shareholders' agents, the Company's accountants and the managing director, even if he is not a shareholder, have the right to participate in shareholders' meetings. Furthermore, the Board of Directors may invite specialists to attend the shareholders' meeting if their advice or assistance is required. The Board of Directors is authorised to decide that shareholders may participate in shareholders' meetings by electronic means without being physically present. If the Board of Directors feels that the Company has equipment which is sufficiently safe to allow shareholders to participate in shareholders' meetings electronically without being physically present and the Board of Directors decides to use this authorisation it shall be announced in the invitation to the meeting. If a shareholder wishes to participate electronically in shareholders' meeting, the shareholder must submit his questions five days before the meeting.

A shareholders' meeting is lawful without regard to attendance if it is lawfully called for. A shareholder may send an agent to the shareholders' meeting on his behalf. The agent shall submit a written or an electronic power of attorney which shall be dated. The Board of Directors may decide that a shareholders' meeting will only be held electronically. If the Board of Directors feels that the meeting can be held only electronically with suitable equipment and thereby allowing shareholders to participate electronically, the invitation to the meeting shall give clear information regarding the technical equipment and information on how shareholders notify the Company of their electronic participation and where they can receive information, instructions and a password for participation. An inserted password into a computer system is deemed to be equal to the shareholder's signature and is viewed as valid participation in the shareholders' meeting.

An annual general meeting shall be held within eight months from the end of the financial year. Shareholders' meetings shall be called for with a method which is considered to ensure swift access to the meeting on equal grounds. Trustworthy media shall be used which ensure the circulation of the invitation to the public in the European Economic Area. Such media include the NASDAQ OMX information system and Huginonline. The meeting shall also be called for with an advertisement in Icelandic media. The Board of Directors shall call for shareholders' meetings when it deems it necessary, or when the elected auditor or shareholders controlling at least 1/10 of the share capital insist in writing and suggest an agenda for the meeting. Shareholders' meetings shall be called for with a minimum of three weeks' notice.

The invitation to an annual general meeting shall include information regarding place of the meeting, time and draft agenda. Clear and precise rules on participation in and voting at shareholders' meetings and information about where shareholders can get all relevant documentation that will be presented at the meeting. If a proposal on amendments to the Company's Articles of Association is to be addressed at the meeting, the substance of the proposal shall be described in the invitation.

FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP HF.

Icelandair Group hf. announced on 14 and 15 June 2010 that the Enterprise Investment Fund (EIF) and the Pension Fund of Commerce (PFC) had entered into a binding agreement with the Company to the effect that the two funds would invest in Icelandair Group for approximately ISK 4 billion at a share price of approximately 2.5. In the agreement EIF undertook to contribute approximately ISK 3 billion, thereby acquiring approximately 1.2 billion New Shares in the Company. The PFC undertook to contribute approximately ISK 1 billion, thereby acquiring approximately 400 million New Shares in the Company.

The agreements were concluded with the following conditions:

- Positive results of Icelandair Group due diligence
- Exemption of the EIF by the Financial Supervisory Authority (FME) from an obligatory take-over of the Company
- That Icelandair Group hf. raised a minimum ISK one billion in market value through the sale of New Shares to other investors

All of the above conditions have been met as Icelandair Group hf. announced on 12 August 2010, and investors have subscribed to a total of approximately ISK 5.5 billion at market value in new share capital, which corresponds to approximately 2.2 billion New Shares in Icelandair Group hf.

The agreement assumes the conversion by Icelandair Group hf.'s two largest creditors of debt in the amount of approximately ISK 3.6 billion into shares based on a share price of ISK 5 per share, which corresponds to a subscription to ISK 720 million new shares. The total increase in share capital will thus amount to ISK 2,941,000,000 New Shares at nominal value.

Icelandair Group hf. plans furthermore to raise approximately ISK 2.5 billion in additional share capital at the same price (2.5) from shareholders and employees in 2010. The timing and structure of that offering will be disclosed later.

Overview of the Financial Restructuring

The major steps of the financial restructuring of Icelandair Group are listed below:

- New shares issued for cash consideration in the nominal amount of approximately ISK 2.2 billion at the price of ISK 2.5, which equals approximately ISK 5.5 billion in market value.
- Íslandsbanki and the Resolution Committee of Glitnir Bank convert debt in the amount of approximately ISK 3.6 billion into shares based on a price of ISK 5 per share, which corresponds to a subscription to ISK 720 million New Shares.
- Vindabudir ehf. ID No. 680807-2560, a company fully owned by the Resolution Committee of Glitnir Bank, will directly acquire 100% of the share capital of SmartLynx for ISK 1 (one) as SmartLynx has no value. Icelandair Group will continue to guarantee SmartLynx operational leasing obligations.
- The Resolution Committee of Glitnir Bank and Íslandsbanki incorporated an SPV, a special purpose vehicle, (hereinafter "SPW ehf.") which will acquire Travel Service and Bluebird Cargo from Icelandair Group. A binding agreement on the divestment and the incorporation of SPW ehf. was signed on 12

August 2010. However, the documentation process was not concluded and contracts signed until on 21 October 2010. The contract has reservations and SPW ehf. will not take control of the divested companies until these reservations have been fulfilled.

- Icelandair Group will continue to own and manage IG Invest, but it will be controlled by SPW ehf. However, Icelandair Group has made an agreement with SPW ehf., which will receive economic benefits from IG Invest. The total proceeds to Icelandair Group from the sale of Bluebird Cargo, Travel Service, and the economic benefits of IG Invest to SPW ehf. amount to ISK 7.6 billion. The ISK 7.6 billion in proceeds contributes to reducing the debt of Icelandair Group by ISK 7.6 billion. There is no cash contribution involved in the asset divestment.

- If SPW ehf. receives more than ISK 7.6 billion, in addition to interest amounting to REIBOR + 3%, from its assets when it sells them before September 2015 (Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group will receive 50% of any potential yield that is higher than ISK 7.6 billion. On the other hand, if SPW ehf. receives a lower amount than ISK 4.0 billion before September 2015 from the sale (of Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group must pay SPW ehf. ISK 0.5 billion. The contracts state that if SPW ehf. has not sold its assets before September 2015, the banks can extend the period until September 2017.

The financial restructuring is subject to certain conditions being satisfied or waived as soon as practicable and in any event no later than by close of business on 15 December 2010. The material conditions are as follows:

- An approval from competition authorities in Iceland and Latvia for the sale and purchase of the shares in Bluebird Cargo ehf. and SmartLynx respectively;

- Icelandair Group and SPW ehf. shall enter into a shareholders’ agreement and a call option agreement and other relevant agreements and arrangements in relation to their shareholding in IG Invest ehf. Icelandair Group and SPW ehf. shall enter into following agreements:

    - Shareholders' agreement in terms of IG Invest ehf. that outlines how IG Invest will be controlled;

    - Service agreement in terms of IG Invest whereas Icelandair Group undertakes to manage IG Invest on behalf of SPW.

    - SPW ehf. shall have call options on Icelandair Group’s shareholding in IG-Invest.

- Icelandair and Vindabúðir ehf. shall enter into an operating agreement in relation to SmartLynx;

- The signing of a conditional guarantee issued by Icelandair Group for the benefit of Íslandsbanki and Glitnir banki in the total amount of ISK 500,000,000;

- Exemptions from the Central Bank of Iceland from the Rules on Foreign Exchange, No. 370/2010 (issued by the Central Bank of Iceland), with regards to the sale and purchase of the shares in Travel Service and SmartLynx;

- A written confirmation from certain creditors of Travel Service and SmartLynx, confirming that (i) the relevant loans are not in default and (ii) Icelandair Group can transfer the title of the shares in Travel Service and SmartLynx;

- Waiver letters in relation to change of control provisions in certain agreements entered into by Bluebird Cargo;

- Amendments to existing general bonds, granted by Icelandair Group and its subsidiaries; and

- New security granted by Icelandair Group. Specifically: (i) share pledge agreement, granting 2nd priority security over shares in IG Invest and (ii) a security interest over a Boeing 757-200 aircraft to Íslandsbanki.

It should be noted that the above conditions are largely formalities which are expected to be satisfied by 15 December 2010.

Notice is drawn to the fact that the financial data in this section is not extracted from the issuer's audited financial statements. The data in this section is unaudited and based on management calculations derived from negotiations with the creditors of the Group.

Shareholders List after Financial Restructuring

The following table shows the largest shareholders of Icelandair Group hf. after the financial restructuring.

Item 13. Largest shareholders of Icelandair Group hf. after the financial restructuring

Shareholders after financial restructuring	ID Number	Nominal Value	Holding (%)
The Enterprise Investment Fund slhf...........	651109-0510	1,200,000,000	30.4%
Íslandsbanki hf..	491008-0160	1,028,492,387	26.1%
The Pension Fund of Commerce.................	430269-4459	400,000,000	10.1%
Landsbanki Íslands hf..................................	540291-2259	238,348,350	6.0%
Lífeyrissjódir Bankastræti 7..........................	711297-3919	200,000,000	5.1%
Glitnir Bank hf..	550500-3530	182,205,000	4.6%
Virding hf..	561299-3909	137,000,000	3.5%
Icebank hf..	600390-9619	93,572,562	2.4%
Stefnir ÍS-15...	470206-8450	85,000,000	2.2%
Íslensk Verdbréf hf.......................................	610587-1519	54,000,000	1.4%
Stefnir ÍS-5...	430407-9610	45,000,000	1.1%
Other shareholders......................................		277,381,701	7.0%
Total...		**3,941,000,000**	**100%**

THE LISTING ADVISOR

The Listing Advisor, Íslandsbanki, ID No. 491008-0160, registered office Kirkjusandur 155, Reykjavík, Iceland, has been the advisor to the Issuer in the preparation of this Summary. The Listing Advisor has not independently verified the information contained herein.

Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Listing Advisor as to the accuracy or completeness of the information contained in this document or any other information provided by the Issuer in connection with the issuing of the New Shares, which is expected to be no later than 5 November 2010.

DOCUMENTS ON DISPLAY

For the life of this Prospectus, or for 12 months from the date of the issue, the following documents are available for viewing at the registered office of the Issuer, or electronically from the Company´s website www.icelandairgroup.is:

- The Registration Document, Security Note and Summary all dated 28 October 2010.
- The Issuer's Articles of Association.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2007, together with the audit report prepared in connection therewith.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2008, together with the audit report prepared in connection therewith.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2009, together with the audit report prepared in connection therewith.
- The Company's reviewed condensed consolidated interim financial statement in respect of the six months ended 30 June 2009.
- The Company's reviewed condensed consolidated interim financial statement in respect of the six months ended 30 June 2010.

II.

Registration Document

CONTENTS

1 RISK FACTORS

Investing in shares is subject to numerous risks. Prior to making any investment decision regarding shares in the Company, please consider all the information in this document and, in particular, the risks and uncertainties described below. These risks and uncertainties may materially affect the Company and any investment made in its shares. If any combination of these events occurs, the trading price of the shares could decline and investors might lose part or all of their investment. Additional risks and uncertainties that do not currently exist, that are not presently considered material, or of which the Company is unaware, may also impair the business and operations of the Company. These risks and uncertainties could have a material adverse impact on the business, income, profits, assets, liquidity and share price of the Company.

1.1 Risks Related to Shares Investment

1.1.1 Stock Returns

Empirical evidence is generally considered to lend support to the fact that in the long run, stock returns exceed those of bonds and alternative securities. Yield on stocks consists of dividend payments, on one hand, and the change in share prices on the other, profit or loss resulting from the difference between the price per share when bought and sold. However, stock investment is considered to be riskier than that of alternative securities. Stock prices are prone to greater volatility and payments of dividends are often uncertain, as is the effect of such payments on the share price. The risk involved in investing in individual companies can be spread by disbursing it into a portfolio of registered companies of different character and markets. Such a strategy can even out individual firm-level risk and constrain it close to the average stock market level of risk and returns.[1] Hence, stock investment will always be under the risk and influence of external market related disturbances, e.g. currency exchange fluctuations, changes in general interest rates, market mood, news, speculation, investors' sentiment, risks accompanying political developments, changes in the economic outlook, etc.

1.1.2 Ownership and Control

The structure of shareholder ownership can be a risk factor for investors. The share price could be adversely affected if a potentially large shareholder decides to sell a substantial number of shares or in the case of additional shares being sold. Note that company ownership can change rapidly and without prior warning. Furthermore, a principal-agent problem of ownership and control is a theoretically and practically known phenomenon within large corporations which is based on the concentration of ownership. A high concentration of ownership tends to be at the cost of minority shareholders' rights whereas a low concentration and a lack of investors could render administrative complications and lead to ill-fated decision processes.

1.1.3 Dilution

When new shares are issued, the proportional shareholding of those who already hold shares in the Company will be reduced accordingly unless they acquire the new shares pro rata to their existing holdings. Shareholders face dilution unless they exercise subscription rights or proportionally increase their stake when there are new share offerings. The purpose of equity funding is generally to reshape capital structure to increase company value by financing new profitable projects and to reduce the debt ratio. Shareholders may therefore be faced with increased risk to their investment alongside dilution of their existing shares depending on how the added capital will be disbursed. In addition, it is open for future shareholder meetings to consider continued equity financing.

[1] Investment theory offers the capital asset price model, CAPM to explain this as a case where the measurement of risk, the beta coefficient, equals one, which is a benchmark of market risk and expected market returns.

1.2 Risks Related to the Airline and Tourism Industry

The Group owns and operates companies in the airline, and tourism industries.

1.2.1 Competition

The Group faces intensive competition in all its fields of activities. The airline aspect of the Company's operations includes both scheduled[2] and charter[3] services for passengers and freight. The level of competition amongst airlines is high, and pricing decisions are heavily dependent on competition from other airlines. The low marginal costs relating to servicing additional customers on scheduled flights, compared to flying with vacant seats, have also resulted in the airline industry being susceptible to fare discounting. The frequency of new market entrants, mergers, acquisitions, consolidations and new partnerships adds to airline competition (see *Chapter 1.2.7 Consolidation and Partnerships*). A number of reasons may inspire new entrants and maintain a higher turnover of airlines on the market.

These parties can range from governments and ambitious private enterprises that fulfil national need to opportunistic investors who often are motivated by enthusiasm and joy for flying rather than profitability. Further, the increased importance of low-cost carriers in the transport industry and their imaginative cost saving ventures and pricing techniques has only increased pressure on the existing carriers. On-line sales have increased the price transparency in the air travel market, which has in turn resulted in more intense competition. The Company is also to some extent subject to competition from alternative modes of transport, such as buses and private cars. Finally, an "open skies" [4] agreement between the EU and North America has boosted competition on intercontinental routes and thus importantly increased the possibility of squeezed margins on the transatlantic route. Should competition increase even further in any of the Company's key transport markets, including the Icelandic market, it is possible that this would have considerable effect on the Company's profitability.

In the tourism sector the Company faces intense competition with hotels and apartments in Reykjavik as capacity has increased rapidly. Icelandair Hotels has been able to maintain unchanged utility by strong marketing strategies and a franchising agreement with Hilton Hotels. Further, funds have been invested in renovation and hotel restaurants. The ISK devaluation since 2008 has supported tourism in 2010, but increasing service capacity in the market puts constant pressure on pricing. Air Iceland enjoys a robust domestic network to the major towns in Iceland, but faces competition from the improving road network and travel agencies offering coach tours.

1.2.2 Fuel Price and Availability

Airline operators are highly sensitive to jet fuel prices and availability. Jet fuel has been subject to significant price volatility due to fluctuations in supply and demand and investor behaviour through speculative trading. Increased prices and/or restricted availability of aviation fuel may affect the profitability of airlines. Political unrest, terrorist attacks, hurricanes and other possible external disasters in addition to economic forces contribute to price volatility. In order to improve risk control relating to volatile fuel prices, airlines commonly integrate hedging into their projected portion of their aviation fuel requirements. Other means of protection include counterparty risk shifting through service agreements, fuel surcharges and economising on fuel consumption. The last factor is more effective in the long term through investment opportunities in equipment. For scheduled services hedging plays an important role in fixing future fuel prices and during times of increasing energy prices such action is fruitful. However, hedging can pose risks as many airlines have experienced, owing to fluctuations in commodity prices. From 2007 to 2010 the price of jet fuel has varied from USD 500/t to USD 1450/t.

Many airlines invested considerable sums in hedging fuel prices during the summer of 2008 when commodity prices peaked, basing their strategy on general perception and forecasts of continued price increases. When prices collapsed, hedge positions turned negative, adding to liquidity problems which some airlines faced in the

[2] Icelandair, Air Iceland and Icelandair Cargo
[3] Loftleidir-Icelandic.
[4] This agreement brings together the world's two largest aviation markets, allowing EU and U.S. airlines fly to any destination and charge prices at their own discretion.

wake of the 2008 credit crunch due to added collateral payments and margin calls. The dilemma of a hedging decision is the risk involved. If fuel prices rise, the Company's cost structure and its competitiveness vis-à-vis its competitors will be damaged. If prices were to fall at the same time as the Company has a higher level of hedging than its rivals, its competitiveness will be damaged. When high fuel prices have prevailed, airlines have been more efficient in passing price increases on to their customers through fuel surcharges and other methods, especially when anticipating a downward correction. If fuel prices start rising again with improved economic prospects, there is no guarantee that the increase in cost can be continuously passed on to customers due to the competitive nature of the airline industry, and therefore the Company could be affected adversely.

For further information about the Icelandair Group's risk management policy, please refer to *Chapter 2 RISK MANAGEMENT POLICY*.

1.2.3 **Seasonality**

The Company operates in a seasonal industry where there has traditionally been much higher demand for air travel and general tourism in the summer. The high seasonal fluctuation in turnover makes the business riskier. This seasonal pattern explains why the Company operates more aircraft during the summer season than during other seasons and has considerably better results in the second and third quarters of the year than in the first and fourth. Lower demand for air travel, flight cancellations or other factors affecting aircraft utilisation would therefore have a proportionately greater impact on the Company during the summer than during other periods. The seasonality in turnover and profitability poses greater risk for the annual financial outcome than otherwise as it is confined to only two quarters annually rather than four. This leaves the Company more vulnerable against disruptions to production inputs or external demand shocks. Due to the magnitude of seasonality, any interruptions during the high season could have adverse effects on the financial outcome of operations for the whole financial year.

1.2.4 **Environmental Laws and Regulations**

Many government regulations that are often based on international agreements and concern the environment, have in recent years become a growing issue for the airline industry. The Kyoto Protocol is anticipated to have wide spread effects because of future targets for carbon dioxide emissions, but attention should also be paid to varying local restrictions around airports to reduce noise and pollution. As such, they can concern opening hours of airports, availability of slots and the usage of airspace. Congestion and environmental restrictions can for example lead to delays or increase the complexity of departure and approach manoeuvres which undoubtedly reduces productivity and increases costs.

As a step to meet the Kyoto obligations and limit the emissions of carbon dioxide from civil aviation the EU has issued legislation whereby any airline flying to or from a member country has to comply with the regulations through purchases of traded emission units reflecting the physical carbon dioxide emission created by the consumption of jet fuel. The EU Directive will effectively support quota trading by bringing the airline industry into the Emission Trading Scheme as of 2012. To begin with airlines will receive free allowances reflecting a combination of total 2004 to 2006 emissions and 2010 relative airline supply of tonne kilometres (a utility indicator). Between the years 2013 to 2020, the free emission allowances will be reduced from the 2012 levels, and after that all emission will have to be purchased on the carbon market.[5]

Carbon dioxide emission can be quantitatively linked to jet fuel consumption and is already traded on a market in such units. However, as is the case with jet fuel prices, it is impossible to forecast the future price of emission allowances. Currently, commodity traders are giving indications of “clean fuel price” by adding the price of each ton of allowance to the price of jet fuel, an indication of future trends and the associated increased cost of flying.

[5] See e.g. http://www.eubusiness.com/topics/environ/emissions-trading-2013/

1.2.5 **Airport Access**

At some airports, an air carrier needs landing and takeoff authorisations (slots) before being able to introduce new services or expand its existing services. The Company is dependent on its slots in order to be able to compete on the international market. If the Company is not able to secure and retain slots, it could be restrained from competing in valuable markets. Generally, access to airports is vital to minimize the likelihood of delays, which can affect the Company's profitability negatively. Based on its long history of aviation services, Icelandair ehf. has valuable access to some important destinations, e.g. London Heathrow Airport and JFK Airport. The slots are valuable assets in the sense of opening up competitive gateways to large markets.

1.2.6 **Fixed Costs**

Airline operations tend to be burdened with high level of fixed costs due to the nature of provided services, e.g. the operation of expensive equipment and obligations due to leasing and investments. The high proportion of fixed costs to total operating costs can be devastating when demand shocks take place, which unavoidably can happen at any given time, e.g. due to external disruptions of some kind. Fixed costs include employees involved in flight operations, service and maintenance, aircraft leasing and overhead costs of administration and infrastructure systems. Variable costs for comparison are completely linked to the provided supply of services and include catering costs, airport charges, jet fuel etc. Cost structure flexibility is crucial for the Company's competitiveness, and identifying the degree of rigidity of the individual fixed cost items is important, but that depends on circumstances, e. g. how quickly an airline can adapt to a changed environment by further putting excess capacity into productive use or by clamping down on costs. In general, contractually fixed costs can be from 3 months up to a year depending on individual cost items. With an increased ratio of fixed costs, for instance, due to increased maintenance costs, the risk of unexpected deviation from budgeted profitability is increased.

1.2.7 **Consolidation and Partnerships**

Mergers, acquisitions, consolidations and partnerships (see *Chapter 1.2.1 Competition*) are common in the airline industry. To name but a few of a number of recent strategic actions, the following airlines can be mentioned: Lufthansa and Swissair, Lufthansa and Austrian Airlines, Lufthansa and Brussels Airlines and finally Air France, KLM and Alitalia. Mergers, acquisitions, consolidations and partnerships are strategic methods to make use of expanded networks and economies of scale to improve efficiency and productivity. To the extent that such endeavours prove successful in the industry, then that will only mean greater competition and reduced margins for the closest competitors. Yet, such actions are often extremely expensive and not always successful.

The Company is currently not a member of any alliance. The Company has evaluated and undertaken strategic investments in the past, notably by investing in SmartLynx and Travel Service (see *Chapter 12.4 Discontinued Businesses*). To the extent that the Company consolidates or invests in industrial partnership with other airlines and expected revenue gains or cost savings are not realised or additional unexpected costs are incurred, this could have a material adverse effect on the Company's business results and financial conditions.

1.2.8 **Taxes, Fees and Charges**

The airline and tourism industries are subject to an ever changing environment of taxes, aviation and licence fees and charges which can have a direct effect on ticket pricing and demand. The trend has been to increase taxation rather than to reduce it. Some of the fees that are levied on the airline industry are charges regarding take-off and landing along with emission, noise and navigation charges and ticket tax. Added local taxes are a possibility with respect to the growing imbalances in public finance around the world and much needed government revenue and the fact that some consider travelling still to be a luxury. Jet fuel is still untaxed but could be burdened with taxes in future such as the carbon emission charge. To the extent that such charges can be shifted to air travellers the airline's profitability will not suffer, however beyond that such added charges will have a material adverse effect on the financial outcome.

1.2.9 Insurance

The cost of airline insurance can fluctuate and as a result insurance can expose airlines to substantial costs and losses if such developments cannot be met by income sources. Airlines insure assets and employees to reduce the risk of damage in case of accidents. The insurance covers public liability, passenger liability, property damage and all risk coverage for damage to the airlines' fleets, spare parts and equipment, including liability exposure associated with airline operations. The aftermath of the September 11, 2001 terrorist attacks has shown that the insurance markets can dry up and be susceptible to market failure. On that occasion, governments needed temporarily to provide airlines with guarantees to cover parts of the insurance companies' exposure to risk. Situations could arise in future where governments would not be willing to step in with guaranties for certain insurance cover which insurance companies for one reason or another would not be willing to supply at reasonable rates. Under such circumstances, increased premiums or unavailable insurance cover would have a material adverse effect on the airlines' financial conditions.

1.2.10 Economic Effects

The airline and tourism industries are dependent on the state of the world's economy. In a depressed economy, consumers are likely to travel less, which could affect load factors, yield, and utilization of the fleet and hotel rooms. However, a slump in a domestic economy can provide opportunities for foreigners visiting a country which has a devalued currency as is the case of Iceland in 2010. A slower economy also affects the cargo business to a great extent. Although airlines are continuously working extensively on minimising fixed costs to reduce the adverse effects of decreased demand, they could be negatively affected in the case of a depressed economy. Financial statistics have given indications of there being a great deal of correlation between the two factors.

1.2.11 Overcapacity

Investment has been historically high in recent years, in aircraft mechanics, production capacity and aviation facilities worldwide. The growth in airline industry turnover has been considerable compared to economic growth, and aircraft production and delivery have been increasing as numerous airlines have placed larger orders. Evidence shows that low-cost carriers are placing a larger proportion of those orders, and also in the intercontinental market as a result of an EU-US "open skies" agreement (see *Chapter 1.2.1 Competition*). Although some orders have been deferred or cancelled altogether in the wake of the economic depression, the market could become oversupplied. Overcapacity, especially if concentrated amongst low-cost carriers, could have a negative impact on price margins and profitability of scheduled and charter services. The same applies to the domestic tourism industry. Overcapacity has generally affected the profitability of hotels and travel agencies negatively since 2008. If there is a reduction in the numbers of visitors to Iceland due to external shocks e.g. the world recession, volcanic eruptions, strengthening of the ISK or for other reasons, the hotel business and the financial results of the Company could be adversely affected.

1.2.12 Disruptions and Interruptions

Delays and cancelled flights occur for various reasons and impose increased costs on airlines. Possible reasons include computer faults, accidents, industrial action, weather conditions, delays by service providers, congestion and unexpected maintenance. These events incur not only direct added costs for operations but also indirect costs through damage to reputations and brand names which may take a long time to repair. Successful business turnover is contingent on successful third party service providers and the undisrupted supply chain mechanisms. This includes a range of crucial suppliers, including travel agents, air traffic control, ground services, maintenance support, IT service providers, etc. Interruptions due to any of the aforementioned disruptions could seriously affect sales and the profitability of the Company.

1.2.13 **Terrorist Incidents, Volcanic Eruptions and Pandemics**

Following the terrorist attacks of 11 September 2001, demand for airline travel dropped. Similarly, many airlines were affected by the outbreak of SARS (Severe Acute Respiratory Syndrome) in 2003. International awareness of the possibility of a worldwide outbreak and spread of the bird flu pandemic in 2007 and 2008 and the Swine flu pandemic in 2009 has had some effect on travel, but severe epidemics of flu or other diseases could be very damaging for tourism. The occurrence of another large scale terrorist attack or an outbreak of a disease that resulted in fear of travelling could depress the aviation and tourism industry and affect the Company adversely, both the airline and tourism operations. The airline industry seems vulnerable to volcanic ash clouds due to disruptions of flights and cancelled bookings. With the possibility of continued volcanic eruptions, financial outcome could be exposed to uncertainty.

After the volcanic eruption that took place at the beginning of the year 2010 in the Eyjafjallajökull Glacier, the Group has gained experience in dealing with flight disruptions stemming from volcanic ash distribution.

- One of the key ingredients in the Group's response to volcanic ash flight disruptions has been to add new flights to its schedule when possible.
- Furthermore, the Group has put in place provisions to relocate its primary flight hub from Keflavik to Europe.

The Group has ascertained that volcanic ash mainly affects the operations of Icelandair ehf. and Icelandair Cargo. In addition, some disruptions are foreseeable in the operations of Air Iceland, Iceland Travel and Vita. Icelandair Group estimates that the Group's total daily loss amounted to ISK 100 million due to flight disruptions and other complications stemming from flight disruptions due to volcanic ash.

1.2.14 **Airport Security**

Security measures have increased internationally in the long term, especially after the terrorist attacks in September 2001 when security surveillance was stepped up, and any suspicious activity is treated with greater intensity than before. Airline businesses have therefore been occasionally disrupted on temporary or long-term grounds and may possibly be similarly affected in the future. For instance, a terrorism alert in the United Kingdom in August 2006 led to additional security restrictions at UK airports and delays and cancellations of numerous flights. Such increased security measures may affect the Company's profitability.

1.2.15 **Accidents**

Airline operators could be affected adversely if one of their aircraft were to be involved in an accident or crash. This may involve not only the repair or replacement of damaged or lost aircraft and the consequent temporary or permanent loss of services, but also claims from injured passengers and the surviving relatives of deceased passengers. Even though the Company is insured, the insurance cover may be inadequate, in which case it might face significant losses. Additionally, if an aircraft from the Company is involved in an accident, this might create a public perception that the Company's aircraft are not reliable, which in turn could harm the business.

1.3 Risk Related to Group-Level Operations

1.3.1 Operational Risks

1.3.1.1 Aircraft Pricing and Availability

Aircraft prices and leasing are cyclical by nature. If the market value of an aircraft drops due to lower demand for air travel or any other reason, the value and leasing rates will be affected. If this happens, the Company's profitability could be affected. Furthermore, when the Company needs to replace the aircraft which it is currently operating, add new aircraft or renegotiate leasing agreements, the Company's aircraft operating cost could increase or decrease depending on the market conditions at that time, which would affect its profitability. The Company owns a number of aircraft, the value of which will have to be tested for impairment when there is an indication of impairment. Such impairment tests could result in the writing down of the aircraft if the market value and the value in use are below the carrying value of the aircraft. The Company owns seven Boeing 757-200 aircrafts and one Boeing 757-300 aircraft for its international flights. Furthermore, the Company owns six Fokker F-50 aircrafts and two Dash 8 aircrafts. The remainder of the fleet is leased for various time spans for flexibility, should the Company need to react to lower demand.

The Company mainly uses Boeing aircraft, since the Company's management believes that they satisfactorily meet its objectives of minimising costs while maximising passenger safety. Generally, having only one aircraft supplier makes the Company more dependent on the supplier. There is also the exposure of being adversely affected should aviation authorities be forced to issue an AD note (airworthiness directive) on a particular aircraft model, especially if the carrier in question is dependent on one type only as is the case within Icelandair Group. The Icelandair ehf., Loftleidir-Icelandic and Icelandair Cargo fleet is mainly composed of B757-200s, while Air Iceland's fleet consists mainly of F-50s.

1.3.1.2 International Operations

Operating in foreign markets exposes the Company to various risks. There is a risk that its prospects in some markets could diminish due to various factors, including political climate, exchange controls and taxation. Loftleidir-Icelandic has expanded rapidly in recent years, most prominently in countries considered to be politically high risk.[6] Although it has contributed importantly to the consolidated income and been extremely successful, there is an awareness of credit risk and the possibility of business disruptions.[7]

1.3.1.3 Key Employees and Human Resources

The Company is dependent on its key employees and their willingness to continue working for it. The prospects for future cooperation between the key employees and the Company are always uncertain. If any of them should decide to leave, the Company could be adversely affected. Should key personnel decide to join competitors or start competing independently with the Company, this may have consequences for the Company's business. In order to reduce the risk of losing key employees, some measures have been taken, including competitive remuneration packages, which amongst other things offer a first class working environment and incentives based on the management and financial results of individual subsidiaries. Furthermore, the Company actively manages its information systems to keep know-how within the company. Employment agreements with certain key employees also contain provisions that exclude them from working for competitors for up to 24 months after their resignation. Both these factors should reduce the consequences for the company if one of its key employees decides to resign.

1.3.1.4 Labour Disputes and Strikes

The airline and tourism industries are inherently labour-intensive industries. The majority of the Company's employees is unionised; they are represented by several unions, each of which has its own agreement on salaries

[6] Source: AON insurance underwriters' Political Risk Map

[7] Classic portfolio theory may promote risk distribution as giving greater returns at lower risk, but with respect to the purpose of this Registration Document, individual risks are to be identified separately and explained.

and benefits with the Company. Each contract comes up for renegotiation every few years, and every time this happens there is a risk that the parties will not reach an agreement; such situations may end in a strike. Strikes can affect the Company badly, and in the worst case halt the operation of one or more of its subsidiaries. Strikes in the aviation industry can be extremely expensive for airlines due to the nature of the business, which is burdened with high fixed costs. In addition to relying on hired personnel, the Company relies on third parties to provide its customers with services on behalf of and in cooperation with it. Any inability of the relevant third parties to provide such services may impact the business.

1.3.1.5 Computer and Communication Systems

An increasing proportion of ticket sales are transacted over the internet. The Company's planning, communication and revenue management systems are also computer based. These systems are vulnerable to disruptions that are beyond the Company's control, although the Company is gradually working towards finding ways and means to improve it and has a number of schemes for responsive measures. One stepping stone of security improvements will be PCI compliance[8], which is based on cooperation between the IATA airlines and the credit card schemes. Possible computer disruptions can never be excluded and could result from viruses, hackers, equipment failure, power failure, natural disasters and human errors. The Company has various initiatives in place to minimise the risk of failure to those systems, but there can be no assurance that these initiatives will adequately prevent disruption to its systems.

1.3.1.6 Insurance

The Company carries insurance for passenger liability, property damage, public liability and all-risk cover for damaged aircraft. There may be losses which the business may suffer that are not covered by insurance. Furthermore, individual losses may exceed the cover under applicable insurance. In both cases, losses may subject the Company to considerable financial harm. The Company is a member of the SAFIT[9] group of airlines which is a collective cooperation and manages negotiations and agreements with insurance underwriters. The SAFIT Group manages to offer their members competitive premiums by adhering to the highest safety standards. Through safety technology[10] and safety management systems[11], SAFIT has been able to negotiate lower insurance premiums for hull and liabilities which are among the lowest on the airline insurance market today. Although the cooperation has worked well in the past and provided the Company very competitive insurance premiums, there is no guarantee that it can benefit from such discounts in the future as insurance premiums are extremely sensitive to industry developments and to the composition of SAFIT membership.

1.3.1.7 Anti-Trust Regulations

Due to the market position of some of Icelandair Group's subsidiaries in Iceland, the Group is subject to even more stringent anti-trust regulations than a company with a smaller market share would be. The Company is from time to time involved in disputes with its competitors over alleged breaches of anti-trust regulations. Should the competition authorities reach the conclusion that the Company has breached such regulations, serious consequences for the Company could ensue, which may include substantial fines and hinder its ability to conduct its business in the usual manner.

1.3.2 Economics and Accounting

1.3.2.1 Market Risk

Fluctuations in market prices such as fuel prices, exchange rates, interest rates and possibly carbon prices in future can materially impact the Company's profitability. The Company aims to reduce any such risk as much as possible by actively managing its currency balance and capital structure. Market price fluctuations can also be

[8] Payment Card Industry (PCI) compliance in accordance with the PCI data security standards.
[9] Members of the SAFIT Group are SAS, Austrian Airlines, Finnair, Icelandair and TAP Portugal
[10] All five core members' fleets utilise TCAS II, enhanced ground proximity warning system (EGPWS), forward looking wind shear system, and various other systems.
[11] The members have in place a system that utilises an accident prevention and flight safety system according to JAR OP 1.037 which includes among other things Flight Operations Quality Assurance.

controlled through surcharges, counterparty risk shifting, economising and hedging. The Company's Board of Directors supports a policy of risk management directed at all Group subsidiaries and managed by a Risk Committee (see *Chapter2.1 Risk Management*). Apart from that, each subsidiary is expected to use the abovementioned tools to reduce market risk exposure. Due to market conditions, the Group has not been able to adhere to risk management policies. Various hedge instruments are not being offered on same terms as before. The ISK forward market is non-existent, OTC swap trade is conditional on collateral payments and option purchases require upfront payments of premiums. The domestic currency market has also achieved a risk factor from a rather surprising dimension, i.e. through regulations and sanctions. All exporting enterprises have, since December 2008, been obliged to return foreign income to a domestic foreign exchange at an official exchange rate or divert it to a currency account unless exempted from the regulations. As around 80% of the Company's income and cost is denominated in foreign currency it has not been much affected by these regulations. They could however be in place for some time to come and could have a material adverse effect on the Company's profits.

1.3.2.2 Economic Risk

The company is dependent on external economic factors, but the economic risk factors have different effects on individual subsidiaries. Icelandair ehf.'s business model is based on flight services between destinations in Europe and North America via a hub in Iceland. The model identifies three client classes: "To", "From" and "Via" passengers. The economic shock has different effects on clientele as it can be considered as a portfolio of negatively correlated customers. With the devaluation of the ISK, the domestic "From" market suffers, but the foreign "To" market offsets the impact to some extent. Further, the "Via" market seems to offer opportunities due to market restructuring and the low value of the ISK (e.g. new routes). The charter business is more flexible than scheduled services in adapting to sudden changes in the environment.

Tourism is sensitive to economic crises. A diversification of tourists travelling to Iceland is inherent in the business model so that expansion in one nationality may make up for contraction in another. However, the current world recession is a threat to the industry—overcapacity is a particular danger.

The economic turmoil could bring excessive public spending and increased taxation, which could hit the Company through direct taxes (e.g. income tax) and indirect taxes (e.g. employment related expenses and VAT) in addition to possible temporary new charges and fees which might place extra burden on operating costs.

1.3.2.3 Liquidity Risk

The Company faces the risk of having insufficient working capital to meet payments, e.g. due to inability or difficulties in liquidating its assets. This risk is mitigated to some extent by maintaining liquid assets. Liquidity risk is also reduced to some extent by the nature of the Company's business, as it realises income before paying the cost associated with providing the services. The necessity of liquid cash has however intensified since the credit crunch in October 2008 due to contraction in available credit lines and increased collateral requirements in the financial markets. These include upfront payments for purchased goods and services, security payments to back up hedge positions and delayed payments from credit card acquirers. These factors have all had a negative impact on profits because of the increased cost of funds and they could continue to do so until either markets improve or the Company's capital structure improves. For further information on Icelandair Group's risk policy, please refer to *Chapter 2.3 Liquidity Risk*.

1.3.2.4 Credit Risk and Fraud

The Group has been historically stable in recovery and collection rates from business clients and counterparties, and depreciation of trade receivables is low. However, uncertainty and market volatility have increased and as a result, the credit ratings of banks as well as corporations have been hit by the ongoing economic downturn since 2008. Further, fraud, e.g. in credit card and internet payments, has been on the rise internationally. The possibility of higher impairment rates on current assets should cause concern as this may have an adverse effect on the P/L statement.

1.3.2.5 Effects of Budget Deviations and Capital Structure

Financial conditions and results of operations can be adversely affected if the targets and objectives of the Company are not met. Such developments could make financing more costly and difficult. High debt levels could in turn affect competitiveness and again create difficulties in fulfilling budget expectations. The favourable development of domestic interest rates is crucial, but domestic money market rates have been exceptionally high in recent years and placed added strain on the cost of funds and profitability. It should also be noted that any downgrading of credit ratings could have an adverse effect on the Group's liquidity and cost of funds.

1.3.2.6 Intangible Assets and Risks of Impairment

The Group's intangible assets on the balance sheet are valued at ISK 24 billion[12], the majority of which originates from the time the company was floated in February 2007. This item is composed of two asset classes: identifiable and unidentifiable intangible assets. The former includes the estimated values of slots, customer relationships and contracts, favourable leases, franchise agreements, and non-competitive agreements and trademarks. Identifiable intangible assets are evaluated per individual subsidiary and depreciated on an annual basis and gradually diminish as they will, other things being equal, not be revalued. Unidentifiable intangible assets make up the bulk of the intangible asset class and they are treated as goodwill. Goodwill has been allocated to cash generating units in accordance with anticipated profitability and cash flow. Annual impairment tests are implemented in relation to the annual financial report to evaluate whether possible disruptions in each subsidiary market value could violate the subsequent allocation of those assets. If evidence for impairment is found, the impaired amount is written off in the P/L statement. Such impairment took place in the 2008 Annual Accounts with substantial effects amounting to over ISK 6 billion.[13]

1.3.2.7 Trademark and Reputational Risks

The Company owns a number of registered trademarks, some of which have been in use for over 70 years. A valuable reputation is attached to some of the trademarks, which have to some extent been monetarily valued on the balance sheet. Any misfortune, whether associated with service suppliers' disruption or external shocks by nature or otherwise, could easily ruin the Company's reputation. The Company has benefited indeed from its trademarks and reputation when maintaining existing markets and embarking on new ones. Any reputational defect could instantaneously wipe out markets which have taken a painstakingly long time to establish and accordingly have a material adverse effect on the financial outcome.

1.3.3 **Regulatory and Legal Risks**

1.3.3.1 Applicable Law

The Company and its subsidiaries are subject to various laws and regulations. Changes to the laws that apply to the Group, or if the Company becomes subject to different laws, might have an impact on how it continues to conduct its business and adversely affect the company's financial outcome.

1.3.3.2 Covenants – Contractual Risk

The Company is contractually bound to honour various contracts in leasing and financing agreements via covenants or default event conditions, e.g. through certain accounting figure minimum requirements. Should the Company become unable to fulfil the relevant covenants, or for some reason discontinue to do so, the lessors and financiers may become entitled to rescind these agreements, which might have financial consequences for the Company.

Some of the Company's current long term-loan agreements contain covenants which have to be honoured at all times and if violated will entail consequences for the servicing of debt and the capital structure as a whole. These loans are estimated to amount to around 40% of the total long-term loans after completion of the loan

[12] Intangible assets at 30 June 2010 were valued at ISK 23,781 million.
[13] Amortisation of intangible assets was ISK 662 million and impairment loss ISK 6,415 million.

restructuring. For further information about current covenants in loan agreements, refer to *Chapter 25.3 Liquidity Risk and Covenants in Loan Contracts.*

1.3.3.3 Securities Regulation

The Company's shares are traded on the NASDAQ OMX Iceland hf. and therefore subject to Icelandic securities regulations, e.g. those in the Securities Transactions Act No. 108/2007, government regulations and rules adopted by the NASDAQ OMX Iceland hf. The Company has at all times managed satisfactorily to comply with the said provisions, but any violation of these provisions may have a financial impact on the Company. Serious breaches may result in penalties and the NASDAQ OMX Iceland hf. ceasing to list the Company's securities. Should the Company violate the relevant rules, this may furthermore impact its reputation, forego this source of financing and consequently result in the price of its shares dropping.

1.3.3.4 Aviation Regulations

Air transportation is subject to intensive regulation. An Air Operator's Certificate (AOC) has been issued to the relevant subsidiaries[14] of Icelandair Group authorising it to conduct its airline operations. There is no guarantee that the Company will be issued such licenses in the future. Occasionally, the FAA[15] and its European counterparts issue directives and other regulations relating to the maintenance of aircraft that may result in significant costs for the Company. There is no guarantee that the Company will be compensated for this through higher ticket prices, so it is likely that the Company will be adversely affected. The Company's operating authority is subject to aviation agreements between governmental authorities of the European Union and the respective countries. Those agreements are periodically subject to renegotiation. Changes in the aviation policies of those countries could result in the termination of such agreements and adversely affect the Company's operations. Individual airline regulators, including the regulator in Iceland, may impose restrictions and requirements that would impact the Company's profitability.

Other aspects of the Company's business, such as the segments relating to tourism, are subject to various conditions set by the relevant regulations and public permits. If any regulations were changed or violated, or permits were cancelled or not renewed, this might affect the Company adversely.

1.3.3.5 Litigation

Given the Company's size and the scope of its operations, it can easily find itself involved in some form of litigation at any given time which might adversely affect its financial position. Currently, the Company is involved in various legal disputes, none of which is of any financial significance, see *Chapter 13 LITIGATIONS*.

1.3.3.6 Trademarks and Intellectual Property

The Company owns a number of trademarks and other intellectual property through its operational subsidiaries. It has used all means available to secure legal rights to such trademarks and intellectual property. Should it, for some reason, be unable to continue to rely on the relevant intellectual property rights, this could adversely affect the Company.

1.3.3.7 Internal Controls

The Company is dependent on having sufficient internal controls in place in various areas, including controls relating to the integrity of the IT systems, data processing and the handling of electronic documents. The Company has focused on strengthening such controls. Should such controls prove to be insufficient, it might result in a negative impact for the Company.

1.3.3.8 Tax

The Company could be affected by changes in tax legislation in any country, hence inflicting damage on financial outcome. The parliament passed a new law in 2009 which includes several new financial items among which a new tax is levied on interest payments originating from domestically based foreign assets. This matter is

[14] Icelandair, Icelandair Cargo and Air Iceland have been issued an AOC.
[15] Federal Aviation Administration, a U.S. government agency responsible for overseeing air transportation in the USA.

under inspection and could add to the Company’s cost of funding as some Company liabilities might fall under the relevant clause.[16] Icelandair Group is not aware of any other current tax inspection concerning the Group which may have a material impact on its shares, and has no reason to believe that any such inspection is imminent. Investigation of the Company’s tax returns, as for any other company, may be initiated at a later stage in accordance with relevant regulations and affect its prospects.

There could be some tax issues regarding withholding taxes on aircraft lease payments. There is uncertainty regarding the Company’s duty to withhold tax on lease payments to countries that don’t have a tax treaty with Iceland. The Company has taken steps to clarify the situation to the tax authorities based on the current stance of not withholding tax and referring to a precedent set by current interpretation of the law, custom and actions by other Icelandic companies, but the risk is inevitably that tax authorities will reach a different conclusion and view the Company’s approach to these tax issues as not fully compliant with tax legislation applicable in this context.

It is recommended that any potential investor should note the situation. No assurance can be given on the likelihood of payments having to be made in this respect, or the possible scale of such payments.

[16] AIRCO is an Icelandair ehf. subsidiary which is a USD denominated aircraft financing unit. It is financed with foreign loans but registered in Iceland.

2 RISK MANAGEMENT POLICY

2.1 Risk Management

Financial risk from various sources has a considerable effect on the Group's operations. The Board of Directors is responsible for defining treasury policy measures to reduce the exposure to risk. The approved treasury policy outlines the parameters and framework to which the Group is subject, when dealing with financial risk arising from price volatility, liquidity fluctuations, asset management and corporate financing. An internal Risk Management Team, chaired by the CEO, actively controls risk exposure within the Board's policy limits. The main policy objectives outline the methods to be used to reduce costs and inconvenience arising from price volatility and uncertainty. To that end, the financial budget is used as a benchmark when evaluating market conditions and hedging strategies.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee has its own guidelines which it operates under. Among other things it oversees management compliance with the Group's risk management policies. The committee is assisted by Internal Audit to evaluate ad hoc reviews of risk management controls and procedures. For more information see *Chapter 19.3.1 Audit Committee.*

2.1.1 Derivatives and Accounting

Derivatives are financial contracts which can be valued at any time, and that value should fluctuate against the underlying exposure which the derivatives are intended to hedge. Risk is managed by deciding to what extent exposure should be hedged and what combination of derivatives to use. The purchase of production inputs with costs that are dependent on market prices gives rise to the exposure. The derivatives enable the company to limit price fluctuations of inputs such as jet fuel, interest rates, foreign currency and possibly carbon emission units in the future. The way derivatives positions are registered and then accounted for in the company's financial statements until they expire is crucial as regards the effects that their value will have on the income statement and the balance sheet.

Derivative instruments are initially recorded at fair value, and the changes in fair value are recorded in either the income statement or shareholders' equity, depending on whether or not the instrument is designated as a hedge for accounting purposes or not. As derivatives are used for hedging purposes only within the Group according to policy procedures, all derivatives are designated as such. They are accordingly documented and tested for as required by the IAS 39.[17] If a derivative is designated as a cash flow hedge, which includes derivative transactions entered into to hedge risk relating to jet fuel costs, currency exchange rate fluctuations in relation to aircraft purchasing obligations and commercial cash flows and exposure to variable interest rates, changes in the fair value of the derivative are recognized in a hedging reserve in the shareholders' equity. As the derivative matures, the amount of any deferred gains or losses is recorded in the income statement in the same line item as the corresponding hedged item.

If a derivative is designated as a fair value hedge, which includes derivatives that convert the Group's fixed-rate interest exposure to a floating rate, the change in fair value is recorded directly in the income statement. The impact on the income statement is recorded in financial income and expenses, together with the change in the

[17] International Accounting Standards

fair value of the hedge borrowings. Hedges of net investments are accounted for in a way similar to cash flow hedges. Changes in the fair value of a derivative instrument which are not designated as a hedge for accounting purposes are recorded directly in the income statement. In addition, the ineffective portion of cash flow hedges, those hedges failing prospective and retrospective effectiveness tests, is recorded directly in the income statement.

The company's exposure to financial risk can mainly be attributed to three types of risk sources: client credibility, level of liquidity and market prices. These classes will be discussed and explained with reference to historical year-end data for 2009 and 2008 where applicable.

The tables in the following sections will not quote the June figures of 2010 in relation to the interim financial statement. The result at end of year 2009, referred to in the tables in this section, is considered to be an adequate indicator for the particular items as of 30th of June 2010. There have not been any relevant deviations in the business operations of the Company which should seriously affect these items apart from normal seasonality.

2.2 Credit Risk

Credit risk is the risk of financial loss by the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and it arises principally from the Group's receivables from customers.

2.2.1 Receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Credit risk is linked to the investment of liquid assets, the management of those assets and agreements with financial institutions related to financial operations, e.g. hedging and collateral payments. The risk involved is directly related to the fulfilment of outstanding obligations of the Group's counterparties. The Group is aware of potential losses related to credit risk exposure and chooses its counterparties subject to business experience and satisfactory credit ratings.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

2.2.2 Guarantees

The Group's policy is to provide financial guarantees only to wholly-owned subsidiaries. We refer to *Chapter 12.4.2.7 Future Strategy* for information on the guarantees of Icelandair Group for SmartLynx

2.2.3 Exposure to Credit Risk

The carrying amount of financial assets represents the maximum credit exposure.

Item 1. The maximum exposure to credit risk at the reporting date

(mISK)	2009	2008
Long-term receivables and deposits	3,449	3,834
Trade receivables and other receivables	9,725	13,836
Cash and cash equivalents	1,909	4,065
Total	**15,083**	**21,735**

2.2.3.1 *Impairment Losses*

The ageing of trade receivables at the end of 2009 was:

(mISK)	Gross 2009	Impairment 2009	Gross 2008	Impairment 2008
Not past due	5,302	-27	5,637	0
Past due 0–30 days	380	-9	1,278	0
Past due 31–120 days	773	-71	1,477	-160
Past due 121–365 days	288	-162	653	-266
More than one year	318	-179	569	-399
Total	**7,061**	**-448**	**9,614**	**-825**

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

(mISK)	2009	2008
Balance January	825	241
Impairment loss recognised (reversed)	-313	0
Balance at 31 December	-64	584
Total	448	825

The allowance account in respect of trade receivables is used to record impairment losses unless the Group is satisfied that no recovery of the amount owing is possible; at that point the amount is considered irrecoverable and is written off against the financial asset directly.

2.3 **Liquidity Risk**

The risk of not being able to meet financial obligations as they fall due is referred to as liquidity risk. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient available funds to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The Group's policy on liquidity risk extends to three asset classes determined by duration. Those classes are matched against the Group's liquidity preferences laid out by the management on an annual basis. Classes one and two include the estimated minimum level of accessible funds for immediate and intermediate operational liquidity. Class three includes assets of longer duration for strategic liquidity, such as medium-term investments. The amounts in each class of assets are targeted once a year with reference to a number of economic indicators, most importantly the annual level of fixed costs, and turnover.

Since the Group was floated in 2007, the ratio of short term loans in the capital structure has been excessive and plans for restructuring have not been met. Under the circumstances, short-term loans have therefore simultaneously been a vital source for operational liquidity and hence, the Group has not been able to fulfil policy obligations as preferred, but rather has aimed to keep short-term funding sources open to meet seasonal demands.

Item 2. Contractual maturities of financial liabilities, including estimated interest payments and payments of off-balance sheet items.

2009 **(mISK)**	**Carrying amount**	**Contractual cash flows**	**Within 12 mths**	**1–2 yrs**	**2–5 yrs**	**After 5 yrs.**
Financial liabilities:						
Unsecured bond issue	18,807	(18,807)	(18,807)	0	0	0
Secured bank loans	11,211	(13,266)	(2,884)	(2,161)	(8,004)	(217)
Convertibles notes	1,947	(2,344)	(229)	(2,115)	0	0
Payables and prepayments	20,334	(20,334)	(14,392)	(2,252)	(3,690)	0
	52,299	**(54,751)**	**(36,312)**	**(6,528)**	**(11,694)**	**(217)**
Off-balance sheet liabilities:						
Operating lease payments	0	(38,137)	(12,502)	(10,939)	(13,489)	(1,207)
Pre-delivery payments	0	(18,531)	(839)	(1,966)	(15,726)	0
	0	**(56,668)**	**(13,341)**	**(12,905)**	**(29,215)**	**(1,207)**
Exposure to liquidity risk	**52,299**	**(111,419)**	**(49,653)**	**(19,433)**	**(40,909)**	**(1,424)**

2008 **(mISK)**	**Carrying amount**	**Contractual cash flows**	**Within 12 mths**	**1–2 yrs**	**2–5 yrs**	**After 5 yrs.**
Financial liabilities:						
Unsecured bond issue	16,175	(16,175)	(16,175)	0	0	0
Secured bank loans	25,542	(31,396)	(5,852)	(4,674)	(14,379)	(6,491)
Convertibles notes	1,918	(2,189)	0	0	(2,189)	0
Trade and other payables	28,334	(28,334)	(24,119)	(2,026)	(2,189)	0
	71,969	**(78,094)**	**(46,146)**	**(6,700)**	**(18,757)**	**(6,491)**
Off-balance sheet liabilities:						
Operating lease payments	0	(66,556)	(17,345)	(14,672)	(28,302)	(6,237)
Pre-delivery payments	0	(23,287)	(876)	(815)	(14,907)	(6,689)
	0	(89,843)	(18,221)	(15,487)	(43,209)	(12,926)
Exposure to liquidity risk	**71,969**	**(167,937)**	**(64,367)**	**(22,187)**	**(61,966)**	**(19,417)**

Unused loan commitments at year end 2008 amounted to ISK 1,643 million.

2.4 Market Risk

Market risk is composed of changes in market prices, such as foreign exchange rates, interest rates and fuel prices, and it inevitably has a continuous effect on the Group's operations. The objective of risk management is to manage and control market risk exposures within acceptable parameters subject to optimised returns, by using derivatives or other means at hand. All such actions are carried out within the guidelines set by the Board of Directors. The Group seeks to apply hedge accounting in order to manage volatility on the income statement.

2.4.1 Currency Risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of Group entities. The Group seeks to reduce its foreign exchange exposure arising from transactions in various currencies through a policy of matching, receipts and payments under each individual currency. Then internal trades across the range of subsidiaries are arranged by the Group as possible. Nevertheless, the USD cash inflow falls short of USD outflow due to fuel costs and lease- and capital-related payments which are to a large extent denominated in USD. This shortage is financed by a surplus of European currencies, most importantly EUR and Scandinavian currencies. The Group follows a hedging policy of 40–80% of net exposure with a 12-month horizon and uses a portfolio of instruments, both forwards and options. Due to a stressed economic environment since 2008 and risk-averse financial markets, hedge ratios have temporarily fallen below the lower policy boundaries of 40%, mainly as a result of the added opportunity costs of supporting hedging activities with market requirements for collateral and up-front premium payments.

2.4.2 **Exposure to Currency Risk**

Item 3. The Group's exposure to foreign currency risk notional amounts in major currencies

2009 (mISK)	USD	EUR	DKK	SEK	NOK	CZK
Net bal. sheet exposure..	1,786	-2,199	279	337	331	545
Estimated forecast revenue..	27,302	15,356	3,618	3,220	2,985	0
Estimated forecast purchases..	-40,850	-5,675	-1,644	-340	-455	0
Net currency exposure...	**-11,762**	**7,482**	**2,253**	**3,217**	**2,861**	**545**

2008 (mISK)	USD	EUR	DKK	SEK	NOK	CZK
Net balance sheet exposure..	5,563	-1,271	132	120	53	-2,142
Estimated forecast revenue..	45,820	30,031	2,064	1,973	1,412	27,296
Estimated forecast purchases..	-70,405	-23,421	-655	-469	-467	-9,364
Forward FX contracts..	3,997	-3,997	0	0	0	0
Net currency exposure...	**-15,025**	**1,342**	**1,541**	**1,624**	**998**	**15,790**

2.4.2.1 Sensitivity Analysis

A 10% strengthening of the ISK against the following currencies at 31 December 2009 would have increased (decreased) post-tax equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

Item 4. Sensitivity analysis, assuming 10% appreciation of ISK

2009 (mISK)	Equity	Profit or loss
USD..	964	964
EUR..	(614)	(614)
DKK..	(185)	(185)
SEK..	(263)	(263)
NOK..	(235)	(235)
CZK..	(45)	0

2008 (mISK)	Equity	Profit or loss
USD..	1,277	1,517
EUR..	(114)	45
DKK..	(131)	(131)
SEK..	(135)	(135)
NOK..	(85)	(85)
CZK..	(1,342)	0

A 10% weakening of the ISK against the above currencies would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

2.4.2.2 Interest Rate Risk

The largest share of outstanding long-term loans carries 3–6 months floating interest rates and is directly related to aircraft financing and denominated in USD. That is a consequence of the fact that the most liquid market for commercial aircraft denominates prices in USD. The Group follows a policy of hedging 40–80% of interest rate exposure. Swap contracts are mainly used to exchange floating rates for fixed rates up to 5 years ahead, which currently amounts to USD 65 million, and they carry on average 4.65% interest rates. In recent years, the contracts have proved favourable as the floating rates have exceeded the fixed rates; however, since 2008 there has been a turnaround with rates falling sharply below 2%. All of the swap contracts expire in 2010 apart from one contract amounting to USD 10 million which expires in 2011.

The management has not been in a position to hedge interest rates beyond 2010 as a result of unattractive offers.

Item 5. The interest rate profile of the Group's interest bearing financial instruments

(mISK)	2009	2008
Fixed rate instruments:		
Financial assets	3,449	3,834
Financial liabilities	(331)	(5,617)
	3,118	**(1,783)**
Variable rate instruments:		
Financial liabilities	**(36,059)**	**(38,018)**

2.4.2.3 Fair Value Sensitivity Analysis for Fixed Rate Instruments

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore, a change in interest rates at the reporting date would not affect profit or loss.

2.4.2.4 Cash Flow Sensitivity Analysis for Variable Rate Instruments

A change of 100 basis points in interest rates at year end reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

Item 6. Sensitivity analysis, 100bp change in interest rates

(mISK) Effect of IR shift on equity	100 bp increase	100 bp decrease
2009		
Variable rate instruments	49	(50)
2008		
Variable rate instruments	122	(125)

2.4.3 **Fuel Price Risk**

The price of jet fuel has a significant influence on the cost of operations. Among the Icelandair Group subsidiaries, Icelandair ehf. has by far the greatest risk exposure as the other companies are in a better position to price in the risk or transfer it to the counterparty. Price development for the past five years has been characterised by a steep upward trend, generated by excessive world demand and periodic cycles which have added to price volatility. In 2008, the monthly average of jet fuel prices reached a record level of USD 1,356 /t in

July, having continuously rallied from USD 550 /t in January 2007.[18] Oil prices were mainly demand driven, and in general the market was under the impression that the new price territory was sustainable.

Market specialists argued that increased future demand for oil in the Far East supported the price rally and that the concept of oil as an alternative asset class for investors and speculators underpinned this development. Market sentiment took sides with this conception until July 2008 when the oil price collapsed and became within four months a mere fraction of what it had been. Since the beginning of 2009, prices have stabilised somewhat and remained between USD 600 and USD 700 /t. This scenario gives an idea of the volatile market environment the Group faces and the need for protective measures.

The Group maintains a policy of hedging fuel price exposure by a ratio of 40–80% with a 12–month horizon by using swaps and options. The average hedge ratio in 2008 was roughly 40–50%, but other protective measures were used, including fuel surcharges, third party risk shifting and economic fuel saving measures. Due to high opportunity costs of collateral and up-front payments, the Board of Directors has allowed hedging activities to fall below policy limits. In 2010, around 20% of annual fuel consumption is hedged to cover the summer season. For further information on hedging policy, see *Chapter 10.7.3.2 Derivative Financial Instruments, Including Hedge Accounting.*

2.4.3.1 Sensitivity Analysis

The following table demonstrates the sensitivity of financial instruments to a reasonably possible change in fuel prices, with all other variables held constant, on profit before tax and equity:

Item 7. Sensitivity analysis, 10% change in fuel prices

(mISK)	**Effect on equity**		**Effect on profit**	
	2009	**2008**	**2009**	**2008**
Increase in fuel prices of 10%.........	0	412	0	(60)
Decrease in fuel prices of 10%.........	0	(414)	0	67

[18] Source: http://www.bloomberg.com/markets/commodities/futures/

3 PERSONS RESPONSIBLE

3.1 Issuer's Statement

The CEO and the Board of Directors of Icelandair Group hf. ID No. 631205-1780, registered office Reykjavik Airport, 101 Reykjavík, Iceland, hereby declare that having taken all reasonable care to ensure that such is the case, the information contained in the Registration Document is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import.

Reykjavík, 28 October 2010
Reykjavik Airport, 101 Reykjavík, Iceland:

Sigurdur Helgason,
Chairman of the Board of Directors,
Icelandic ID No. 010546-2069

And

Björgólfur Jóhannsson,
CEO,
Icelandic ID No. 280855-3409.

3.2 Statutory Auditor's Statement

KPMG hf., ID No. 590975-0449, registered office Borgartún 27, 105 Reykjavík, Iceland, which contains members of the Institute of State Authorized Public Accountants in Iceland

and

Jón S. Helgason, state-authorised public accountant at KPMG hf. and Gudný Helga Gudmundsdóttir, state-authorised public accountant at KPGM hf.,

hereby jointly declare that we have audited and expressed an opinion on the consolidated financial statements of the Company for the financial years ended 31 December 2007, 2008 and 2009, and declare that nothing has come to our attention that causes us to believe that the consolidated financial statements for the abovementioned financial years do not give a true and fair view of the financial position of the Company as at 31 December, 2007, 2008 and 2009, and of the results of the Company's operations and cash flows for the years then ended in accordance with International Financial Reporting Standards as adopted by the EU.

KPMG also conducted a review and issued a review report on the condensed consolidated interim financial information for the half-years ended 30 June 2009 and 30 June 2010 and declares that nothing has come to its attention that causes it to believe that the interim financial information of the Company for the first six months ended 30 June 2009 and 30 June 2010 is not prepared, in all material respects, in accordance with International Accounting Standard 34 "Interim Financial Reporting". Furthermore KPMG hf. confirms that any information in this Registration Document, regarding such financial statements is consistent with the said financial statements.

KPMG has examined the profit forecast of Icelandair Group for the year 2010 set forth in *Chapter18 PROFIT FORECAST* in this Registration Document in consideration of whether it is presented in accordance with the accounting policies of Icelandair Group and the International Financial Reporting Standards. The Company's management and the Board of Directors are responsible for the profit forecast and the assumptions on which it is based. Our responsibility is to express an opinion on the presentation of the profit forecast based on our examination.

In our opinion the profit forecast presented and set forth in *Chapter 18 PROFIT FORECAST* has been presented in accordance with the accounting policies of Icelandair Group and the International Financial Reporting Standards.

Emphasis of matter for consolidated financial statements for 2009[19]

The following paragraph is from the independent auditors report in the Icelandair Group's Financial Statement for the year 2009

"Without qualifying our opinion, we draw attention to note 53 to the consolidated financial statements, which states that the Company has entered into a framework agreement with its main creditors regarding the financial restructuring plan. If the restructuring, according to the agreement, will not be completed and the debt maturity profile and financial position of the Company will not be improved in any other way it may cast doubt about the Company's ability to continue as a going concern."

On 12 August 2010, Icelandair Group announced that the financial restructuring process of the Group had been completed. However, the documentation process of the financial restructuring was not concluded and contracts signed until on 21 October 2010. The emphasis of matter was not a part of the Independent Auditor's Report for the consolidated financial statement of Icelandair Group for the first six months of 2010.

[19] Independent Auditor's Report for the Consolidated Financial Statement of Icelandair Group hf. 2009.

Reykjavik, 28 October 2010

On behalf of KPMG hf.

Jón S. Helgason

State-authorised public accountant and member of The Institute of State Authorized Public Accountants in Iceland

Icelandic ID No. 050269-3619

and

Gudný Helga Gudmundsdóttir

State-authorised public accountant and member of The Institute of State Authorized Public Accountants in Iceland

Icelandic ID No. 221168-4029

4 THE LISTING ADVISOR

The Listing Advisor, Íslandsbanki hf., ID No. 491008-0160, registered office Kirkjusandur 155, Reykjavík, Iceland, has been the advisor to the Issuer in the preparation of this Registration Document. The Listing Advisor has not independently verified the information contained herein.

Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Listing Advisor as to the accuracy or completeness of the information contained or incorporated by reference in this document or any other information provided by the Issuer in connection with the issue of the New Shares no later than 3 November 2010.

The Listing Advisor has in consultation with the management and the Board of the Directors of Icelandair Group construed this Registration Document and is acting in reliance on the information provided by the management and Board of Directors of Icelandair Group.

Íslandsbanki is the largest shareholder in Icelandair Group with a 46.98% share of the common stock and a voting right which is limited at 30%, see *Chapter 21 MAJOR SHAREHOLDERS*. Íslandsbanki is also the owner of all of the Groups convertible bonds; the bank will refinance the convertible bonds in connection with the restructuring of Icelandair Group and the convertible bonds will accordingly be cancelled. Íslandsbanki is the Groups largest creditor and with an agreement which was made between Íslandsbanki and Icelandair Group, regarding the financial restructuring of the Group, certain assets of the Group will be transferred to a separate SPV owned by Íslandsbanki and Glitnir Bank. For further information refer to *Chapter 27.3.3 Debt Conversion into Equity*. Notice is drawn to the fact that after the financial restructuring is completed with the issue of the New Shares, Íslandsbanki's stake in the common stock will be 26.1%.

5 DOCUMENTS ON DISPLAY AND INCORPORATED BY REFERENCE

The following documents shall be deemed to be incorporated by reference in, and to form part of, this Registration Document:

- The Company's audited consolidated financial statements in respect of the year ended 31 December 2007, together with the audit report prepared in connection therewith.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2008, together with the audit report prepared in connection therewith.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2009, together with the audit report prepared in connection therewith.
- The Company's reviewed condensed consolidated interim financial statement in respect of the six months ended 30 June 2009.
- The Company's reviewed condensed consolidated interim financial statement in respect of the six months ended 30 June 2010.

Copies of the aforementioned documents can be obtained from the registered office of the Issuer or electronically from the Company's website www.icelandairgroup.is.

For the life of this Registration Document, or for 12 months from the date of issue, the following documents are available for viewing at the registered office of the Issuer, or electronically from the Company´s website www.icelandairgroup.is:

- The Registration Document, Security Note and Summary all dated 28 October 2010.
- The Issuer's Articles of Association.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2007, together with the audit report prepared in connection therewith.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2008, together with the audit report prepared in connection therewith.
- The Company's audited consolidated financial statements in respect of the year ended 31 December 2009, together with the audit report prepared in connection therewith.
- The Company's reviewed condensed consolidated interim financial statement in respect of the six months ended 30 June 2009.
- The Company's reviewed condensed consolidated interim financial statement in respect of the six months ended 30 June 2010.

6 REFERENCES

References to “Icelandair Group”, “the Issuer”, “we”, “us”, “the Group” and “the Company” in this Registration Document shall be construed as referring to Icelandair Group hf., Icelandic ID No. 631205-1780, unless otherwise clear from the context.

References to “Icelandair ehf.” in this Registration Document shall be construed as referring to Icelandair ehf., Icelandic ID No. 461202-3490, unless otherwise clear from the context. Icelandair ehf. is the largest subsidiary within Icelandair Group.

References to “Loftleidir-Icelandic” in this Registration Document shall be construed as referring to Loftleidir-Icelandic ehf., Icelandic ID No. 571201-4960, unless otherwise clear from the context. Loftleidir-Icelandic is a subsidiary within Icelandair Group.

References to the “European Union” or “EU” shall be construed as referring to the member states of the European Union, unless otherwise clear from the context.

References to “FME” shall be construed as referring to the Financial Supervisory Authority in Iceland (Fjármálaeftirlitid), unless otherwise clear from the context.

References to “Glitnir Bank” shall be construed as referring to Glitnir Bank hf., incorporated under the laws of Iceland, ID No. 550500-3530. On 8 October 2008, in accordance with the authority provided to the FME by Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc., the FME appointed the Resolution Committee of Glitnir Bank. On that date, the Resolution Committee took over all authority of the Board of Directors of Glitnir Bank hf. in accordance with the articles of Act No. 2/1995 on Public Limited Companies including oversight of all treatment of its assets, as well as the handling of all other business. References to “the Resolution Committee of Glitnir Bank” shall be construed as referring to the Resolution Committee of Glitnir Bank hf., unless otherwise clear from the context.

References to “SPW ehf.” in this Registration Document shall be construed as referring to a special purpose vehicle, incorporated under the laws of Iceland, ID No. 530910-0590 whose registered office is at Sóltún 26, 105 Reykjavík, unless otherwise clear from the context. SPW ehf. common stock is divided between two shareholders: Íslandsbanki with 71.1% and Glitnir Bank which holds the remaining 28.9% share in the company.

References to “Landsbanki Íslands” shall be construed as referring to Landsbanki Íslands hf., incorporated under the laws of Iceland, ID No. 540291-2259. On 7 October, in accordance with the authority provided to the FME by Act No. 125/2008 on the Authority of Treasury Disbursements due to Unusual Financial Market Circumstances etc., the FME appointed the Resolution Committee of Landsbanki Íslands hf. On that date, the Resolution Committee took over all authority of the Board of Directors of Landsbanki Íslands hf. in accordance with the articles of Act No. 2/1995 on Public Limited Companies, including oversight of all treatment of its assets, as well as the handling of all other business. References to “the Resolution Committee of Landsbanki Íslands” shall be construed as referring to the Resolution Committee of Landsbanki Íslands hf., unless otherwise clear from the context.

References to “Icebank” shall be construed as referring to Icebank hf. (Icelandic name, Sparisjódabanki Íslands hf.), incorporated under the laws of Iceland, ID No. 691086-1379.With a decision made on 21 March 2001, the FME assumed the power of a shareholders’ meeting of Icebank in accordance with the authority provided to the FME by Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. On 27 March, the FME appointed a Resolution Committee for Icebank, which has taken all authority of the Board of Directors in accordance with the articles of Act No. 2/1995 on Public Limited Companies. References to “the Resolution Committee of Icebank” shall be construed as referring to the Resolution Committee of Icebank hf., unless otherwise clear from the context.

References to “the ISD” in this Registration Document shall be construed as referring to the Icelandic Securities Depository (Icelandic name, Verdbréfaskráning Íslands hf.) incorporated under the laws of Iceland, ID No. 500797-3209, unless otherwise clear from the context. Eignarhaldsfélagid Verdbréfathing hf., incorporated under the laws of Iceland, ID No. 650602-4390, is the sole owner of Verdbréfaskráning Íslands hf., and is currently fully owned by NASDAQ OMX Group inc., which is the world’s largest exchange company.

References to “NASDAQ OMX Iceland” in this Registration Document shall be construed as referring to NASDAQ OMX Iceland hf., incorporated under the laws of Iceland, ID No. 681298-2829, part of the NASDAQ OMX Group inc.; it shall also refer to the former names of NASDAQ OMX Iceland such as OMX Nordic Exchange Iceland hf. and OMX ICE, unless otherwise clear from the context.

Reference to “the Main Market NASDAQ OMX Iceland” in this Registration Document shall be construed as referring to the Main Market at NASDAQ OMX Iceland hf.; it shall also refer to the former names of the Main Market of NASDAQ OMX Iceland such as OMX ICE Main Market, unless otherwise clear from the context.

References to “the Listing Advisor” and “Íslandsbanki” in this Registration Document shall be construed as referring to Íslandsbanki hf., ID No. 491008-0160, unless otherwise clear from the context.

References to “the Prospectus” in this Registration Document shall be construed as referring to the Prospectus dated 28 October 2010, comprising of a Summary, a Registration Document and a Securities Note, which are all issued on the same date, unless otherwise clear from the context.

We present our financial statements in Icelandic kronur, and references in this Registration Document to “ISK” refer to the currency of Iceland. References to “USD” refer to the currency of the United States of America, and references to “Euro” and “EUR” refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended, unless otherwise clear from the context.

References to “the New Shares” in this Registration Document shall be construed as referring to 2,941,000,000 new shares in Icelandair Group, admitted to trading on the Main Market of NASDAQ OMX Iceland and subscribed for by professional investors, unless otherwise clear from the context.

References to the *Hub and Spoke* concept in this Registration Document shall be construed as referring to a system created in the 1980s unless otherwise clear from the context. The Icelandair ehf. *Hub and Spoke* concept is based on the geographical position of Iceland on the flight route between Europe and North America. By combining in its aircraft, passengers visiting Iceland, passengers departing from Iceland and passengers travelling across the Atlantic via Iceland, Icelandair ehf. and its predecessors have been able to expand their network steadily over the past decades. Icelandair ehf. connects 15–20 European cities to 5–8 North American cities through the hub in Iceland. The network is based on a 24-hour rotation with morning and afternoon connections in Iceland.

7 THIRD PARTY INFORMATION

Where third party information has been used in this Registration Document, the information has been accurately reproduced and the source of such information has been identified. As far as the Company is aware and able to ascertain from information published by those third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading.

When third party information has been used in this Registration Document, it has been on the basis of publicly available information which is cited in footnotes where they are referred to. The footnotes are structured in such a way as to make it straightforward for the reader to identify the relevant source of the information if the need or will arises to examine the underlying documents in further detail.

8 NOTICE TO INVESTORS

The Registration Document is compiled in accordance with Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 (“the Prospectus Directive”). The Prospectus Directive has been implemented into Icelandic law.

Only the Issuer is entitled to procure information about conditions described in this Registration Document. Information procured by any other person is of no relevance in relation to the Registration Document and cannot be relied on.

This Registration Document is not an offer to sell or a request to buy Shares in the Company.

The Registration Document is not being distributed, and must not be mailed or otherwise distributed or sent in or into any country in which distribution would require any additional registration measures or other measures to be taken, other than as applicable under Icelandic law and regulations, or would be in conflict with any law or regulation in such country. On the other hand the Registration Document may be passported in accordance with the provisions of the Prospectus Directive into other jurisdictions within the European Economic Area. The purpose of this Registration Document is to have available information about the Company in conformity with the Prospectus Directive. Any exposure or distribution of the content of this Registration Document, in any other purpose, is forbidden, without a prior written consent of the Issuer. Binding subscriptions for New Shares in the Company are in the form of a private tender offer with professional investors.

No person is authorised to give information or to make any representation in connection with the New Shares other than as contained in the Registration Document. If any such information is given or made, it must not be relied upon as having been authorised by the Company or any of the Company’s respective affiliates or advisers. Neither the delivery of the Registration Document nor any sale made hereunder shall under any circumstances imply that there has been no change in the Company’s affairs or that the information set forth in the Registration Document is correct as of any date subsequent to the date hereof.

This Registration Document should by no means be viewed or construed as a promise by the Company, or other parties of future success either in operations or return on investments. Investors are reminded that investing in securities entails risk, as the decision to invest is based on expectations and not promises. Investors must rely primarily on their own judgement regarding any decision to invest in the Company’s securities, bearing in mind inter alia the business environment in which the Company operates in, anticipated profits, external conditions and the risk inherent in the investment itself. Prospective investors are advised to contact experts, such as licensed financial institutions, to assist them in their assessment of the securities issued by the Company as an investment option. This Registration Document does not constitute legal, financial or tax advice. Investors are furthermore advised to consider their legal status, including taxation issues that may concern the purchase or sale of the Company’s securities and seek external and independent advice in that respect.

This Registration Document has been prepared to provide clear and thorough information on the consolidated company Icelandair Group. Investors are encouraged to acquaint themselves thoroughly with this Registration Document. They are advised to pay particular attention to *Chapter 1 RISK FACTORS* of this Registration Document.

Notwithstanding a special statement to the contrary, references to any laws, acts or regulations are references to acts passed by the Icelandic parliament and regulations issued by Icelandic governmental agencies unless otherwise clear from the context.

The admission to trading will proceed pursuant to Icelandic law and regulations. NASDAQ OMX Iceland has, in its authority under agreement between it and the Icelandic Financial Supervisory Authority, scrutinised and approved this Registration Document, which is published in English only.

In the event of any significant new factor, material mistake or inaccuracy relating to information included in this Registration Document which could be capable of affecting the assessment of the New Shares, the Issuer will, in accordance with Article 46 of the Securities Transactions Act No. 108/2007, publish a supplement to the Prospectus which will be published with the same process as the Prospectus. The supplement shall be approved within seven business days and published in the same manner as the Prospectus. In the event of the above mentioned, the Issuer will also issue an announcement that will be made public.

On 15 September, an extraordinary shareholders meeting was convened. The agenda of the meeting was to elect a new Board of Directors and vote on proposals for a vote of no confidence in the Company's auditing firm and for the election of a new auditing firm. The proposals were withdrawn and subsequently the only item on the agenda for the meeting was the election of a new Board of Directors. For a list of the new Board Members, please refer to *Chapter 19.1 Board of Directors*.

9 SELECTED FINANCIAL INFORMATION

The following tables present selected consolidated financial data as of the dates or for the periods indicated and are qualified in their entirety by, and should be read in connection with *Chapter 10 OPERATING AND FINANCIAL REVIEW,* and audited and/or reviewed consolidated financial statements and related notes incorporated by reference, see *Chapter 5 DOCUMENTS ON DISPLAY AND INCORPORATED BY REFERENCE.*

The selected consolidated income statement data for the years ended 31 December 2007 and 2009 and the selected consolidated balance sheet data as of 31 December 2007 and 2009 have been derived from our audited consolidated financial statements prepared in accordance with International Financial Reporting Standards, as adopted by the European Union ("IFRS").

The selected consolidated income statement data for the year ended 31 December 2008 has been derived from our re-presented consolidated financial statements prepared in accordance with IFRS as it was re-presented in the consolidated financial statement for the financial year 2009.

At year end 2009, the Group changed its accounting procedures regarding leased engines capitalisation. The different accounting procedures altered the balance sheet and cash flow classification. When the 2009 balance sheet and cash flow were published in the financial statement, the 2008 figures were reclassified. The result of the reclassification was that the total assets for the year 2008 were ISK 99,947 million in the 2009 financial statement as compared to ISK 98,830 million shown in the 2008 financial statement. The change in accounting procedures regarding the capitalisation of leased engines does not affect the classification of the consolidated income statement.

The balance sheet and cash flow figures for the year 2008 are derived from the financial statement for the year 2009 from the 2008 comparative figures. Therefore, it is hereby noted that the classification shown for the year 2008 in the 2009 financial statement is not the same classification as originally shown in the financial statement for the year 2008.

The selected consolidated income statement, balance sheet and cash flow for the first six months of 2010 have been derived from our reviewed financial statement prepared in accordance with IFRS. The selected consolidated income statement for the six months ended 30 June 2009 has been derived from the re-presented and reviewed consolidated financial statement prepared in accordance with IFRS, as it was re-presented in the consolidated financial statement for the first six months of 2010.

At year end 2009, the Group changed its accounting procedures regarding leased engines capitalisation. The different accounting procedures altered the balance sheet and cash flow classification. When the first half of 2010 cash flow was published in the financial statement, the first half 2009 cash flow figures were reclassified. The change in accounting procedures regarding the capitalisation of leased engines does not affect the classification of the consolidated income statement. The cash flow figures for the first half of 2009 are derived from the first half 2010 condensed consolidated interim financial information. Therefore, it is hereby noted that the cash flow classification shown for the first half of 2009 in the first half of 2010 financial statement is not the same classification as originally shown in the financial statement for the first half of 2009.

It must be noted that, as part of the financial restructuring plan of Icelandair Group, the Board of Directors proposed a redefinition of the business model of the Group leading to subsidiaries being split between core and non-core operations. Accordingly, SmartLynx Latvia, and the remaining shares in Travel Service are defined as non-core, leading to reclassification of these companies' financial results as discontinued operations.

- Travel Service was not a part of the Group in 2007 and SmartLynx operations were immaterial so 2007 amounts have not been re-presented.

- Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons. Note 6 in the Group's Consolidated Financial Statement for the year 2009 re-presents the income statement of the non-core businesses in more detail.
- Amounts for the first six months of 2009 have been re-presented in the profit and loss statement for comparative reasons, including the operations of Travel Service. Note 6 in the Group's Consolidated Financial Statement for the first six months of 2010 re-presents the income statement of the non-core businesses in more detail.

9.1 Annual Accounts of Icelandair Group 2007–09

9.1.1 Basis of Presentation of Financial Information in What Follows

- Actual results show the results as they were presented in the audited, consolidated financial statements for the years 2007 and 2009. However, the results for 2008 were re-presented in the 2009 annual accounts and are published that way in the following chapters.
- Travel Service was not part of the Group in 2007 and the operations of SmartLynx were immaterial for the Group, so the 2007 accounts have not been re-presented.
- Income Statement 2008: SmartLynx and the remaining shares (30%) in Travel Service are defined as non-core, leading to reclassification on these companies financial results for the year 2009 as discontinued operations. Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons.
- Balance Sheet 2009: The Company's Board of Directors decided in December 2009 as a part of its financial restructuring plan, to consider two of its subsidiaries, Bluebird Cargo and SmartLynx as assets held for sale. All assets and liabilities of these companies are classified as held for sale. Also included is the 30% remaining share in Travel Service.
- Bluebird Cargo is classified as an asset held for sale at year-end 2009 and on 30 June 2010, but its operations are fully included in the 2008 (re-presented), 2009 and 1H 2010 income statements. This is due to the fact that although the Group is divesting Bluebird Cargo, the Group will continue to operate cargo operations from Iceland. The total operating income of Bluebird Cargo for the years 2007, 2008, 2009 and the first six months of 2010 amounted to ISK 2.7 billion, ISK 4.5 billion, ISK 5.1 billion and ISK 2.4 billion, respectively.
- Note 6 in the Group's Consolidated Financial Statement for the year 2009 re-presents the income statement of the non-core businesses in more detail.

The highlights of the annual consolidated accounts of Icelandair Group for 2009 are highlighted below:

- Operating income in 2009 was ISK 80.3 billion as compared to 72.2 billion in 2008 and 63.5 billion in 2007.

- EBITDA was ISK 8.1 billion in 2009, as compared to ISK 3.1 billion in 2008 and ISK 5.5 billion in 2007.
- EBIT was ISK 1.5 billion in 2009, as compared to a negative result of ISK 7.4 billion in 2008 and a positive result of ISK 2.3 billion in 2007.
- Depreciation and amortisation amounted to ISK 6.7 billion in 2009, as compared to ISK 10.4 billion in 2008 and ISK 3.1 billion in 2007.
- Losses after taxes came to ISK 10.7 billion in 2009, as compared to ISK 7.5 billion in 2008 and a profit of ISK 257 million in 2007.
- Cash at the end of the year amounted to ISK 1.9 billion, as compared to ISK 4.1 billion at year-end 2008 and ISK 2.0 billion at year-end 2007.
- Total assets amounted to ISK 89.1 billion at year-end 2009 and the equity ratio was 16.4% at the end of 2009, as compared to total assets of ISK 99.9 billion and an equity ratio 20.1% at the end of 2008. Total assets at year-end 2007 amounted to ISK 66.8 billion and the equity ratio was 37%.

9.1.2 Income Statement

Note 6 in the financial statement 2009 regarding the income statement figures for the year 2008[20]:

For the past year [2009] the Company has been working with its commercial bank, Íslandsbanki, on improving its debt maturity profile and equity ratio. As part of the restructuring plan, the Board of Directors has, in addition to the dilution of Travel Service (note 49), proposed redefinition of the business model of the company, leading to subsidiaries being split between core and non-core. Accordingly, the main focus of the Group will be on scheduled airline operations and tourism evolving around Iceland, and related services. SmartLynx and the remaining shares in Travel Service are defined as non-core, leading to reclassification of these companies' financial results for the year 2009 as discontinued operations. Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons. [Note ends.]

Chapters 10.4 Actual Results for Years Ended 31 December 2007 and 2008 and *10.5 Actual Results for Years Ended 31 December 2008 and 2009* address the matter in more detail.

EBITDA was ISK 8.1 billion in 2009, as compared to ISK 3.1 billion in 2008 and ISK 5.5 billion in 2007. EBIT was ISK 1.5 billion, as compared to a negative result of ISK 7.4 billion in 2008 and a positive result of ISK 2.3 billion in 2007. Losses after taxes over the year amounted to ISK 10.7 billion in 2009, as compared to ISK 7.5 billion in 2008 and compared to a profit of ISK 257 million in 2007. EBITDAR amounted to ISK 16.3 billion in 2009, as compared to ISK 8.8 billion in 2008 and ISK 11.1 billion in 2007.

[20] Note number 6, is derived from the consolidated financial statements of Icelandair Group hf. for the year 2009.

Item 8. Income Statement FY2007–FY2009

(mISK)	2007	2008**	2009
Transport revenue	35,949	41,885	47,139
Aircraft and aircrew lease	15,510	16,951	19,425
Other	12,018	13,363	13,757
Operating Income	**63,477**	**72,199**	**80,321**
Salaries and related expenses	20,008	20,275	18,652
Aircraft fuel	9,769	15,703	13,250
Aircraft and aircrew lease	7,353	8,921	12,797
Aircraft servicing, handling and communication	4,367	5,060	5,881
Aircraft maintenance	5,128	5,499	6,825
Other	11,375	13,688	14,782
Operating Expenses	**58,000**	**69,146**	**72,185**
EBITDA	**5,477**	**3,053**	**8,136**
Impairment and Depreciation	-3,141	-10,404	-6,652
EBIT	**2,336**	**-7,351**	**1,483**
EBT	**128**	**-8,985**	**-4,468**
Net Profit/Loss from continuing operations	**257**	**-8,905**	**-3,983**
Net Profit (Loss) from discontinuing operations	0	1,437	-6,681
Net Profit/Loss for the year / quarter	**257**	**-7,468**	**-10,665**
EBITDAR	**11,056**	**8,821**	**16,332**

**** Re-presented**

9.1.3 Balance Sheet

Note 7 in the financial statement 2009 regarding the balance sheet figures for the year 2009:[21]

The Company's Board of Directors decided in December 2009, as a part of its financial restriction plan, to consider two of its subsidiaries, Bluebird Cargo and SmartLynx, as assets held for sale. Also included is the 30% remaining share in Travel Service. Total assets and liabilities of these companies are classified as held for sale in the financial position. [Note ends.]

The balance sheet figures in the table below for the year 2008 are derived from the financial statement for the year 2009 from the 2008 comparative figures. Therefore, it is hereby noted that the classification shown for the year 2008 in the 2009 financial statement, is not the same classification as originally shown in the financial statement for the year 2008.

Total assets amounted to ISK 89.1 billion at the end of 2009, as compared to ISK 99.9 billion at the end of 2008 and ISK 66.8 billion at year-end 2007. The increase between 2007 and 2008 in total assets is driven by the acquisition of Travel Service and the devaluation of the Icelandic Krona. The decrease between 2008 and 2009 is largely a result of the sale of a 20.1% stake in Travel Service in November 2009. Travel Service is no longer part of the consolidated accounts.

Total non-current assets amounted to ISK 57.2 billion at year-end 2009, as compared to ISK 77.2 billion at year end 2008 and ISK 54 billion at year-end 2007. Thereof, operating assets amounted to ISK 27 billion at the end of 2009, as compared to ISK 36.8 billion at the end of 2008 and ISK 22.8 billion at year-end 2007. Intangible assets amounted to ISK 23.6 billion at the end of 2009, as compared to ISK 29.3 billion at the end of 2008 and ISK 26.9 billion at year-end 2007. Other non-current assets amounted to ISK 6.6 billion at year-end 2009; they amounted to ISK 11.1 billion at year-end 2008 and they amounted to ISK 4.4 billion at year-end 2007.

[21] Note number 7, is derived from the consolidated financial statements of Icelandair Group hf. for the year 2009.

Total current assets amounted to ISK 31.9 billion at year-end 2009, as compared to ISK 22.7 billion at year-end 2008 and ISK 12.7 billion at year-end 2007. Thereof, assets classified as held for sale amounted to ISK 17.5 billion at the end of 2009, as compared to zero at the end of 2008 and 2007. Trade and other receivables amounted to 9.7 billion at the end of 2009, as compared to ISK 13.8 billion at the end of 2008 and ISK 9.0 billion at year-end 2007. Other current assets amounted to ISK 4.7 billion at year-end 2009, as compared to ISK 8.9 billion at year-end 2007 and ISK 3.7 billion at year-end 2007.

Total Equity at year-end 2009 amounted to ISK 14.6 billion while it was ISK 20.1 billion at year-end 2008 and ISK 25.0 billion at year-end 2007. Share capital amounted to ISK 981 million at year-end 2007 and it amounted to ISK 975 million at year-end 2008 and year-end 2009. Reserves amounted to ISK 6.9 billion in 2009, ISK 1.9 billion in 2008 and were negative by ISK 1.3 billion at year-end 2007. Share premium in 2007, 2008 and 2009 amounted to ISK 25.5 billion. Accumulated deficit amounted to ISK 293 million at year-end 2007, ISK 8.2 billion at year-end 2008 and ISK 18.8 billion at year-end 2009.The decrease in equity is explained by negative operating result.

Total liabilities were ISK 74.5 billion at year-end 2009, ISK 79.9 billion at year-end 2008 and ISK 41.7 billion at year-end 2007. Thereof, non-current liabilities amounted to ISK 19.6 billion at year-end 2009, ISK 27.1 billion at year-end 2008 and ISK 14.2 billion at year-end 2007. Other non-current liabilities amounted to ISK 5.9 billion at year-end 2009, ISK 4.2 billion at year-end 2008 and ISK 134 million at year-end 2007. The increase between 2007 and 2008 is explained by the acquisition of Travel Service and the devaluation of the Icelandic krona.

At year-end 2009, total current liabilities amounted to ISK 54.9 billion, while they were ISK 52.7 billion at year-end 2008 and ISK 27.6 billion at year-end 2007. Thereof, loans and borrowing were ISK 22.7 billion at year-end 2009, as compared to ISK 20.7 billion at year-end 2008 and ISK 11.1 billion at year-end 2007. Other current liabilities amounted to ISK 32.2 billion at year-end 2009, ISK 32 billion at year-end 2008 and ISK 16.5 billion at year-end 2007.

For further information, we refer to *Chapter 14 OPERATING ASSETS* and *Chapter 17 INVESTMENTS.*

Item 9. Balance Sheet FY2007–FY2009

(mISK)	31.12.2007	31.12.2008	31.12.2009
Assets:			
Operating assets	22,832	36,798	27,014
Intangible assets	26,846	29,306	23,598
Investments in associates	2,335	1,008	545
Prepaid aircraft acquisitions	249	4,226	1,134
Long-term cost	0	2,029	1,347
Long-term receivables and deposits	1,788	3,834	3,449
Deferred tax asset	0	0	140
Total non-current assets	**54,050**	**77,201**	**57,227**
Inventories	1,301	2,309	1,393
Trade and other receivables	9,037	13,836	9,725
Assets classified as held for sale	0	0	17,500
Prepayments	366	2,536	1,350
Cash and cash equivalents	2,006	4,065	1,909
Total current assets	**12,710**	**22,746**	**31,877**
Total assets	**66,760**	**99,947**	**89,104**
Equity:			
Share capital	981	975	975
Share premium	25,593	25,450	25,450
Reserves	(1,296)	1,856	6,899
Accumulated deficit	(293)	(8,216)	(18,755)
Total equity attributable to equity holders of the Company	24,985	20,065	14,569
Non-controlling interest	48	15	36
Total equity	**25,033**	**20,080**	**14,605**
Liabilities:			
Loans and borrowings	14,040	22,900	13,676
Prepayments	0	2,189	2,254
Long-term payables	0	2,026	3,688
Deferred income tax liability	134	23	0
Total non-current liabilities	**14,174**	**27,138**	**19,618**
Loans and borrowings	11,058	20,735	22,714
Trade and other payables	12,591	24,119	14,392
Liabilities classified as held for sale	0	0	10,597
Deferred income	3,904	7,875	7,178
Total current liabilities	**27,553**	**52,729**	**54,881**
Total liabilities	**41,727**	**79,867**	**74,499**
Total equity and liabilities	**66,760**	**99,947**	**89,104**

9.1.4 Statement of Cash Flows

The cash flow figures in the table below for the year 2008 are derived from the financial statement for the year 2009 from the 2008 comparative figures. Therefore, it is hereby noted that the classification shown for the year 2008 in the 2009 financial statement, is not the same classification as originally shown in the financial statement for the year 2008.

Working capital from operations amounted to ISK 5.4 billion in 2009, as compared to ISK 5.8 billion in 2008 and ISK 1.5 billion in 2007. The increase in working capital from operations from 2007 to 2008 amounted to ISK 4.3 billion and is attributable to an improvement in net cash flow from operations between periods.

Net cash provided by operating activities in 2009 was ISK 8.8 billion, as compared to ISK 4.5 billion in 2008 and ISK 3.9 billion in 2007. The significant improvement in net cash from operating activities from 2008 to 2009 is explained by an increase in sales.

Net cash used in investing activities over the year 2009 amounted to ISK 7.8 billion, as compared to ISK 7.5 billion in 2008 and ISK 5.5 billion in 2007. The net cash used in investing activities is mainly explained by investments in operating assets and the acquisition of long-term costs relating to overhauls of leased engines. Further information about capital expenditure is available in *Chapter 17INVESTMENTS.*

Net cash used in financing activities amounted to ISK 3.3 billion in 2009. Net cash from financing activities amounted to ISK 3.2 billion in 2008 and to ISK 853 million in 2007. The reason for the large difference between 2007 and 2008 on one hand and 2009 on the other hand, is that the Group was largely financed in short-term debt in 2007 and 2008 that was subsequently repaid in 2009.

Cash at year-end amounted to ISK 1.9 billion in 2009, as compared to ISK 4.1 billion in 2008 and ISK 2.0 billion in 2007.

Item 10. Statement of Cash Flows FY2007–FY2009

(mISK)	**2007**	**2008**	**2009**
Working capital from (used in) operations	1,495	5,795	5,373
Net cash from operating activities	3,889	4,531	8,781
Net cash used in investing activities	-5,461	-7,452	-7,799
Net cash (used in) from financing activities	853	3,171	-3,283
Increase (Decrease) in cash and cash equivalents	**-719**	**250**	**-2,301**
Effect of exchange rate fluctuations on cash held	-51	1,809	145
Cash and cash equivalents at 1 January	2,776	2,006	4,065
Cash and cash equivalents at year-end	**2,006**	**4,065**	**1,909**

The effects of exchange rate fluctuations on cash held were a large contributory factor in 2008 when they contributed ISK 1.8 billion to cash and cash equivalents at year-end. This is almost solely due to the sharp depreciation of the Icelandic krona in 2008.

Cash and cash equivalents at year end 2009 comprised ISK 1,877 million of bank deposits and ISK 32 million as cash on hand. Cash and cash equivalents at year end 2008 comprised ISK 3,743 million of bank deposits, ISK 90 million of marketable securities and ISK 232 million as cash on hand.

9.2 Half Year Interim Financial Accounts of Icelandair Group 2009 and 2010

9.2.1 Basis of Presentation of Financial Information

- Income Statement 1H 2009: SmartLynx and the remaining shares (30%) in Travel Service are defined as non-core, leading to reclassification on these companies financial results for first half of the year 2009 as discontinued operations. Amounts for the first half of the year 2009 have been re-presented in the profit and loss statement for comparative reasons.
- Bluebird Cargo is classified as an asset held for sale at year-end 2009 and on 30 June 2010 but its operations are fully included in the 2008 (re-presented), 2009 and 1H 2010 income statements. This is

due to the fact that although the Group is divesting Bluebird Cargo, the Group will continue to operate cargo operations from Iceland.

- Note 6 in the Group‘s Consolidated Financial Statement for the first six months of 2010 represents the income statement of the non-core businesses in more detail.

The highlights of the first half (1H) 2010 interim financial accounts are highlighted below:

- Operating income was ISK 38.2 billion in the first half of 2010, an increase of 14%, as compared to the first six months of 2009.
- EBITDA was ISK 2.3 billion (6.1%) in 1H 2010, as compared to ISK 1.5 billion (4.4%) in the 1H 2009.
- Depreciation and amortisation was ISK 2.6 billion in 1H 2010 and was ISK 220 million higher than in the first six months of 2009.
- Losses after taxes came to ISK 2.0 billion in the first six months of 2010, as compared to ISK 5.0 billion over the corresponding period in 2009.
- Cash on 30 June 2010 amounted to ISK 7.5 billion, as compared to ISK 1.9 billion at 31 December 2009.
- Total assets amounted to ISK 97.8 billion at the end of the period 2010 and the equity ratio was 13.5%, as compared to 16.4% at 31 December 2009.

9.2.2 Half Year Income Statements 2009 and 2010

As shown in the table below, EBITDA was ISK 2.3 billion in 1H 2010, as compared to ISK 1.5 billion over the same period last year. EBIT was negative by ISK 320 million in the first six months of 2010, as compared to a negative result of ISK 962 million over the same period last year. Losses after taxes in the first half of 2010 amounted to ISK 2.0 billion, as compared to ISK 5.0 billion over the corresponding period in 2009. Loss from continuing operations amounted to ISK 1.6 billion in 1H 2010. EBITDAR amounted to ISK 6.6 billion in the first half of 2010, as compared to ISK 5.8 billion in the first half of 2009.

Item 11. Income Statement 1H 2009 and 1H 2010

(mISK)	1H 2009**	1H 2010
Transport revenue	18,763	22,016
Aircraft and aircrew lease	9,064	9,719
Other operating revenue	5,756	6,433
Operating Income	**33,583**	**38,168**
Salaries and related expenses	8,994	9,841
Aircraft fuel	5,549	6,644
Aircraft and aircrew lease	5,649	5,941
Aircraft handling, landing and communication	2,545	2,783
Aircraft maintenance	2,855	3,400
Other operating expenses	6,526	7,232
Operating Expenses	**32,118**	**35,841**
EBITDA	**1,465**	**2,327**
Depreciation and amortisation	-2,427	-2,647
EBIT	**-962**	**-320**
EBT	**-2,630**	**-2,043**
Net Profit/Loss from continuing operations	**-2,232**	**-1,646**
Net Profit (Loss) from discontinuing operations	-2,747	-400
Net Profit/Loss for the year / quarter	**-4,979**	**-2,046**
EBITDAR	**5,779**	**6,629**

**** Re-presented**

Operating income amounted to ISK 38.2 billion, as compared to ISK 33.6 billion in the corresponding first half of last year. Transport revenues amounted to ISK 22.0 billion, as compared to ISK 18.8 billion in the 1H of 2009. Aircraft and aircrew lease revenues amounted to ISK 9.7 billion, as compared to ISK 9.1 billion in the first half of 2009. Other income amounted to ISK 6.4 billion in the first half of 2010, as compared to ISK 5.8 billion in the first half of 2009.

Operating expenses amounted to ISK 35.8 billion, as compared to ISK 32.1 billion in the first half of 2009. Salaries and personnel expenses amounted to ISK 9.8 billion in the first half 2010, as compared to ISK 9.0 billion in the first half of 2009. Aircraft fuel costs amounted to ISK 6.6 billion, as compared to ISK 5.5 billion in the first half of 2009. Aircraft and aircrew lease amounted to ISK 5.9 billion, as compared to ISK 5.6 billion in the first half of 2009. Aircraft handling, landing and communication expenses amounted to ISK 2.8 billion, as compared to ISK 2.5 billion in the first half of 2009. Aircraft maintenance costs amounted to ISK 3.4 billion, as compared to ISK 2.9 billion in the first half of 2009. Other operating expenses amounted to ISK 7.2 billion, as compared to ISK 6.5 billion in the first half of 2009.

For further information on the half year income statements for the years 2009 and 2010, refer to *Chapter 10.6 Results for 1H Ended 30 June 2009 and 2010*.

9.2.3 **Balance Sheet 30 June 2010**

Item 12. Balance Sheets 31 December 2009 and 30 June 2010

(mISK)	31.12.2009	30.6.2010
Assets:		
Operating assets	27,014	30,391
Intangible assets	23,598	23,781
Investments in associates	545	635
Prepaid aircraft acquisitions	1,134	1,179
Long-term cost	1,347	1,318
Long-term receivables and deposits	3,449	3,365
Deferred tax asset	140	439
Total non-current assets	**57,227**	**61,108**
Inventories	1,393	1,619
Trade and other receivables	9,725	13,332
Assets classified as held for sale	17,500	12,824
Prepayments	1,350	1,463
Cash and cash equivalents	1,909	7,471
Total current assets	**31,877**	**36,709**
Total assets	**89,104**	**97,817**
Equity:		
Share capital	975	975
Share premium	25,450	25,450
Reserves	6,899	7,368
Accumulated deficit	(18,755)	(20,695)
Total equity attributable to equity holders of the Company	14,569	13,098
Non-controlling interest	36	30
Total equity	**14,605**	**13,128**
Liabilities:		
Loans and borrowings	13,676	12,541
Prepayments	2,254	2,303
Long-term payables	3,688	4,132
Deferred income tax liability	0	0
Total non-current liabilities	**19,618**	**18,976**
Loans and borrowings	22,714	26,252
Trade and other payables	14,392	16,682
Liabilities classified as held for sale	10,597	6,708
Deferred income	7,178	16,071
Total current liabilities	**54,881**	**65,713**
Total liabilities	**74,499**	**84,689**
Total equity and liabilities	**89,104**	**97,817**

Assets amounted to ISK 97.8 billion at the end of the first half of 2010, as compared to ISK 89.1 billion at year-end 2009.

Total non-current assets amounted to ISK 61.1 billion at 30 June 2010, as compared to ISK 57.2 billion at year end 2009. At the end of June 2010 operating assets amounted to ISK 30.4 billion, as compared to ISK 27.0 billion at year-end 2009. Intangible assets amounted to ISK 23.8 billion at the end of June 2010, as compared to ISK 23.6 billion at year-end 2009. Other non-current assets totalled ISK 6.9 billion at the end of the period in 2010, as compared to ISK 6.6 billion at the end of the year 2009.

At 30 June 2010, total current assets amounted to ISK 36.7 billion, as compared to ISK 31.9 billion at the end of the year 2009. Thereof, trade and other receivables amounted to ISK 13.3 billion, as compared to ISK 9.7 billion at year-end 2009. Other current assets amounted to ISK 23.4 billion at 30 June 2010, as compared to ISK 22.1 billion at year-end 2009.

At 30 June 2010, total equity amounted to ISK 13.1 billion, as compared to ISK 14.6 billion at year-end 2009. Share premium in both quarters amounted to ISK 25.5 billion. Total accumulated deficit amounted to ISK 20.7 billion at the end of June 2010, as compared to ISK 18.8 billion at year-end 2009.

Total liabilities amounted to ISK 84.7 billion at 30 June 2010, as compared to ISK 74.5 billion at year-end 2009.

Non-current liabilities amounted to ISK 19.0 billion at end of June 2010, as compared to ISK 19.6 billion at end of 2009. Thereof, loans and borrowing amounted to ISK 12.5 billion at 30 June 2010, as compared to ISK 13.7 at year-end 2009. Other non-current liabilities amounted to ISK 6.4 billion at 30 June 2010, as compared to ISK 5.9 billion at year-end 2009.

Total current liabilities amounted to ISK 65.7 billion at the end of June 2010, as compared to ISK 54.9 billion at year-end 2009. Thereof, loans and borrowings amounted to ISK 26.3 billion at the end of June 2010, as compared to ISK 22.7 billion at year-end 2009. Other current liabilities totalled ISK 39.5 billion at 30 June 2010, as compared to ISK 32.2 billion at year-end 2009.

For further information, refer to *Chapters 14 OPERATING ASSETS* and *17 INVESTMENTS*.

9.2.4 **First Half Statements of Cash Flows 2009 and 2010**

At year end 2009, the Group changed its accounting procedures regarding leased engines capitalisation. The different accounting procedures altered the cash flow classification. When the cash flow for the first half of 2010 was published in the financial statement, the cash flow figures for the first half 2009 were re-classified. The cash flow figures for the first half of 2009 are derived from the first half 2010 condensed consolidated interim financial information. Therefore, it is hereby noted that the cash flow classification shown for the first half of 2009 in the first half of 2010 financial statement, is not the same classification as originally shown in the financial statement for the first half of 2009.

Working capital from operations amounted to ISK 1.7 billion in the first half of 2010, as compared to ISK 749 million in working capital used in operations in the first half of 2009. The turnaround between years amounts to ISK 2.5 billion and is solely explained by an improvement in net cash flow from operations between periods.

Net cash from operating activities amounted to ISK 9.4 billion in the first half of 2010, as compared to ISK 5.0 billion in the first half of 2009. The increase between periods amounts to ISK 4.4 billion and is largely explained by an increase in sales and improvements in net cash flow from operations.

Net cash used in investing activities amounted to ISK 2.3 billion in the first half of 2010, as compared to ISK 1.8 billion in the first half of 2009. The increase between periods is explained by an increase in investments in operating assets and acquisitions of long-term cost relating to engine overhauls of leased engines.

Net cash used in financing activities amounted to ISK 1.5 billion in the first half of 2010, as compared to ISK 1.4 billion in the first half of 2009. Financing activities largely reflect the repayment of long-term and short-term debt.

Item 13. Statement of Cash Flows, 1H 2009 and 1H 2010

(mISK)	1H 2009	1H 2010
Working capital from (used in) operations	-749	1,708
Net cash from operating activities	5,010	9,386
Net cash used in investing activities	-1,780	-2,304
Net cash used in financing activities	-1,397	-1,543
Increase in cash and cash equivalents	**1,833**	**5,539**
Effect of exchange rate fluctuations on cash held	287	23
Cash and cash equivalents at 1 January	4,065	1,909
Cash and cash equivalents at 30 June	**6,185**	**7,471**

The increase in cash and cash equivalents was ISK 5.5 billion in the first half of 2010, as compared to ISK 1.8 billion in the corresponding first half of 2009. Cash at the end of the first six months of 2010 amounted to ISK 7.5 billion, as compared to ISK 6.2 billion for the first six months of 2009.

10 OPERATING AND FINANCIAL REVIEW

10.1 Overview

10.1.1 General Information About the Group

The Group is an operating company with subsidiaries focused on the international airline and tourism sectors. The operations of the Company are based on two business segments: route network and tourism services. The main focus of the route network is to operate flights based on the *Hub and Spoke* concept between Europe and across the Atlantic to North America via Iceland. The focus of the tourism services business segment is on catering to the growing demand for universal services for tourists in Iceland and on offering a wide variety of support services relating to airline operations. During 2009, the Group employed an average of 2,150 full time employees, and the Group generated total revenues of ISK 80.3 billion and carried approximately 1.7 million passengers on its routes.

The Group aspires to have a brand synonymous with efficient and reliable operations, sound and trustworthy management, and dependable and flexible services for the benefit of its customers. The airline, Icelandair ehf., is the largest and most important subsidiary of the Group and even though its market share in the North Atlantic market is less than 1%, it is a key factor in the Group's operation. Due to the immense size of this market and the nominal market share held by Icelandair ehf., it serves in effect as a large reservoir of passengers.

In addition to passenger flights operated by the airline, the Group has vast interests in most parts of Icelandic tourism and aviation, including hotel chains, travel agencies, domestic airlines, support services, ground handling and technical services, as well as a fledgling ACMI[22] and lease operations.

10.1.2 Operational Highlights 2007–10

Chapters 10.1.2.1 to *10.1.2.4* provide an overview of noteworthy issues and events in the operations of Icelandair Group during the period under review.

10.1.2.1 Year Ended 31 December 2007

May

- Icelandair Group signs a letter of intent for the acquisition of Travel Service, the largest privately owned airline in the Czech Republic. Travel Service operates charter flights to and from Prague and Budapest and also owns and operates the low cost brand Smart Wings.
- Hilton Hotels Corporation announces that it will enter into a Franchise Agreement with Icelandair Hotels, a fully owned subsidiary of Icelandair Group, for the 252 room 4-star Nordica Hotel in Reykjavik (now the Hilton Reykjavik Nordica).

June

- Icelandair Group celebrates the 70th anniversary of Flugfélag Akureyrar, the predecessor of Icelandair ehf. established on 3 June 1937.

[22] Acronym for: Aircraft, Crew, Maintenance and Insurance.

September

- Icelandair ehf. awards a USD 100 million maintenance contract to Rolls-Royce, covering the RB211-535s which power the airline's fleet of 21 Boeing 757s.

December

- Icelandair ehf. announces plans to shift its focus in North Atlantic flights in 2008. Toronto was introduced as a new destination, while Baltimore operations were shut down. More capacity was added to London and up to 5 daily flights to Copenhagen were operated, along with morning departures to North America.

10.1.2.2 Year Ended 31 December 2008

January

- Björgólfur Jóhannsson, a former CEO of the seafood company Icelandic Group hf., takes over as CEO of Icelandair ehf. and Icelandair Group.

March

- At the Annual General Meeting of Icelandair Group in March, the Board of Directors of the Company is re-elected.

April

- Icelandair Group's subsidiaries Icelandair Cargo and Icelease decide not to go ahead with the lease and purchase of four Airbus A330-200 cargo aircraft. This decision is made because of a more volatile business environment. In April, the Group increases its shareholding in Travel Service from 50% to 80% and the Czech company substantially increases the Group's turnover.

May

- Sigthór Einarsson is appointed deputy CEO of Icelandair Group and extensive changes are made within Icelandair ehf. Birkir Hólm Gudnason is appointed CEO of this largest company within the Group; Mr Gudnason has been with Icelandair ehf. since 2000.

June

- The Group and its affiliated companies launch extensive streamlining measures in light of rising fuel prices and general economic uncertainty. The 2008–09 winter flight schedule is cut by almost 20%, and the staff of Icelandair ehf. is reduced by 230. The company's organisational chart is altered and management is trimmed. Other companies within the Group also go through wide-ranging cost cutting measures and staff reductions during the year, especially IGS and Icelandair Cargo. In September, Bogi Nils Bogason is appointed Chief Financial Officer of Icelandair Group.

November

- Four new Loftleidir-Icelandic aircraft leasing contracts are announced, amounting to a total of USD 125 million. The largest is a contract with Yakutia Air Company in the Republic of Sakha in Siberia, Russia, a long-standing customer of the Group.

December

- Icelandair Group enters into an agreement with its co-shareholders in Travel Service, reducing Icelandair Group's share from 80% to 66%.

10.1.2.3 Year Ended 31 December 2009

January

- Ómar Benediktsson is appointed Managing Director of the charter airline SmartLynx in Latvia. Mr Benediktsson was Vice-chairman of the Board of Directors of Icelandair Group for the last two years, but leaves the board at the Annual General Meeting in March 2009.

March

- The AGM of Icelandair Group is held in March. Icelandair ehf. introduces four direct scheduled flights a week to Seattle in the USA, starting in the summer of 2009. This destination fits with Icelandair ehf.'s route network, which is based on Iceland's geographical location between North America and Europe.

May

- Íslandsbanki acquires 42% of the shares in Icelandair Group through the enforcement of a pledge in shares held by shareholders in the Company. Íslandsbanki is granted an exemption from a mandatory takeover bid. It is announced that the Company will continue to be listed on NASDAQ OMX Iceland hf. and that the bank's stake will be sold in an open and transparent sales procedure as soon as possible.

June

- A share capital increase in Travel Service is carried out. Icelandair Group's co-owners Unimex Group and Roman Vik subscribe to the new shares in the company. Following the share capital increase, the shareholding of Icelandair Group in Travel Service is reduced to 50.1% from the previous 66%.

July

- The Board of Directors announces that a shareholders' meeting will be held on 6 August. The Board of Directors asks for shareholders' approval of authorisation to increase the share capital of the Company by up to ISK 4,000,000,000 – four billion Icelandic kronur – by means of subscriptions to new shares. The Board of Directors also announces that elections to the Board will be held at the shareholders' meeting.

August

- The shareholders' meeting announces in July that it had approved the proposals submitted at the meeting and the following candidates are elected to the Board of Directors of Icelandair Group:

Board members:

- Finnur Reyr Stefánsson
- Jón Ármann Gudjónsson
- Katrín Olga Jóhannesdóttir
- Pétur J Eiríksson
- Sigurdur Helgason

Alternate board members:

- Kristín Einarsdóttir
- Magnús Magnússon
- Tómas Kristjánsson

Following the meeting, the Board of Directors meet and elect Sigurdur Helgason as chairman and Finnur Reyr Stefánsson as vice-chairman.

September

- Icelandair ehf. announces the expansion of its schedule and plans to increase tourism in 2010. The subsidiary announces plans to increase capacity by up to 10% between years, increasing the number of foreign tourists by 20–25,000 and creating over 400 jobs in aviation and tourism throughout the country. Brussels in Belgium and Trondheim in Norway are announced as new destinations in the summer of 2010.

November

- Icelandair Group signs an agreement for the sale of 20.1% of its share in the Czech airline Travel Service. Following the divestment, Icelandair Group holds a 30% share in Travel Service. The sale results in Travel Service becoming an affiliated company instead of being a subsidiary. The effects of the sale on the income statement are negative by ISK 0.9 billion and equity decreases by ISK 1.5 billion. The Group's total assets are reduced by ISK 12 billion. Detailed information on the effects of the divestment of the 20.1% share in Travel Service on the profit and loss statement can be found in note 6 in the consolidated accounts of Icelandair Group for the year 2009.

10.1.2.4 Events of 2010

March

- At the end of March 2010, Icelandair Group and its largest lenders, Íslandsbanki and The Resolution Committee of Glitnir Bank, announce that they have reached an agreement to finalise the financial restructuring of Icelandair Group. Approval from a shareholders' meeting of the Group is needed for certain aspects of the restructuring, in addition to the final approval of creditors. For further information on the financial restructuring of Icelandair Group, see *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

April

- On 14 April 2010, a volcanic eruption starts in the glacier Eyjafjallajökull in Iceland. Volcanic ash from the eruption has a severe impact on flight schedules around the world. The financial impact of the flight restrictions are discussed in more detail in the note on August 2010 which follows.

June

- On 14 June, the Enterprise Investment Fund (EIF – Icelandic: Framtakssjódur Islands), an investment company owned by 16 Icelandic pension funds, enters into a binding agreement with Icelandair Group concerning an ISK 3 billion investment in the Group. The agreement is concluded with normal reservations regarding the results of due diligence, which the Fund performs. The EIF has subscribed to New Shares in the nominal amount of ISK 1.2 billion at the price of ISK 2.5, making a total of ISK 3 billion.

- On 15 June, The Pension Fund of Commerce (PCF – Icelandic: Lífeyrissjódur Verslunarmanna) enters into a binding agreement with Icelandair Group on investing ISK 1 billion in the Group in return for a 10.1% share in the Company. The PCF subscribes to New Shares in the nominal amount of ISK 400 million at a price of 2.5, making a total of ISK 1 billion.

August

- Icelandair Group publishes its accounts for the first six months of 2010 on 13 August 2010. A financial statement released by the CEO of Icelandair Group reveals that the volcanic activity in Eyjafjallajökull has had a severe impact on operations, as the Company reported earlier. In the Group's assessment, the negative impact of the flight restrictions amounts to about ISK 1.5 billion. However, EBITDA from continuing operations in the first half of the year exceeds the budget in spite of the impact of the volcanic eruption. As a result, the decision is made to increase the EBITDA forecast for the year from ISK 7.6 billion to ISK 8.5 billion in 2010, which corresponds to a 12% increase from the previously published forecast. For further information, see *Chapter 18 PROFIT FORECAST*.

September

- On 15 September, an extraordinary shareholders meeting is convened. The agenda of the meeting is to vote a new Board of Directors and to consider a proposal for a vote of no confidence in the Company's auditing firm and a proposal to elect a new auditing firm. The proposals are withdrawn and subsequently the only item on the agenda is the election of a new Board of Directors. The following Board Members were elected:

  Board members:

  - Audur Finnbogadottir.
  - Finnbogi Jónsson.
  - Katrín Olga Jóhannesdóttir.
  - Sigurdur Helgason.

- Úlfar Steindórsson.

Alternate board members:

- Herdís Dröfn Fjelsted.
- Magnús Magnússon.
- Vilborg Lofts.

October

- On 21October 2010 the Company makes public an announcement which states that the financial restructuring and the documentation process is completed and contracts have been signed. The Company also states that the operations of the Company have been strong this year and it has outperformed its original financial forecast. To reflect that, the Company has revised its EBITDA forecast for the year from ISK 8.5 billion to ISK 9.5 billion for the full year.

10.2 Developments in the Global and Local Airline Markets and the Economy

Since the onset of the global financial turmoil in 2008, market sentiment has fallen sharply, causing a drop in asset values and a slump in economic activity. The ensuing credit crunch has left the average consumer financially worse off than before. These developments have put a substantial demand squeeze on worldwide air carrier services and have therefore forced many companies in the industry to undertake various operational streamlining measures. Most airlines around the world have been feeling the effects of this demand squeeze for several quarters. The industry is generally seeing a drastic reduction in the scope of its operations with capacity cuts and cost cutbacks. In a recent forecast, IATA[23] estimated that global airlines lost USD 9.4 billion in 2009 and that they are going to lose approximately USD 2.8 billion in 2010.[24]

The Icelandic economy has been particularly badly hit by the current economic crisis with unemployment going from 2.3% in Q1 of 2008 to 9.1% in Q2 of 2009 and then down to 7.6% in Q1 of 2010. The inflation rate has gone from 5.8% at the start of 2008 to 18.6% at the start of 2009 to 6.6% at the start of 2010.[25] This high level of inflation, along with the devaluation of the ISK, has weakened the purchasing power of the general Icelandic consumer.

The Group has felt the effects of similar global developments in demand for cargo services, scheduled air travel and aircraft leases. Air freight volumes have been particularly badly hit with regard to imports into Iceland, as the ISK is near its historically lowest level and the real exchange rate is far below its long-term equilibrium. However, exports have been buoyant and their contribution to the economy has, therefore, cushioned the economic impact, with fish exports remaining particularly strong.

Scheduled flight services from Iceland have been relatively weak. There has also been a large shift in customer behaviour, which is shifting from flying business class to flying in economy class. This changed operating environment has been met with a considerable reduction in capacity and a downsizing of the workforce. Icelandair ehf. has also changed its pricing structure to include the “Economy-Comfort” class as of November 2008 to better meet the altered demand pattern. This has managed to reduce the yield drop caused by the change in customer behaviour. Available seat kilometres of the Group’s scheduled airline operations were reduced by approximately 9% in 2009 as compared to 2008, and passenger numbers decreased by 10% over the same period. However, in 2010 demand has increased again, as is best indicated by the increase in supply by Icelandair ehf. and its new routes to Stavanger (Norway), Bergen (Norway) and Seattle (North America) in 2009

[23] Acronym for: International Air Transport Association. www.iata.org
[24] IATA Financial Forecast, March 2010: http://www.iata.org/pressroom/pr/Pages/2010-03-11-01.aspx
[25] Statistics Iceland, http://www.statice.is/Pages/1390.

and to Brussels (Belgium) and Trondheim (Norway) in the summer of 2010. Finally Icelandair ehf. announced in October 2010 it´s new routes to Washington DC (USA), Billund (Denmark), Gothenburg (Sweden), Hamburg (Germany) and Alicante (Spain) in 2011.

The wet leasing arm of the Group has played a vital part in keeping the Group's fleet utilised. In today's challenging market, SmartLynx suffered defaults on existing contracts from their biggest customer. This posed a threat not only to SmartLynx but to the Group as a whole, as the Group had entered into guarantees on behalf of SmartLynx. Guaranteed lease amounts were lowered to USD 19.7 million at the end of June 2010. See *Chapter 12.4.2.7 Future Strategy (third paragraph)* for further information on the parent guarantee.

However the Group's structure and diversity proved its value as this excess capacity was quickly picked up by one of the Groups subsidiaries, Loftleidir-Icelandic, and this poised threat was turned into an opportunity and aircraft were placed in new projects. Furthermore, when it became apparent that Icelandair ehf. would need to cut its capacity in 2008 and 2009 due to less demand on the market because of the economic downturn, Loftleidir-Icelandic also managed to place two of the company's Boeing 757s in new projects and thereby fully reflect the Groups commitments to the aircraft.

A notice made public by the Group on 19 April 2010 revealed that restrictions on air traffic resulting from the volcanic activity in Eyjafjallajökull had a significant impact on the operation of the Group.[26] The Company expressed its view that the daily cost resulting from the restrictions amounted to approximately ISK 100 million, but the Company has not revised its budget projections for 2010. Among other things, the Company takes into account the fact that revenues in the first quarter increased by over 16% from the preceding year, and in addition the Company moved its hub to Glasgow and thereby succeeded in minimizing the loss of income resulting from the air traffic restrictions.

10.2.1 **Core Icelandair Group**

The Group undertook major cost-cutting measures in the first half of 2008. The Group made more than 500 staff redundant and these cuts were followed by capacity cuts and renegotiations with suppliers. Furthermore, the top management of many subsidiaries has been changed over the course of the last two years. Around the same time, orders for four Airbus 330 cargo aircraft were cancelled, which lowered the Group's commitments by USD 450 million. The cost-cutting measures taken in 2008 are one of the main reasons for the Group's ability to shoulder the downturn in 2008 and early 2009.

However, the balance sheet of the Group was set in a period when the owners and the Board of Directors focused on acquisitions and expansion abroad. The balance sheet was not self-sustaining, in particular due to the high level of indebtedness, and it was a major problem for the Group even before the collapse of the Icelandic banking system. Although the daily operations of the Group largely went according to plan in 2009, financial expenses were a drain on the cash flow of the Group. It had been evident for some time that the balance sheet needed to be restructured.

The collapse of the banking system in Iceland late in 2008 along with the worldwide recession has also affected the Group's operational landscape, especially as domestic demand dropped significantly. Strain on cash flow followed due to termination of the Group's banking services coupled with severe outflows of cash to meet an ever-growing demand for cash collateral by international financial institutions to replace bank guarantees. As a consequence, it become more challenging for the Group to meet its refinancing needs since its liquidity largely dried up after the collapse of the Icelandic banking system in 2008.

To meet these changes, the Board of Directors of the Group announced its plans to adapt to this new environment. A step in this process was the financial restructuring. Debt was restructured through a mix of debt-to-equity conversions and extension of maturities. Furthermore, certain assets were divested and Íslandsbanki and the Resolution Committee of Glitnir Bank acquired the assets by taking over debt from the Group.

[26] Further information: https://newsclient.omxgroup.com/cdsPublic/viewDisclosure.action?disclosureId=397020 &messageId=477620

The future focus of the restructured Group is on the operations of Icelandair ehf., Icelandic Tourism along with the *Hub and Spoke* concept that is a pivotal part of Icelandair ehf.'s business model.[27]

The Company is adapting to this new environment.

- The Group has simplified its business model to reflect a new strategy.
- In the restructuring process, Icelandair Group was advised by DVB bank.
- From now on, Icelandair Group defines itself as an operating company focusing on route network and tourist services, and should not be looked upon as a holding company.
- By placing Travel Service, Bluebird Cargo and SmartLynx under the ownership of Icelandic creditors, the size of the Group's balance sheet will be reduced.
- The new business structure is based on two business segments. As before, the support functions will work across both business segments and provide support for the subsidiaries and associate companies.

Item 14. Subsidiaries of the core Icelandair Group going forward

Vindabudir ehf. ID No. 680807-2560, a company fully owned by the Resolution Committee of Glitnir Bank, will directly acquire 100% of the share capital of SmartLynx for ISK 1 (one) as SmartLynx has no value. Icelandair Group will continue to guarantee SmartLynx operational leasing obligations.

The Resolution Committee of Glitnir Bank and Íslandsbanki incorporated an SPV, a special purpose vehicle, (hereinafter "SPW ehf.") which will acquire Travel Service and Bluebird Cargo from Icelandair Group. A binding agreement on the divestment and the incorporation of SPW ehf. was signed on 12 August 2010. However, the documentation process was not concluded and contracts signed until on 21 October 2010. The contract has reservations and SPW ehf. will not take control of the divested companies until these reservations have been fulfilled. For an overview of the reservations refer to *Chapter 27.2 Overview of the Financial Restructuring*.

Icelandair Group will continue to own and manage IG Invest, but it will be controlled by SPW ehf. However, Icelandair Group has made an agreement with SPW ehf., which will receive economic benefits from IG Invest. The total proceeds to Icelandair Group from the sale of Bluebird Cargo, Travel Service, and the economic benefits of IG Invest to SPW ehf. amount to ISK 7.6 billion. The ISK 7.6 billion in proceeds contributes to reducing the debt of Icelandair Group by ISK 7.6 billion. There is no cash contribution involved in the asset divestment.

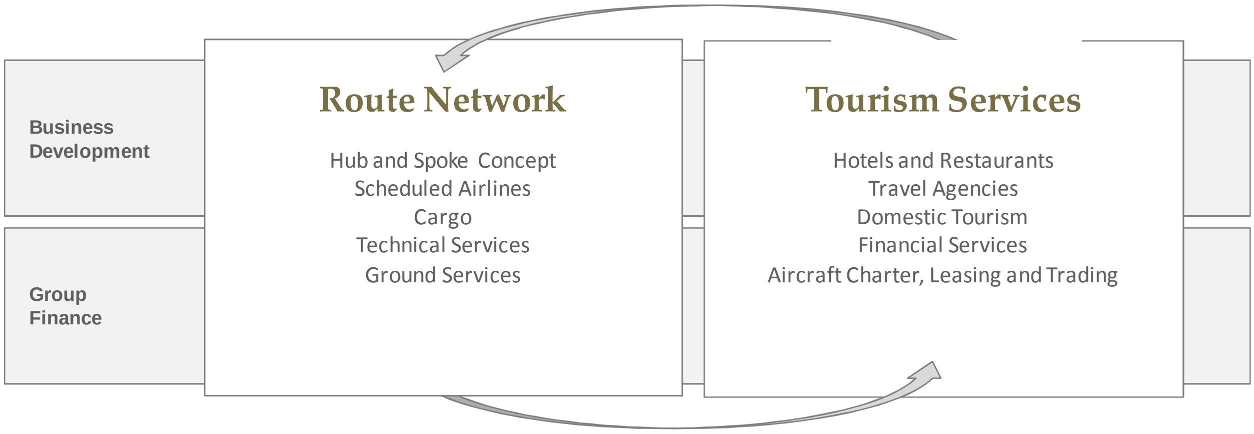
If SPW ehf. receives more than ISK 7.6 billion, in addition to interest amounting to REIBOR + 3%, from its assets when it sells them before September 2015 (Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group will receive 50% of any potential yield that is higher than ISK 7.6 billion. On the other hand, if SPW ehf. receives a lower amount than ISK 4.0 billion before September 2015 from the sale (of Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group must pay SPW ehf. ISK 0.5 billion. The contracts state that if SPW ehf. has not sold its assets before September 2015, the banks can extend the period until September 2017.

[27] See *Chapter 10.1.1.General Information About the Group*.

Item 15. Businesses divested in the financial restructuring

The Group's management emphasises the importance of collaboration between its subsidiaries as highlighted in the segmentation of the Group into the Route Network and Tourist Services. The business segmentation stresses the importance for subsidiaries to focus on a Group-wide approach in their daily operations.

Item 16. The business concept of the Group



The Group's mission is to operate an integrated network of companies within air travel and related services, providing quality services built on over 70 years' experience and knowledge from its subsidiaries. Furthermore, its mission is to create value for customers and other stakeholders by focusing on efficiency and flexibility, as well as synergies between its companies. Further information on the financial restructuring and the Core Icelandair Group can be found in *Chapter27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

Icelandair Group was adversely affected by the volcanic eruption in Eyjafjallajökull in April and May of 2010. The eruption and the volcanic ash affected most companies within the Group, in particular the operations of Icelandair, Icelandair Cargo and Bluebird Cargo. In addition, there was some disruption to the operations of Iceland Travel. Icelandair Group estimates that the Group's total cost relating to the volcanic activity amounted to ISK 1.5 billion. Despite cost relating to the flight disruptions, EBITDA ratio for the first six months was 6.1%, as compared to 4.4% in the first half of 2009.

The present situation offers various opportunities for all of the companies within Icelandair Group, and the history and tradition of its subsidiaries shows that versatility and flexibility are key components of the Group. The weak ISK is proving an incentive for tourists to visit Iceland.

10.2.2 Seasonality and Capacity Utilisation

The airline industry tends to experience seasonal variations in demand, where utilisation is high during the summer months (Q2 and Q3) and low over the winter months (Q1 and Q4). The operational volatility caused by these seasonal fluctuations is prone to further distortion by events such as 9/11, SARS, the swine flu outbreak and volcanic eruptions. See *Chapter 1.2 Risks Related to the Airline and Tourism Industry*.

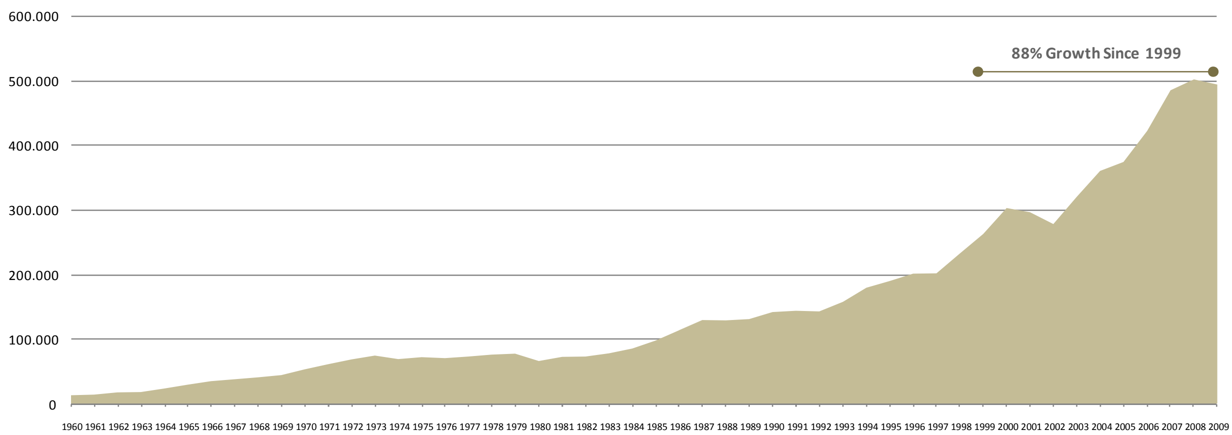
The Group has steadily increased its focus on its core operations and highlighted the importance of cross-selling between both business segments. This includes utilising unused belly space in scheduled flights for cargo transportation and short- and long-term leasing of aircraft in low seasons, to name but a few of the contributing factors encompassed by the Group's wide approach.

An important factor of the business model is the ability to readily adjust capacity to ever-changing demand patterns. This is achieved by increasing or decreasing the number of available seat kilometres at any given time by transferring aircraft from the route network to leasing operations at short notice.

The goal of revenue seasonality controls is to reduce fluctuations in the Group's revenue streams by expanding the high-season into the shoulder seasons, and to meet lower demand over the winter by leasing excess capacity to gain short-term cost coverage. However, the fluctuations highlight the importance of liquidity within the Group to meet seasonality.

The number of tourists visiting Iceland has grown rapidly in recent years, and over the past decade the number of visitors to Iceland has grown by more than 88%. The Group remains one of the most important factors in attracting tourists to the country and is in a key position to meet the ever growing numbers of tourists visiting Iceland annually as is depicted in the following graph.

Item 17. Number of tourists to Iceland 1960–2009[28]



Since the financial turmoil of 2008, the international operations of the Group have been counter-cyclical to the downturn in the Icelandic economy as the number of foreign clients of the Group has increased notably. Icelandair ehf. has continued in 2010 to increase its international exposure by media campaigns on both sides of the Atlantic.

10.2.3 **Growth Opportunities**

Extended route network:

- The route network of Icelandair ehf. was extended to Seattle in 2009, which has proved to be a successful addition to the route network. Given the current state of the airline industry worldwide, it remains likely that other similar opportunities will arise.
- Booking figures and research into new routes confirms that other additions to the route network may prove to be a success, and management has plans to further capitalise on the demand for flights to the West Coast of North America.
- The first step will be to increase the supply of flights over the high season, while later steps will include marketing new routes as off-season destinations.

Code sharing:

[28] See http://www.ferdamalastofa.is/displayer.asp?cat_id=503

- Over the years, Icelandair ehf. has extended its route network by entering into code sharing agreements with other airlines.
- In July 2010, the Group signed a code sharing agreement with Air Alaska.
- The next steps will be to negotiate further code sharing agreements, e.g. with extensions to Central Europe and Asia.

Inter-company synergies:

- Following the transformation of Icelandair Group into an operating company, management efforts will increasingly be focused on developing synergies between Group companies and between business segments.
- It is foreseen that considerable economies of scale will transpire in the Route Network and especially in Tourist Services as support functions are centralised and rationalisation of each business gets more support from Group management going forward.

Other growth opportunities:

- Through its existing fleet, Air Iceland has identified a void in the market that can be met by increasing both frequency and by adding new routes to and from Greenland.
- It has transpired that the increase in the number of foreign travellers to Iceland over the high season has led to a shortage in hotel room availability around the country. Management is currently investigating the possibility of increasing the number of available hotel rooms by expanding the current facilities both in the capital and around Iceland.

10.3 Full Year Results of Operations 2007–09

10.3.1 Key Income Statement Line Items

10.3.1.1 Operating Income

The Group's operating income comprises transport revenue, aircraft and aircrew lease revenue and other operating revenue. Transport revenue consists of all revenue relating to the transportation of passengers, mail and cargo. Aircraft and aircrew lease revenue consists of all income related to wet[29] and dry[30] lease contracts. Other operating revenue consists of items such as revenue from tourism, sales at airports and hotels, commission income and maintenance service as well as non-recurring items such as gain on the sale of operating assets.

Passenger ticket sales are not recognised as revenue until transportation has been provided. Sold documents (tickets, gift certificates, etc.) not used within twelve months from the month of sale are recognised as revenue. Revenue from mail and cargo transportation is recognised in the income statement after transportation has been provided. Revenue from aircraft and aircrew leases is recognised in the income statement when the service has been provided at the end of each charter flight. Revenue from other services rendered is recognised in the income statement when the service has been provided. Gain on the sale of operating assets is recognised in the income statement after the risks and rewards of ownership have been transferred to the buyer.

[29] The leasing of an aircraft including crew, maintenance and insurance, usually for a very short period of time.
[30] Leasing of an aircraft without insurance, crew, ground staff, supporting equipment, maintenance, etc.

Despite operating out of Iceland, the Group's revenue originates from all corners of the world. Among airlines, Icelandair ehf. attracts an unusually high percentage of its customers from outside its home market.

As part of operating income of continuing businesses, foreign origin accounts for 72% in 2009 as well as in 1H 2010. Future growth will chiefly originate outside of Iceland, and special emphasis will continue to be placed on the transatlantic route, originating in both North America and Europe.

Item 18. Revenue distribution 1H 2010 and 2008–09 by world regions

	2008	2009	1H 2010
North Amercia	13%	14%	16%
South America	3%	4%	5%
Iceland	31%	28%	28%
Scandinavia	12%	13%	14%
UK	5%	5%	6%
Rest of Europe	28%	28%	22%
Africa	1%	1%	0%
Asia	3%	5%	5%
Oceania	4%	2%	4%
Total	**100%**	**100%**	**100%**

Item 19. Revenue distribution 1H 2010 and 2008–09 by Iceland and the rest of the world

	2008	2009	1H 2010
Iceland	31%	28%	28%
Rest of the world	69%	72%	72%
Total	**100%**	**100%**	**100%**

10.3.1.2 Operating Expenses

The operating expenses reported by the Group include salaries and other expenses related to employees, jet fuel cost (net of hedging effects), lease of aircrew and aircraft, costs related to aircraft servicing, handling and communications, aircraft maintenance and other operating expenses. Other operating expenses include administration and office costs, advertising costs, consultancy services and insurance fees. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

10.3.1.3 Jet Fuel Price Developments

The Group's jet fuel costs have varied over the past 3 years between 17% and 24% of total operating expenses. This illustrates that jet fuel cost contributes a substantial amount to the overall cost base. Since 2002, jet fuel has traded in a price range from USD 200 per tonne to USD 1,450 per tonne with most of the volatility occurring in 2008. Prices broke the USD 900 barrier in February 2008, reaching USD 1,450 in July and were back below USD 900 in October of that year. Average jet fuel prices for the year 2009 were USD 568 per tonne as compared to the average price of jet fuel of USD 1,008 per tonne in 2008.[31] In the first six months of 2010, the average market price of jet fuel was USD 704 per tonne.

Item 20. Jet fuel comparison 2007–09 and 1H 2010 [32] [33]

Jet Fuel Comparison	2007	2008	2009	1H 2010
Average market price of jet fuel (USD/tonne)	711	1,008	568	704
Tonnes of jet fuel consumed	171,000	147,000	127,000	61,941
Total jet fuel expenditure (mISK)	9,769	15,703	13,250	6,644
Jet fuel cost as % of revenue	15%	22%	16%	17%
Jet fuel cost per ASK (ISK)	1,715	3,133	2,918	3,029
Turnover (mISK)	63,477	72,199	80,321	38,168
ASK	5,694,618	5,012,045	4,541,298	2,193,073

[31] See e.g. http://www.bloomberg.com/markets/commodities/futures/
[32] Company data and information derived from www.bloomberg.com
[33] ASK is an abbreviation for Available Seat Kilometres

Of all the subsidiaries within Icelandair Group, Icelandair ehf. has by far the biggest risk exposure, as the other companies are in a better position to price in the risk or transfer it to the counterparty. Icelandair ehf. has traditionally maintained the hedge ratio level between 40–80%. When prices started falling by the end of August 2008 with increased momentum, the risk committee recommended to the Board of Directors that hedge ratios should be permitted to cross the policy's lower hedge limits. In addition to giving their consent, the Board of Directors approved the purchase of put options to lower the exposure of the open swap and collar positions. Since then, the hedge ratio has been kept below the policy limits due to high opportunity costs. In 2010, around 20% of the annual fuel consumption is hedged to cover the summer season. For further discussion, see *Chapter 2.1 Risk Management* and *Chapter 10.7.3.2 Derivative Financial Instruments, Including Hedge Accounting.*

10.3.1.4 Financial Income and Expenses

Financial income comprises interest income on funds invested, dividend income, foreign currency gains, and gains on financial instruments that are either hedges against interest bearing assets or liabilities or financial instruments not classified as hedges where changes in market value over time are recorded in profit or loss. Interest income is recognised as it accrues in profit or loss, using the effective interest method. Dividend income is recognised in profit or loss on the date that the Group's right to receive payment is established.

Finance expenses comprise interest expense on borrowings, unwinding of the discount on provisions, foreign currency losses, impairment losses recognised on financial assets, and losses on financial instruments that are either hedges against interest bearing assets, liabilities or financial instruments not classified as hedges where changes in market value over time are recorded in profit or loss. Foreign currency gains and losses are reported on a net basis.

10.3.1.5 Income Tax

Income tax on the profit or loss for the year comprises only deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or other comprehensive income.

Current tax is expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, nor differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date. A deferred tax asset is recognised for unused tax losses and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

10.3.1.6 Basis of Presentation of Financial Information in What Follows

For a detailed overview of the consolidated financial information on Icelandair Group for the years 2007–09 as well as comparison between 1H 2009 and 1H 2010, refer to *Chapter* 9 *Selected Financial Information.*

The selected consolidated income statement data for the years ended 31 December 2007 and 2009 and the selected consolidated balance sheet data as of 31 December 2007 and 2009 have been derived from our audited consolidated financial statements prepared in accordance with International Financial Reporting Standards, as adopted by the European Union ("IFRS").

The selected consolidated income statement data for the year ended 31 December 2008 has been derived from our re-presented consolidated financial statements prepared in accordance with IFRS as it was re-presented in the consolidated financial statement for the financial year 2009.

At year end 2009, the Group changed its accounting procedures regarding leased engines capitalisation. The different accounting procedures altered the balance sheet and cash flow classification. When the 2009 balance sheet and cash flow were published in the financial statement, the 2008 figures were re-classified. The result of the re-classification was that the total assets for the year 2008 were ISK 99,947 million in the 2009 financial statement as compared to ISK 98,830 million shown in the 2008 financial statement. The change in accounting procedures regarding the capitalisation of leased engines does not affect the classification of the consolidated income statement.

The balance sheet and cash flow figures for the year 2008 are derived from the financial statement for the year 2009 from the 2008 comparative figures. Therefore, it is hereby noted that the classification shown for the year 2008 in the 2009 financial statement is not the same classification as originally shown in the financial statement for the year 2008.

The selected consolidated income statement, balance sheet and cash flow for the first six months of 2010 have been derived from our reviewed financial statement prepared in accordance with IFRS. The selected consolidated income statement for the six months ended 30 June 2009 has been derived from the re-presented and reviewed consolidated financial statement prepared in accordance with IFRS, as it was re-presented in the consolidated financial statement for the first six months of 2010.

It must be noted that, as part of the financial restructuring plan of Icelandair Group, the Board of Directors proposed redefinition of the business model of the Group, leading to subsidiaries being split between core and non-core operations. Accordingly, SmartLynx Latvia, and the remaining shares in Travel Service are defined as non-core, leading to reclassification of these companies' financial results as discontinued operations.

- Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons. Note 6 in the Group's Consolidated Financial Statement for the year 2009 re-presents the income statement of the non-core businesses in more detail.
  Amounts for the first six months of 2009 have been re-presented in the profit and loss statement for comparative reasons, including the operations of Travel Service. Note 6 in the Group's Consolidated Financial Statement for the first six months of 2010 re-presents the income statement of the non-core businesses in more detail.

Actual Results: Chapters 10.4 and 10.5

- Actual results show the results as they were presented in the audited, consolidated financial statements for the years 2007 and 2009. However, the income statement for 2008 was re-presented in the 2009 annual accounts and is published that way in the following chapters.
- Income Statement 2008: SmartLynx and the remaining shares (30%) in Travel Service are defined as non-core, leading to reclassification of these companies financial results for the year 2009 as discontinued operations. Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons.
- Balance Sheet 2009: The Company's Board of Directors decided in December 2009, as a part of its financial restructuring plan, to consider two of its subsidiaries, Bluebird Cargo and SmartLynx as assets held for sale. Also included is the 30% remaining share in Travel Service. Total assets and liabilities of these companies are classified as held for sale.
- Bluebird Cargo is classified as an asset held for sale at year-end 2009 and on 30 June 2010 but its operations are fully included in the 2008 (re-presented), 2009 and 1H 2010 income statements. This is

due to the fact that although the Group is divesting Bluebird Cargo, the Group will continue to operate cargo operations from Iceland. The total operating income of Bluebird Cargo for the years 2007, 2008, 2009 and the first six months of 2010 amounted to ISK 2.7 billion, ISK 4.5 billion, ISK 5.1 billion and ISK 2.4 billion, respectively.

10.4 Actual Results for Years Ended 31 December 2007 and 2008

The Company has been working with its commercial bank, Íslandsbanki hf., on improving its debt maturity profile and equity ratio. As part of the restructuring plan, the Board of Directors has, in addition to the dilution of Travel Service, proposed redefinition of the business model of the company, leading to subsidiaries being split between core and non-core.

Accordingly, the main focus of the Group will be on scheduled airline operations and tourism evolving around Iceland, and related services. SmartLynx Latvia, and the remaining shares in Travel Service are defined as non-core, leading to reclassification of these companies financial results for the year 2009 as discontinued operations. Travel Service was not part of the Group in 2007 and SmartLynx operations were immaterial so 2007 amounts have not been re-presented.

Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons. The represented income statement reflects the core operations, and the results of the non-core operations are re-presented in the income statement under the line "Net Profit (Loss) from discontinuing operations".

Note 6 in the group's Financial Statement for 2009 re-presents the income statement of the non-core businesses in more detail. The net loss of ISK 7.5 billion in 2008 does not reflect the performance of the core operations as the impairment of intangible assets totalling ISK 6.4 billion dominated the result. The EBITDA for the year, which amounted to ISK 3.1 billion, gives a better indication of how the core business performed.

Item 21. Income Statements for the years ended 31 December 2007 and 31 December 2008.

(mISK)	2007	2008**	Change	Change %
Transport revenue	35,949	41,885	5,936	17%
Aircraft and aircrew lease	15,510	16,951	1,441	9%
Other operating revenue	12,018	13,363	1,345	11%
Operating Income	**63,477**	**72,199**	**8,722**	**14%**
Salaries and related expenses	20,008	20,275	267	1%
Aircraft fuel	9,769	15,703	5,934	61%
Aircraft and aircrew lease	7,353	8,921	1,568	21%
Aircraft handling, landing and communication	4,367	5,060	693	16%
Aircraft maintenance expenses	5,128	5,499	371	7%
Other operating expenses	11,375	13,687	2,312	20%
Operating Expenses	**58,000**	**69,145**	**11,145**	**19%**
EBITDA	**5,477**	**3,053**	**-2,424**	**-44%**
Depreciation and amortisation	-3,141	-10,404	-7,264	-
EBIT	**2,336**	**-7,351**	**-9,687**	**-**
EBT	**128**	**-8,985**	**-9,113**	**-**
Net Profit/Loss from continuing operations	**257**	**-8,905**	**-9,162**	**-**
Net Profit (Loss) from discontinuing operations	0	1,437	1,437	-
Net Profit/Loss for the year / quarter	**257**	**-7,468**	**-7,725**	**-**
EBITDAR	**11,056**	**8,821**	**-2,235**	**-20%**

** Re-presented

The EBITDA for 2008 amounted to ISK 3.1 billion compared to ISK 5.5 billion in 2007.

Profits from the sales of aircraft amounted to ISK 0.2 billion in 2008, as compared to ISK 1.8 billion in 2007. Net loss result in 2008 was ISK 7.5 billion compared to a profit of ISK 0.3 billion in 2007.

For further information on balance sheet items, see *Chapter 9.1.2 Balance Sheet*.

10.4.1.1 Operating Income

Operating income for 2008 was ISK 72.2 billion, representing an increase of 14% from the year before. The largest factor of the increase in revenue was depreciation of the ISK, which largely increased the transport revenue of the Group by 17% between 2007 and 2008.

Transport revenue in 2008 was ISK 41.9 billion and increased by 17% from the year 2007. Aircraft and aircrew lease amounted to ISK 17 billion in 2008 compared to ISK 15.5 billion the previous year. Other operating revenue in 2008 totalled ISK 13.4 billion, increasing 11% from the year before.

10.4.1.2 Operating Expenses

The Group's operating expenses include payroll and related expenses, aircraft fuel, aircraft and aircrew lease, aircraft handling, landing and communication, aircraft maintenance expenses and other operating expenses.

Operating expenses in 2008 totalled ISK 69.1 billion compared to ISK 58 billion in 2007. Salaries and related expenses rose by 1% from 2007. Aircraft fuel costs rose by ISK 5.9 billion, which corresponds to a 62% increase. The average price of fuel in 2008 was USD 1,008 per ton, as compared to USD 711 in 2007.[34] Aircraft handling, landing and communication expenses increased by ISK 693 million between years and aircraft maintenance by ISK 371 million..

Aircraft and aircrew lease increased from ISK 7.4 billion in 2007 to ISK 8.9 billion in 2008, an increase of ISK 1.6 billion, or 21%.

Other operating expenses increased from ISK 11.4 billion in 2007 to ISK 13.7 billion in 2008, an increase of 20%.

10.4.1.3 Depreciation and Amortisation

Impairment of intangible assets amounted to ISK 6.4 billion in 2008, all expensed in the fourth quarter. The Group's intangible assets have been allocated to individual subsidiaries. Impairment tests are conducted in compliance with IFRS[35]. A number of factors were taken into account when conducting the tests, including future operating and investment plans, and required cost of capital. See *Chapter 10.7.9 Impairment,* for further information on the methodology.

Capital costs, and in particular risk premiums, increased between 2007 and 2008, as did the required return on equity. Changes in the operating environment of two companies, SmartLynx and Icelandair Cargo, negatively affected the Group since their allocation of goodwill did result in substantial write-downs. Intangible assets relating to SmartLynx increased in value by ISK 0.8 billion during the year 2008 through equity as a result of the weakening of the ISK. The amount, which previously was entered as equity, was subsequently expensed in the profit and loss account.

In the re-presented income statement, all impairment and losses related to SmartLynx are expensed under the discontinued operations.

A substantial impairment was also entered on account of Air Iceland. The primary reason for this was that the company's aircraft fleet is capitalised in foreign currency and its book value did increase during the course of the year as a result of the weakening of the ISK. This increase was entered through equity. The book value of all assets, both tangible and intangible, must be supported by future cash flow.

[34] See e.g. http://www.bloomberg.com/markets/commodities/futures/
[35] Acronym for: International Financial Reporting Standards. See further: www.ifrs.org

10.4.1.4 Financial Income and Expenses

Net interest expenses increased between 2007 and 2008 due to rising domestic interest rates, higher margins and a bigger balance sheet after the acquisition of Travel Service. Tighter liquidity arising from a very challenging international economic environment in the fourth quarter of 2008 added to this effect. However currency effects due to a weaker ISK in addition to gains from derivative positions had positive counter effects causing the net total finance cost to decrease somewhat from 2007 to 2008.

10.5 **Actual Results for Years Ended 31 December 2008 and 2009**

The Company has been working with its commercial bank, Íslandsbanki, on improving its debt maturity profile and equity ratio. As a part of the restructuring plan, the Board of Directors has, in addition to the dilution of Travel Service, proposed redefinition of the business model of the company, leading to subsidiaries being split between core and non-core.

Accordingly the main focus of the Group will be on scheduled airline operations and tourism evolving around Iceland, and related services. SmartLynx Latvia and the remaining shares in Travel Service are defined as non-core, leading to reclassification of these companies' financial results for the year 2009 as discontinued operations.

Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons. The re-presented income statement reflects the core operations while the results of the non-core operations are re-presented in the income statement under the line "Net Profit (Loss) from discontinuing operations".

Note 6 in the group's Financial Statement for 2008 re-presents the income statement of the non-core businesses in more detail.

The year 2009 was a challenging year in international aviation. However, the operations of Icelandair ehf. and Air Iceland were profitable, and both companies reported their best annual results in years. In addition, Loftleidir-Icelandic, Bluebird Cargo and Iceland Travel reported a net profit in 2009.

The Group's loss of ISK 10.7 billion is the result of parent company guarantees for SmartLynx from 2007, losses from oil hedges entered into by Travel Service and financial costs due to excessive leverage of the parent company dating back to 2006. Net loss from continuing operations amounted to ISK 4.0 billion in 2009, as compared to a loss of ISK 8.9 billion in 2008.

Item 22. Income Statements, years ended 31 December 2008 and 31 December 2009.

(mISK)	2008**	2009	Change	Change %
Transport revenue	41,885	47,139	5,254	13%
Aircraft and aircrew lease	16,951	19,425	2,474	15%
Other operating revenue	13,363	13,757	395	3%
Operating Income	**72,199**	**80,321**	**8,122**	**11%**
Salaries and related expenses	20,275	18,652	-1,623	-8%
Aircraft fuel	15,703	13,250	-2,454	-16%
Aircraft and aircrew lease	8,921	12,797	3,876	43%
Aircraft handling, landing and communication	5,060	5,881	821	16%
Aircraft maintenance expenses	5,499	6,825	1,325	24%
Other operating expenses	13,687	14,782	1,095	8%
Operating Expenses	**69,145**	**72,185**	**3,040**	**4%**
EBITDA	**3,053**	**8,136**	**5,082**	**-**
Depreciation and amortisation	-10,404	-6,652	3,752	36%
EBIT	**-7,351**	**1,483**	**8,834**	**-**
EBT	**-8,985**	**-4,468**	**4,517**	**50%**
Net Profit/Loss from continuing operations	**-8,905**	**-3,983**	**4,922**	**-55%**
Net Profit (Loss) from discontinuing operations	1,437	-6,681	-8,119	-
Net Profit/Loss for the year / quarter	**-7,468**	**-10,665**	**-3,197**	**43%**
EBITDAR	**8,821**	**16,332**	**7,511**	**85%**

** Re-presented

Icelandair Group's foreign investments have caused difficulties for the Group. In 2009, ISK 4.2 billion were expensed as a result of operating losses and written-off receivables and intangible assets of the Latvian airline SmartLynx. In addition, expensed items relating to the Czech airline Travel Service amounted to approximately ISK 1.9 billion. Of this figure, losses on fuel hedging amounted to ISK one billion, and ISK 900 million resulted from the sale of a share in the company below its book value.[36] These expenses are presented as discontinued operations. Neither company forms part of Icelandair Group's core business, therefore the Board of Directors of the company has therefore resolved to sell both companies.

EBITDA was ISK 8.1 billion, as compared to ISK 3.1 billion in the year before. EBT was negative by ISK 4.5 billion, as compared to a negative ISK 9.0 billion in the year before. Loss after tax in 2009 amounted to ISK 10.7 billion, as compared to loss of ISK 7.5 billion in 2008. EBITDAR amounted to ISK 16.3 billion in 2009, as compared to ISK 8.8 billion in 2008.

For further information on balance sheet items, see *Chapter 9.1.2 Balance Sheet*.

10.5.1 Operating Income

Operating income for 2009 was ISK 80.3 billion as compared to ISK 72.2 billion in 2008. Transport revenue in 2009 was ISK 47.1 billion, as compared to ISK 41.9 billion in 2008. The difference in transport revenue is explained by Icelandair ehf., which increased its revenue by ISK 5.0 billion between 2008 and 2009. Aircraft and aircrew lease amounted to ISK 19.4 billion in 2009 compared to ISK 17.0 billion in 2008. Other operating revenue totalled ISK 13.8 billion in 2009, as compared to ISK 13.4 billion the previous year.

10.5.2 Operating Expenses

Operating expenses in 2009 totalled ISK 72.2 billion compared to ISK 69.1 billion in 2008. Salaries and related expenses decreased by 8% or ISK 1.6 billion from 2008.

[36] For the full company announcement see: https://newsclient.omxgroup.com/cdsPublic/viewDisclosure.action?disclosureId=375177&messageId=448824

Aircraft fuel costs decreased by ISK 2.5 billion, which corresponds to a 16% decrease. The average price of fuel in 2008 was USD 1,008 per ton, as compared to USD 567 in 2009.

Aircraft and Aircrew lease increased by ISK 3.9 billion in 2009 to ISK 12.8 billion in 2009, an increase of 43%. Aircraft handling, landing and communication expenses increased by ISK 0.8 billion between years. Aircraft maintenance increased by ISK 1.3 billion between years. Other operating expenses increased from ISK 13.7 billion in 2008 to ISK 14.8 billion in 2009, an increase of 8%.

For further information on balance sheet and cash flow items, see *Chapter 9.1.3 Balance Sheet and 9.1.4 Statement of Cash Flows*.

10.6 **Results for 1H Ended 30 June 2009 and 2010**

- Income Statement 1H 2009: SmartLynx and the remaining shares (30%) in Travel Service are defined as non-core, leading to reclassification of these companies' financial results for first half of the year 2009 as discontinued operations. Amounts for the first half of the year 2009 have been re-presented in the profit and loss statement for comparative reasons.
- Bluebird Cargo is classified as an asset held for sale at year-end 2009 and on 30 June 2010. Its operations are fully included in the 2008 (re-presented), 2009 and 1H 2010 income statements. This is due to the fact that although the Group is divesting Bluebird Cargo, the Group will continue to operate cargo operations from Iceland.
- Note 6 in the Group's Consolidated Financial Statement for the first six months of 2010 re-presents the income statement of the non-core businesses in more detail.
- Operating income in 1H 2010 was ISK 38.2 billion and increased by 14% in the first half of 2009.
- EBITDA was ISK 2.3 billion (6.1%) in the first half of 2010, as compared to ISK 1.5 billion (4.4%) in the first half of 2009.
- Depreciation was ISK 2.6 billion in the first six months of 2010 and decreased by ISK 220 million as compared to the first six months of 2009.
- Losses after taxes came to ISK 2.0 billion in the first six months of 2010, as compared to a loss of ISK 5.0 billion in the first six months of 2009

Item 23. 1H Income Statements, half years ended 30 June 2009 and 2010

(mISK)	1H 2009**	1H 2010
Transport revenue	18,763	22,016
Aircraft and aircrew lease	9,064	9,719
Other operating revenue	5,756	6,433
Operating Income	**33,583**	**38,168**
Salaries and related expenses	8,994	9,841
Aircraft fuel	5,549	6,644
Aircraft and aircrew lease	5,649	5,941
Aircraft handling, landing and communication	2,545	2,783
Aircraft maintenance	2,855	3,400
Other operating expenses	6,526	7,232
Operating Expenses	**32,118**	**35,841**
EBITDA	**1,465**	**2,327**
Depreciation and amortisation	-2,427	-2,647
EBIT	**-962**	**-320**
EBT	**-2,630**	**-2,043**
Net Profit/Loss from continuing operations	**-2,232**	**-1,646**
Net Profit (Loss) from discontinuing operations	-2,747	-400
Net Profit/Loss for the year / quarter	**-4,979**	**-2,046**
EBITDAR	**5,779**	**6,629**

**** Re-presented**

As shown in the table above, EBITDA was ISK 2.3 billion for 1H 2010, as compared to ISK 1.5 billion over the same period last year. EBIT was negative by ISK 320 million, as compared to a negative result of ISK 962 million over the same period last year. Loss after taxes for 1H 2010 amounted to ISK 2.0 billion, as compared to ISK 5.0 billion for same period 2009. EBITDAR amounted to ISK 6.6 billion for 1H 2010, as compared to ISK 5.8 billion in the first half of 2009.

10.6.1 **Operating Income**

Operating income amounted to ISK 38.2 billion in 1H 2010, as compared to ISK 33.6 billion for the same period in 2009, which represents an increase by 14% between years. Transport revenues increased by ISK 3.3 billion between the 1H 2009 and 2010, or by 15%. Aircraft and aircrew lease revenue amounted to ISK 9.7 billion in 1H 2010, as compared to 9.1 billion in the first six months of 2009. Other revenue increased by 10% and amounted to ISK 6.4 billion in the first half of 2010.

10.6.2 **Operating Expenses**

Total operating expenses amounted to ISK 35.8 billion in the first six months of 2010, as compared to ISK 32.1 billion in the first half of 2009.

Salaries and related expenses increased by ISK 0.8 billion in 1H 2010 as compared to 1H 2009.

Aircraft fuel costs increased by ISK 1.1 billion in the first six months of 2010 as compared to the first six months of 2009. Nevertheless, the average world price of fuel in the first half of 2010 was USD 455 per ton, as compared to USD 688 per ton in the first six months of 2009.[37] The increase in fuel costs in the first half of 2010

[37] See e.g. http://www.bloomberg.com/markets/commodities/futures/

as compared to the first six months of 2009 is explained by higher frequency of flights through increased capacity and negative impact of fuel hedges in the first half of 2010.

Aircraft and aircrew lease expenses increased by ISK 292 million between the first six months of 2010 and 2009. Aircraft handling, landing and communication expenses increased by ISK 238 million between the first six months of 2010 and 2009. Aircraft maintenance costs increased by ISK 545 million between the first six months of 2010 and the first six months of 2009.

For further information on balance sheet and cash flow items, see *Chapters 9.2.3 Balance Sheet 30 June 2010* and *9.2.4 First Half Statements of Cash Flows 2009 and 2010*. Regarding cash flow of 1H 2006, the following must be noted:

- At year end 2009, the Group changed its accounting procedures regarding leased engines capitalisation. The different accounting procedures altered the balance sheet and cash flow classification. When the first half of 2010 cash flow was published in the financial statement, the first half 2009 cash flow figures were reclassified. The change in accounting procedures regarding the capitalisation on leased engines does not affect the classification of the consolidated income statement. The cash flow figures for the first half of 2009 are derived from the first half 2010 condensed consolidated interim financial information. Therefore, it is hereby noted that the cash flow classification shown for the first half of 2009 in the first half of 2010 financial statement, is not the same classification as originally shown in the financial statement for the first half of 2009.

10.7 Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the consolidated financial statements are: business combinations, measurement of the recoverable amounts of cash-generating units, utilisation of tax losses, accounting for an arrangement containing a lease, provisions and valuation of financial instruments.

While the Group provides information on the application of accounting principles being used in its financial statements, the following paragraphs describe the critical accounting principles and estimates that are considered most important for understanding the Group's financial condition, results of operations and cash flows.

10.7.1 Basis of Consolidation

10.7.1.1 Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

10.7.1.2 Investments in Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are initially recognised at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Group's share of the total recognised gains and losses and equity movements of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount, including any long-term investments, is reduced to nil, and recognition of further losses is discontinued except to the extent that the Group has any obligations or made payments on behalf of the investee.

10.7.1.3 Transactions Eliminated on Consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

10.7.2 **Foreign Currency**

10.7.2.1 Foreign Currency Transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Group's entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Foreign currency differences arising on retranslation are recognised in profit or loss.

10.7.2.2 Foreign Operations and Icelandic Subsidiaries with Foreign Functional Currency

The assets and liabilities of foreign operations and Icelandic subsidiaries with functional currency other than Icelandic kronur, including goodwill and fair value adjustments arising on acquisitions, are translated to Icelandic kronur at exchange rates at the reporting date. The income and expenses of foreign operations are converted into Icelandic kronur at exchange rates at the date of the transactions. Foreign currency differences arising on retranslation are recognised in other comprehensive income. When a foreign operation is disposed of, in part or in full, the relevant amount in the Foreign Currency Translation Reserve (FCTR) within equity is transferred to profit or loss as part of the profit or loss on disposal.

When the settlement of a monetary item receivable from, or payable to, a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognised in other comprehensive income, and are presented within equity in the FCTR.

10.7.2.3 Hedge of Net Investment in Foreign Operations

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in foreign operations are recognised in other comprehensive income, to the extent that the hedge is effective, and are presented within equity in the FCTR. To the extent that the hedge is ineffective, such differences are recognised in profit or loss. When the hedged net investment is disposed of, the relevant amount in the FCTR is transferred to profit or loss as part of the profit or loss on disposal.

10.7.3 **Financial Instruments**

10.7.3.1 Non-derivative Financial Instruments

Non-derivative financial instruments comprise long-term receivables and deposits, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Cash and cash equivalents comprise cash balances and call deposits.

All other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

10.7.3.2 Derivative Financial Instruments, Including Hedge Accounting

The Group generally holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures. However, the Company has, to a considerable extent, not been in a position to follow its risk management policy from October 2008, as further discussed in *Chapter 2.1 Risk Management.* Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss as incurred.

Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below. The Group holds no trading derivatives.

On initial designation of the hedge, the Company formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. The Company makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80–125 percent. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that could ultimately affect reported net income.

10.7.3.2.1 Cash Flow Hedges

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised in other comprehensive income and presented in the hedging reserve in equity. The amount recognised in other comprehensive income is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the statement of comprehensive income as the hedged item. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated, exercised, or the designation is revoked, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in other comprehensive income and presented in the hedging reserve in equity remains there until the forecast transaction affects profit or loss. When the hedged item is a non-financial asset, the amount recognised in other comprehensive income is transferred to the carrying amount of the asset when the asset is recognised. If the forecast transaction is no longer expected to occur, then the balance in other comprehensive income is recognised immediately in profit or loss. In other cases the amount recognised in other comprehensive income is transferred to profit or loss in the same period that the hedged item affects profit or loss.

10.7.3.2.2 Economic Hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in profit or loss as foreign currency gains and losses.

10.7.3.2.3 Other Non-trading Derivatives

When a derivative financial instrument is not held for trading, and is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in profit or loss.

10.7.3.2.4 Compound Financial Instruments

Compound financial instruments issued by the Group comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognised initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts. Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortised cost using the effective interest method.

The equity component of compound financial instruments is not re-measured subsequent to initial recognition.

10.7.3.3 Share Capital

10.7.3.3.1 Ordinary Shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity, net of any tax effects.

10.7.3.3.2 Repurchase of Share Capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to/from share premium.

10.7.4 **Operating Assets**

10.7.4.1 Recognition and Measurement

Items of operating assets are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Cost also may include transfers from other comprehensive income of any gain or loss on qualifying cash flow hedges of foreign currency purchases of operating assets. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of operating assets have different useful lives, they are accounted for as separate items (major components) of operating assets.

Gains and losses on disposal of an item of operating assets are determined by comparing the proceeds from disposal with the carrying amount of operating assets and are recognised net within “other operating revenue” in the statement of comprehensive income.

10.7.4.2 Aircrafts and Flight Equipment

Aircrafts and flight equipment, e.g. aircraft engines and aircraft spare parts, are measured at a cost less accumulated depreciation and accumulated impairment losses. When aircraft are acquired, the purchase price is divided between the aircraft itself and engines. Aircraft are depreciated over the estimated useful life of the relevant aircraft until a residual value is met. Engines are depreciated according to flown cycles. When an engine is overhauled, the cost of the overhaul is capitalised and the remainder of the cost of the previous overhaul that has not already been depreciated, if there is any, is expensed in full.

10.7.4.3 Subsequent Costs

The cost of replacing part of an item of operating assets is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other costs are recognised in profit or loss as an expense as incurred.

10.7.4.4 Depreciation

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each item of operating assets since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. The estimated useful lives for the current and comparative periods are as follows:

Useful Life

+ Aircraft and flight equipment	4–20 year
+ Engines	Cycles[38]
+ Buildings	17–50 years
+ Other property and equipment	3–8 years

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

10.7.5 **Intangible Assets**

10.7.5.1 Goodwill and Other Intangible Assets with Indefinite Useful Lives

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. In respect of business acquisitions, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment. Negative goodwill arising on an acquisition is recognised directly in profit or loss. Goodwill, trademarks and slots with indefinite useful lives are stated at cost less accumulated impairment losses.

10.7.5.2 Other Intangible Assets

Other intangible assets that have finite useful lives are measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful lives for the current and comparative periods are as follows:

Useful Life

+ Software	3 years
+ Customer relations	7–10 years
+ Favourable aircraft lease contracts	2–3 years
+ Other intangible assets	6–10 years

Amortisation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

10.7.5.3 Subsequent Expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

[38] An aeroplane cycle is one complete takeoff and landing sequence. Depreciation on engines and engine reserves are calculated by count of cycles. Aeroplane cycle are not affected by flight hours, only take off and landing, therefore engine utilisation is better when the cycles have more flight hours.

10.7.6 **Prepaid Aircraft Acquisitions**

Prepaid aircraft acquisitions consist of pre-payments on Boeing aircrafts that are still to be delivered. Borrowing cost related to these pre-payments is capitalised based on the interest rate on the directly related financing.

10.7.7 **Leased Assets**

All leases are operating leases and the leased assets are not recognised in the Group's statement of financial position.

10.7.8 **Inventories**

Goods for resale and supplies are measured at the lower of cost and net realisable value. The cost of inventories is based on first-in first-out principle and includes expenditure incurred in acquiring the inventories in bringing them to their existing location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. Aircraft equipment is capitalised at the foreign exchange rate ruling at the date of acquisition.

10.7.9 **Impairment**

10.7.9.1 Financial Assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, it is reversed through profit or loss.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised in profit or loss, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss.

10.7.9.2 Non-Financial Assets

The carrying amounts of the Group's non-financial assets other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a post-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

10.7.10 **Non-Current Assets Held For Sale**

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are re-measured in accordance with the Group's accounting policies. Thereafter generally the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to inventories, financial assets and deferred tax assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

10.7.11 **Employee Benefits**

10.7.11.1 Defined Contribution Plans

Obligations for contributions to pension plans are recognised as an expense in the statement of comprehensive income when they are due.

10.7.11.2 Share-Based Payment Transactions

The grant date fair value of share-based payment awards to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are met.

The fair value of employee share-based payment awards is measured using a binomial lattice model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility based on weighted average historic volatility adjusted for changes expected due to publicly available information, weighted average expected life of the instruments based on historical experience and general option holder behaviour, expected dividends, and the risk-free interest rate based on government bonds. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

Share-based payment arrangements in which the Group receives services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the Group.

10.7.12 **Provision**

A provision is recognised in the statement of financial position when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

10.7.12.1 Onerous Contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

10.7.12.2 Overhaul Commitments Relating To Aircrafts under Operating Lease

With respect to the Group’s operating lease agreements, where the Group has a commitment to maintain the aircraft, provision is made during the lease term for the obligation based on estimated future cost of major airframe and certain engine maintenance checks by making appropriate charges to the statement of comprehensive income calculated by reference to the number of hours or cycles operated during the year.

Provisions are entered into the statement of financial position among non-current and current payables.

10.7.13 **Deferred Income**

Sold unused tickets, fair value of unutilised frequent flyer points and other prepayments are presented as deferred income in the statement of financial position.

10.7.13.1 Frequent Flyer Program

Frequent flyer points earned or sold are accounted for as a liability on a fair value basis of the services that can be purchased for the points. The points are recognised as revenue when they are utilised or when they expire.

10.7.14 **Operating Income**

10.7.14.1 Transport Revenue

Passenger ticket sales are not recognised as revenue until transportation has been provided. Sold refundable documents not used within twelve months from the month of sale are recognised as revenue. Sold not used, non-refundable documents are recognized as revenue two months after expected transport. Revenue from mail and cargo transportation is recognised after transportation has been provided.

For customer loyalty programmes, the fair value of the consideration received or receivable in respect of the initial sale is allocated between the award credits (frequent flyer points) and the other components of the sale. Awards can also be generated through transportation services supplied by the Group. Through transportation services the amount allocated to the points is estimated by reference to the fair value of the services for which they could be redeemed, since the fair value of the points themselves is not directly observable. The fair value of the services is estimated taking into account the expected redemption rate and the timing of such expected redemptions. Such amount is deferred and revenue is recognised only when the points are redeemed and the Group has fulfilled its obligations to supply the services. The amount of revenue recognised in those circumstances is based on the number of points that have been redeemed in exchange for services, relative to the total number of points that is expected to be redeemed.

10.7.14.2 Aircraft and Aircrew Lease

Revenue from aircraft and aircrew lease is recognised in profit or loss when the service has been provided at the end of each charter flight.

10.7.14.3 Other Operating Revenue

Revenues include revenues from tourism, sales at airports and hotels, sold maintenance revenues and other revenues. Revenue is recognised in profit or loss when the service has been provided or sale completed by delivery of product.

Gain on sale of operating assets is recognised in profit or loss after the risks and rewards of ownership have been transferred to the buyer.

10.7.15 **Lease Payments**

10.7.15.1 Operating lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

10.7.16 **Income Tax**

Income tax on the profit or loss for the year comprises only deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or other comprehensive income.

Current tax is expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, nor differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised for unused tax losses and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

10.7.17 **Discontinued Operations**

A discontinued operation is a component of the Group’s business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative statement of comprehensive income is re-presented as if the operation had been discontinued from the start of the comparative period.

10.7.18 **Earnings per Share**

The Group presents basic and diluted Earnings Per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

10.7.19 **New Standards and Interpretations Not Yet Adopted**

A number of new standards, amendments to standards and interpretations are not yet effective. None of these standards will have a material effect on the consolidated financial statements of the Group.

10.7.20 **Segment Reporting**

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. An operating segment's operating results are reviewed regularly by the CEO to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. The major revenue-earning assets of the Group are the aircraft fleet, the majority of which are registered in Iceland. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis of allocating such assets and related liabilities to geographical segments.

Inter-segment pricing is determined on an arm's length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly investments and related revenue, loans and borrowings and related expenses, corporate assets and head office expenses, and income tax assets and liabilities.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, and intangible assets other than goodwill.

10.8 **Determination of fair values**

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

10.8.1 **Operating Assets**

The fair value of operating assets recognised as a result of a business combination is based on market values. The market value of aircrafts and properties is the estimated amount for which they could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably and willingly. The fair value of items of equipment, fixtures and fittings is based on the market approach and cost approaches using quoted market prices for similar items when available and replacement cost when appropriate.

10.8.2 **Intangible Assets**

The fair value of intangible assets acquired in a business combination is based on the discounted estimated royalty payments that have been avoided as a result of the trademark being owned. The fair value of other intangible assets is based on the discounted cash flows expected to be derived from the use and eventual sale of the assets.

10.8.3 **Inventories**

The fair value of inventories acquired in a business combination is determined based on its estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventory.

10.8.4 **Receivables**

The fair value of receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The fair value is determined for disclosure purposes.

10.8.5 **Derivatives**

The fair value of forward exchange contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate based on government bonds.

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and counterparty when appropriate.

10.8.6 **Non-Derivative Financial Liabilities**

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. In respect of the liability component of convertible notes, the market rate of interest is determined by reference to similar liabilities that do not have a conversion option.

10.8.7 **Deferred Income**

The amount allocated to the frequent flyers points is estimated by reference to the fair value of the discounted services for which they could be redeemed, since the fair value of the points themselves is not directly observable. The fair value of the discounted services for which the points, granted through a customer loyalty programme, can be redeemed takes into account the expected redemption rate and the timing of such expected redemptions. Such amount is recognised as deferred income.

11 INFORMATION ABOUT THE COMPANY

11.1 Name, Incorporation and Registration

The legal and commercial name of the company is Icelandair Group. The Company is registered at the Register of Enterprises in Iceland, under the registration number 631205-1780. Icelandair Group's domicile and headquarters are at Reykjavik Airport, 101 Reykjavík, Iceland, and the telephone number is +354 50 50 300.

Icelandair Group hf. is a public limited company incorporated in Iceland which operates pursuant to the Icelandic Act No. 2/1995 on Public Limited Companies. The date of incorporation was 20 December 2005.

11.2 History

The predecessor of Icelandair Group traces its roots to the year 1937 when Flugfélag Akureyrar was founded in Akureyri on the north coast of Iceland. In 1943, the company moved its headquarters to the capital, Reykjavík, and changed its name to Flugfélag Íslands, which later assumed the international trade name Icelandair.

Another important milestone was passed in 1944, when three young Icelandic pilots, returning from flight training in Canada, founded Loftleidir, which later became known as Icelandic Airlines. Initially, both companies concentrated on Icelandic domestic air services. However, in 1945 Flugfélag Íslands made its first international flight to Scotland and Denmark. Loftleidir began international operations in 1947, and its pioneering low-fare services across the North-Atlantic commenced in 1953.

In 1973, it was agreed to merge both Flugfélag Íslands and Loftleidir under a new holding company, Flugleidir. In October 1979, Flugleidir assumed all the operating responsibilities of its two parent companies, and decided to use Icelandair as its international trade name, only retaining the Flugleidir name in the Icelandic domestic market.

On the company's 50th anniversary in 1987, a breakthrough agreement was signed with the Boeing Company to renew the fleet of Icelandair that served international flights with a new route network. A new generation of Boeing jets, Boeing 757-200 and 737-400, replaced the older fleet gradually from 1989 to 1993, and then a single type fleet of Boeing 757 was established in the years preceding 2003.

In January 2003, Flugleidir became a holding company with 11 subsidiaries in the travel and tourist industry in Iceland, Icelandair (the airline currently known as Icelandair ehf.) being the largest subsidiary. At a Flugleidir's annual general meeting in 2005, the company's name was changed to FL Group and in October 2005, fundamental changes took place by which investment activities became FL Group's main focus. FL Group's acquisitions and corporations were divided into groups, Icelandair Group ehf. being one of them comprising of Icelandair (currently known as Icelandair ehf.), Icelandair Technical Services, Icelandair Ground Services and Icelandair Cargo.

Icelandair Group was founded on 20 December 2005, under the name Icelandair Group ehf., and was wholly owned by FL-Group. In February 2006, the Board of Directors of FL-Group announced its intention to list Icelandair Group ehf. on the Iceland Stock Exchange (currently known as NASDAQ OMX Iceland), but postponed it because of unfavourable market conditions. At that time, Air Iceland, Iceland Travel and Icelandair Hotels were transferred to Icelandair Group ehf. as were Bluebird Cargo, Icelandair Shared Service (Fjárvakur-fjármálathjónusta ehf.), Icelease, IG Invest and Icecap.[39]

[39] ICECAP insurance PCC Limited is owned by Icelandair Group and was formed in 2001 to facilitate the underwriting some of the Group's insurance. The insurance includes Hull Deductible, various insurance for flight crew and management, employer's liability and travel agency bonds. The ICECAP insurance is managed by Heritage Insurance Management Ltd. in Guernsey

At a shareholders' meeting held on 15 November 2006, the Company was altered from being a private limited company (ehf.) to a public limited company (hf.) in accordance with Article 107 of the Private Limited Companies Act No. 138/1994. After that transition, the company obtained its current name, Icelandair Group hf.

In October 2006, Icelandair Group Holding hf.,[40] a company led by three core investors, acquired Icelandair Group hf. from FL-Group with the support and advice of Glitnir Bank. Icelandair Group Holding purchased all the shares in Icelandair Group hf. that month. The largest owners expressed their will to involve further investors and list the company on the Iceland Stock Exchange (currently known as NASDAQ OMX Iceland). Icelandair Group Holding was subsequently listed under the name Icelandair Group Holding hf., ID No. 591006-2150, and trading in the company began in December 2006.

The only assets of Icelandair Group Holding hf. were shares in Icelandair Group hf. The two companies were merged in accordance with an agreement made by a shareholders' meeting of the companies on 28 and 29 December 2006. The shareholders of Icelandair Group Holding hf. received shares in Icelandair Group hf. in the nominal value of ISK 1,000,000,000 as payment for their shares in Icelandair Group Holding hf.

Following the merger of the two companies, it was decided to use the name Icelandair Group hf. with Icelandic ID No. 631205-1780. As a result of the merger, Icelandair Group Holding hf. was delisted in early 2007 after approval from the shareholders, and Icelandair Group hf. was listed on 12 February that year. The Company, in its current form, was subsequently listed on the NASDAQ OMX Iceland, and trading in the Company's shares began in February 2007.[41]

On 3 June 2007, Icelandair Group celebrated 70 years of successful operations in scheduled flight services making the name Icelandair one of the longest serving airline names in the world.

During the second half of 2007, Icelandair Group expanded to the Czech Republic by acquiring a majority shareholding in Travel Service a.s. Later that year, the Group acquired the remainder of Latvian airline SmartLynx after having originally acquired a majority stake in SmartLynx in 2006.

After the turmoil in late 2008, significant changes materialised in the shareholder structure of the Group in 2009. Íslandsbanki acquired 42% of the shares in Icelandair Group through an enforcement of a pledge of shares held by shareholders in the Group. Íslandsbanki was granted an exemption from having to make a mandatory offer for the remaining share capital by the Financial Supervisory Authority. It was announced that the Group would continue to be listed on NASDAQ OMX Iceland and that the bank's stake would be sold in an open and transparent sales procedure as soon as possible.[42]

The Board of Directors of the Group has decided to simplify the business model of the Group to reflect a new strategy. The future focus of the restructured Group will be on the operations of Icelandair ehf. and Icelandic Tourism along with the *Hub and Spoke* concept that has been a pivotal part of Icelandair's airline (currently known as Icelandair ehf.) business model for two decades. For further information on the restructuring of the Group, see *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

Icelandair Group is well positioned to fortify its position as the largest travel service company in Iceland. Through its subsidiaries, the Group will continue to aim to develop its position in international air travel, domestic air travel, the domestic hotel market and various areas of air travel and general tourist services at home and abroad.

[40] Icelandair Group Holding was established on 15 October 2006.
[41] For further information about the share capital of Icelandair Group, see *Chapter23.1 About the Share Capital*.
[42] For further information about the FME's decision, see *Chapter 21.5 Known arrangements which may change control of the issuer*. All the FME's decisions are available on the FME's website: www.fme.is. A direct link to the decision in question is http://fme.is/lisalib/getfile.aspx?itemid=7358.

11.3 **Key Milestones**

- **1937** One of the predecessors of the Group, Flugfélag Akureyrar, was founded in Akureyri.
- **1943** Name changed to Flugfélag Íslands (Air Iceland) and headquarters moved to Reykjavík.
- **1944** Loftleidir (later also known as Icelandic Airlines) was founded.
- **1945** Flugfélag Íslands made its first international flight; Loftleidir follows in 1947.
- **1953** Loftleidir pioneers low-fare services across the North Atlantic.
- **1973** Loftleidir and Flugfélag Íslands merged to form Flugleidir (Icelandair).
- **1979** Flugleidir assumed operating responsibilities of its two parent companies; Icelandair became its international name.
- **1992** Flugleidir was listed on the Icelandic stock exchange (currently known as the Main Market of NASDAQ OMX Iceland hf.).
- **1993** Total renewal of the older aircraft fleet which began in 1989 was finalised.
- **1997** Flugfélag Nordurlands and Flugleidir's domestic flight operations merged to form Air Iceland (Flugfélag Íslands), a wholly-owned subsidiary of Flugleidir.
- **1998** Icelandair Hotels (Flugleidahótel) was founded; the hotels that had been part of Flugleidir became a distinct subsidiary.
- **2000** Icelandair Cargo (Flugleidir Frakt) was founded; the cargo business of Flugleidir became a distinct subsidiary.
- **2001** Icelandair Ground Services (IGS) (*Flugthjónustan Keflavíkurflugvelli*) was founded; IGS became a distinct subsidiary.
- **2002** Loftleidir-Icelandic was founded; the wet lease and charter arm of Icelandair became a distinct subsidiary.
- **2003** Flugleidir became a holding company with 11 subsidiaries in the travel and tourist industry in Iceland; Flugleidir's operations were divided into Icelandair ehf., Icelandair Technical Services and Icelandair Shared Services. Icelandair ehf. was the largest subsidiary.
- **2004** Flugleidir acquired an 8.4% holding in easyJet plc (current ownership is 0%).
- **2005** Flugleidir became FL Group. The holding company announced its emphasis on investment. This was followed by increased investment activities and the acquisitions of Bluebird Cargo and Sterling Airlines A/S.
- **2005** Fundamental changes took place in October whereby investments became the focus of FL Group and its airline and tourist service operations were divided between two subsidiaries: Icelandair Group and FL Travel Group.
- **2006** In February, the current structure of Icelandair Group was formed. On 15 October that year, Icelandair Group Holding hf. was established and on the same day acquired Icelandair Group hf. Icelandair Group Holding was listed on Main Market of NASDAQ OMX Iceland on 14 December. On 28 December the merger of Icelandair Group Holding and Icelandair Group was approved by the shareholders of Icelandair Group and the following day by the shareholders of Icelandair Group holding. The Merger was effective as of 1 November 2006.

- **2006** In June, the Latvian charter airline Latcharter was acquired.
- **2006** Airline Services Estonia (ASE), Estonian accountancy firm acquired.
- **2007** Icelandair Group Holding hf. was delisted on 9 February and Icelandair Group hf. listed on the Main Market of NASDAQ OMX Iceland on 12 February.
- **2007** A 50% share of Travel Service, the largest privately owned airline in the Czech Republic was acquired. Travel Service became an associate member of the Group as of November and became a subsidiary and was included in the consolidated interim financial statements as of April 2008.
- **2007** Icelandair Hotels announced a Franchise Agreement with Hilton Hotels Corporation for the 252 room 4-star Nordica Hotel in Reykjavik.
- **2008** Icelandair Group hf. increased its share in Travel Service by 30% to hold a total of 80% of the share capital in Travel Service. Later that year, Icelandair Group divested a 14% share in Travel Service and held a 66% share at year-end 2008.
- **2008** Iceland Travel launched the VITA brand to sell a wide variety of leisure tours to Icelanders travelling abroad.
- **2008** A new name and appearance were unveiled in September when Latcharter became SmartLynx.
- **2009** Íslandsbanki acquired 42% of the shares in Icelandair Group hf.
- **2009** A share capital increase in Travel Service diluted Icelandair Group's share in Travel Service to 50.1% from the previous 66%. The Company sold a 20.1% share in Travel Service in November and holds a 30.0% share in Travel Service.
- **2009** A shareholders' meeting gave the Board of Directors authorisation to increase the share capital of the Company by up to ISK 4 billion by means of subscriptions to new shares.
- **2010** At the end of March 2010, Icelandair Group hf. and its largest lenders, Íslandsbanki and the Resolution Committee of Glitnir Bank, announced that they had reached an agreement on the best way to finalise the financial restructuring of Icelandair Group.
- **2010** On 14 April 2010, a volcanic eruption commenced in the glacier Eyjafjallajökull in Iceland. The volcanic ash from the eruption had a severe impact on flight schedules around the world.
- **2010** On 14 June, the Enterprise Investment Fund (EIF – Icelandic: Framtakssjódur Islands), an investment company owned by 16 Icelandic pension funds, entered into a binding agreement with Icelandair Group on an ISK 3 billion investment in the Group. The agreement was concluded with normal reservations regarding the results of due diligence, which the Fund performed. The EIF has subscribed to New Shares in the nominal amount of ISK 1.2 billion at the price of ISK 2.5, for a total of ISK 3 billion.
- **2010** On 15 June, The Pension Fund of Commerce (PCF – Icelandic: Lífeyrissjódur Verslunarmanna) entered into a binding agreement with Icelandair Group hf. on investing ISK 1 billion in the Group in return for a 10.1% share in the Company. The PCF has subscribed to New Shares in the nominal amount of ISK 400 million at a price of ISK 2.5, for a total of ISK 1 billion.
- **2010** On 21 October the Company announces that the financial restructuring is completed and the documentation process finalised.

12 BUSINESS OVERVIEW

12.1 Icelandair Group

12.1.1 Purpose and Mission

Icelandair Group has been listed on the NASDAQ OMX Iceland hf. since February 2007. The Group is moving from being a holding company and has redefined itself as an operating company with subsidiaries focused on the international airline and tourism sectors. This marks a major strategic shift for the Group going forward.

The Group has two main business areas:

- **Route Network:** This business segment is focused on the well-established international and domestic route networks based on the *Hub and Spoke* concept that the Group and its predecessors have developed for the last decades.
- **Tourism Services:** With focus on support to the route network as well as offering value-added service to tourists in Iceland and Icelanders travelling abroad.

The roots of the Group lie in the business idea of turning the geographical location of Iceland between Europe and North America into a business opportunity. The heart of the Group lies with the Icelandair ehf. route network, which creates revenues from various sources such as the home market, the tourism market to Iceland and the large international transatlantic market.

Leasing and charter services provide a strategic extension to this network, bringing global operational reach and specialised knowledge to manage capacity within the Group and for third party customers.

The Group is adapting to this new environment.

The future focus of the restructured Group will be on the operations of Icelandair ehf., Icelandic tourism and the *Hub and Spoke* concept that is a pivotal part of Icelandair ehf.'s business model.

Item 24. The core Icelandair Group going forward

Vindabudir ehf. ID No. 680807-2560, a company fully owned by the Resolution Committee of Glitnir Bank, will directly acquire 100% of the share capital of SmartLynx for ISK 1 (one) as SmartLynx has no value. Icelandair Group will continue to guarantee SmartLynx operational leasing obligations.

The Resolution Committee of Glitnir Bank and Íslandsbanki incorporated an SPV, a special purpose vehicle, (hereinafter "SPW ehf.") which will acquire Travel Service and Bluebird Cargo from Icelandair Group. A binding agreement on the divestment and the incorporation of SPW ehf. was signed on 12 August 2010. However, the documentation process was not concluded and contracts signed until on 21 October 2010. The contract has reservations and SPW ehf. will not take control of the divested companies until these reservations have been fulfilled. For an overview of the reservations refer to *Chapter 27.2 Overview of the Financial Restructuring*.

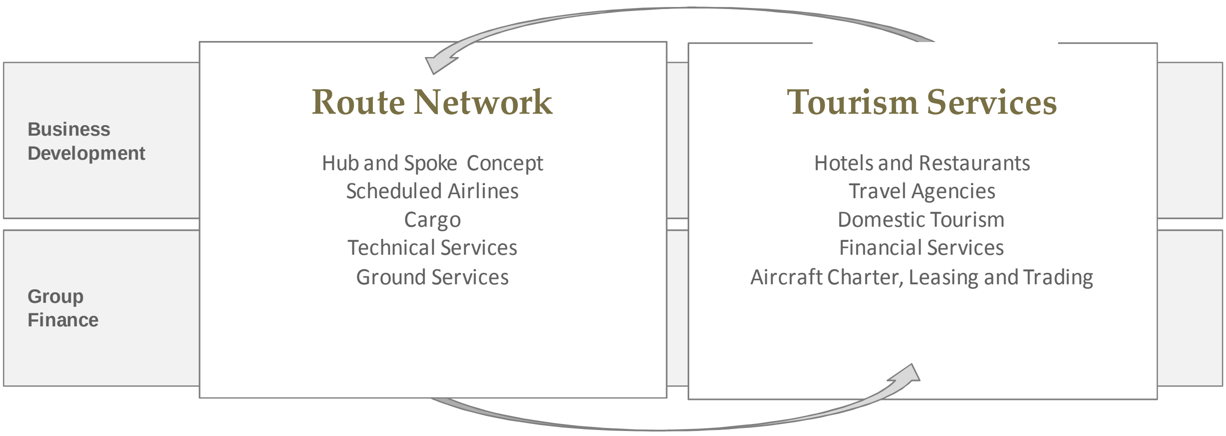
Icelandair Group will continue to own and manage IG Invest, but it will be controlled by SPW ehf. However, Icelandair Group has made an agreement with SPW ehf., which will receive economic benefits from IG Invest. The total proceeds to Icelandair Group from the sale of Bluebird Cargo, Travel Service, and the economic benefits of IG Invest to SPW ehf. amount to ISK 7.6 billion. The ISK 7.6 billion in proceeds contributes to reducing the debt of Icelandair Group by ISK 7.6 billion. There is no cash contribution involved in the asset divestment.

If SPW ehf. receives more than ISK 7.6 billion, in addition to interest amounting to REIBOR + 3%, from its assets when it sells them before September 2015 (Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group will receive 50% of any potential yield that is higher than ISK 7.6 billion. On the other hand, if SPW ehf. receives a lower amount than ISK 4.0 billion before September 2015 from the sale (of Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group must pay SPW ehf. ISK 0.5 billion. The contracts state that if SPW ehf. has not sold its assets before September 2015, the banks can extend the period until September 2017.

Item 25. Businesses divested in the financial restructuring

The Group's management emphasises the importance of collaboration between its subsidiaries as highlighted in the segmentation of the Group into the Route Network and Tourist Services. The business segmentation stresses the importance for subsidiaries to focus on a Group-wide approach to their daily operations.

Item 26. The business concept of the Group



The Group's mission is to operate an integrated network of companies within air travel and related services, providing quality services built on over 70 years' experience and knowledge from its subsidiaries. Furthermore, its mission is to create value for our customers and other stakeholders by focusing on efficiency and flexibility, as well as synergies between its companies.

This is best achieved through a combination of the following efforts:

- To focus on air travel and offer tourism services coupled with related operations that best serve our clients.

- To focus on organic growth and business development by seizing opportunities within its business segments.
- To improve efficiency and consolidate operations where appropriate.
- To achieve greater synergy between the companies.
- To continue to reduce seasonality in the Group’s operations by actively expanding the shoulder season into both spring and autumn.
- To make flexibility an even more integral part of the operations and the services provided by our companies.

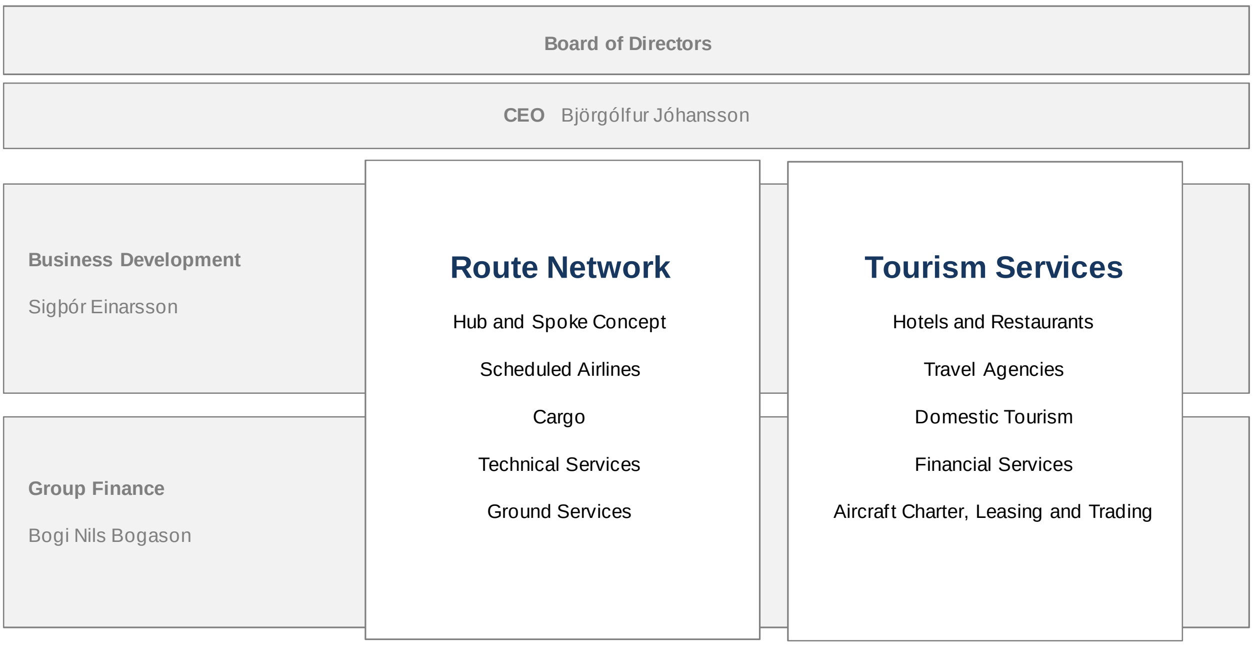
12.1.2 Management

The management team of Icelandair Group is lead by the Executive Board. The Executive Board is comprised of Björgólfur Jóhannsson, Chief Executive Officer, Bogi Nils Bogason, Chief Financial Officer and Sigthor Einarsson, Deputy CEO.

The Group’s management emphasises the importance of collaboration between its subsidiaries as highlighted in the segmentation by the Group into the Route Network and Tourism Services. The business segmentation stresses the importance for subsidiaries to focus on a Group-wide approach to their daily operations.

The Executive Board leads a team of specialists whose task is to harness the potential synergy effects, organise the overall operational network and ensure efficient financial management of Icelandair Group and its subsidiaries. In addition, the Executive Board has direct access to the day-to-day operations of each subsidiary, with the focus on strategy, finance, and business development enhancing Group synergies. The management team also formulates and ensures compliance by all subsidiaries with the overall strategy of the Group. All operational companies of the Group have their individual management, with executives in charge of the daily business, supported by the Group management. This team of subsidiary managers is at all times in close liaison with the Group-level management and contributes greatly to the overall insight and functionality of the organisation.

Item 27. Corporate structure



12.1.3 **Operations and Markets**

In its operations, Icelandair Group focuses on improving operating efficiency by implementing tools of cost control: focused distribution, marketing, sales and revenue management at the subsidiary level. Furthermore, the Group has shown strength at a time that has been volatile for many airline and tourism-related industries. The Group has an experienced workforce with expertise in the airline, transportation and tourism sectors. The Group has consistently been able to renew itself and rapidly adapt to change, which has been one of its key strengths.

The aviation industry is heavily regulated both in terms of operating licences and route rights. Air Operator Certificates (AOC's) are granted by local aviation authorities in the home country of the operator in-line with the local regulatory system. Route rights are based on international bilateral agreements between the operator's home country and the destination country. Such rights are based on the Chicago Convention on the freedoms of the air.[43] As route rights, other licences and certificates are based on different legislation from country to country, it is the opinion of the management that there is an intrinsic value in having such companies based in different countries, thus granting access to a greater variety of rights. The impact of such rights, licences and certificates is briefly described in the profile for each company in this document, and further information can be found in *Chapter 1.2 Risks Related to the Airline and Tourism Industry*. The companies within the Group that can be affected by route rights, other licences and certificates are Icelandair ehf., Icelandair Cargo, Air Iceland and Loftleidir-Icelandic.

At the heart of Icelandair Group's strategy is a principle of diversification across geographical areas as well as product offerings. This has a direct impact on the Group's structure. The Group's choice of subsidiaries and their service offerings reflects this strategy of diversification, as evidenced by a presence in Siberia, Oceania, Africa and South America in addition to the transatlantic network.

In all these different markets, the Group offers a variety of aviation and tourism-related services, such as dry-lease of aircraft, hotel accommodation, financial services for smaller airlines, incoming tourism to Iceland and aircraft maintenance in addition to universal services to travellers travelling to, from and via Iceland.

The purpose of this strategy is increased stability in terms of revenues, both with regard to annual seasonality and economic cycles. Seasonal fluctuations in demand are counterbalanced by activities in the southern hemisphere where demand is countercyclical to Europe and North America.

As economic cycles traditionally affect different areas with varying degree of severity and with a time lag, Icelandair Group has positioned itself in markets which are less interdependent than for example Europe and North America. As a result, the Group has managed to maintain its business in South America and Oceania during the current economic crisis.

At different times during the economic cycle, the demand for various types of services changes. During downturns, when most companies are scaling down operations, demand increases for less labour intensive services and services which, from the customers' standpoint, may be considered as outsourcing. Good examples of this type of service are dry leasing of aircraft and integrated engineering and maintenance planning. During the upswing, when companies need greater capacity and the flow of goods between countries swells, demand for larger capacity aircraft and air cargo services increases. The Group is well positioned for seizing such opportunities with its current cargo airlines and leasing companies.

The table below depicts the revenue distribution of Group companies for the years 2007, 2008 (re-presented), 2009 and the first six months of 2010. (Icelease, IG Invest and IceCap are excluded from the table as they individually represent around 0.1%-0.8% of revenue in each period)

[43] Further information can be found on http://www.icao.int/icao/en/trivia/freedoms_air.htm

Item 28. Revenue distribution 2007, 2008 (re-presented), 2009 and 1H 2010

	2007	2008**	2009	1H 2010
Icelandair	52.4%	55.5%	56.5%	56.0%
Air Iceland	5.7%	5.3%	4.9%	4.6%
Icelandair Hotels	3.4%	3.1%	3.1%	2.7%
Icelandair Cargo	9.8%	11.8%	10.1%	10.7%
Icelandair Shared Services	0.8%	0.7%	0.8%	0.9%
Iceland Travel	2.9%	2.9%	3.8%	3.5%
Loftleiðir Icelandic	16.1%	11.2%	12.5%	12.6%
Bluebird Cargo	3.5%	5.0%	5.2%	5.1%
IGS	4.5%	4.0%	3.0%	3.0%
IG Invest, IceCap and Icelease	0.7%	0.3%	0.1%	1.0%
Total	**100%**	**100%**	**100%**	**100%**

**** Re-presented**

As is evident from the table, Icelandair ehf. has been contributing more than 50% of the Group revenue since 2007. Furthermore, the other companies contribute a relatively constant percentage of Group revenues for each period in question.

12.2 Business Segments: Route Network

This business segment is focused on the well-established international route networks based on the *Hub and Spoke* concept. Three companies are categorised as being part of the Route Network business segment:

- Icelandair ehf., the international, full-service airline with a hub in Iceland;
- Icelandair Cargo, a full-service air freight company;
- Icelandair Ground Services, which handles airlines and passenger services at Keflavik Airport.

These companies work closely together and have long historical ties. The main common task of the focus group is to run a profitable airline network operation with growth potential while supporting local tourism in Iceland. This is done through sales and marketing activity on behalf of all companies, as well as through placing emphasis on revenue management and cost control throughout the operation.

Icelandair's route network, which forms the basis of the Group's scheduled airlines operations, has grown in recent years and has the potential to grow further into international markets as evidenced by new routes to Stavanger (Norway), Bergen (Norway) and Seattle (North America) in 2009 and to Brussels (Belgium) and Trondheim (Norway) in the summer of 2010.

Domestic tourism services have been growing steadily; the current situation is mixed, partly due to the devaluation of the local currency and increased marketing efforts abroad, although the number of tourists travelling to Iceland has been increasing. However, the volcanic activity in the south of Iceland and the ensuing flight disruptions had a negative effect on the local tourist industry.

12.2.1 Route Network: Icelandair ehf.

12.2.1.1 Purpose and Mission Statement

Icelandair ehf. is a key component on the scheduled airline side of Icelandair Group. The Icelandair ehf. mission is to operate a first-rate airline and maintain a reliable quality service through the experience and knowledge gained in over 70 years of operations. Icelandair ehf. aims to be the airline of choice for travel to and from

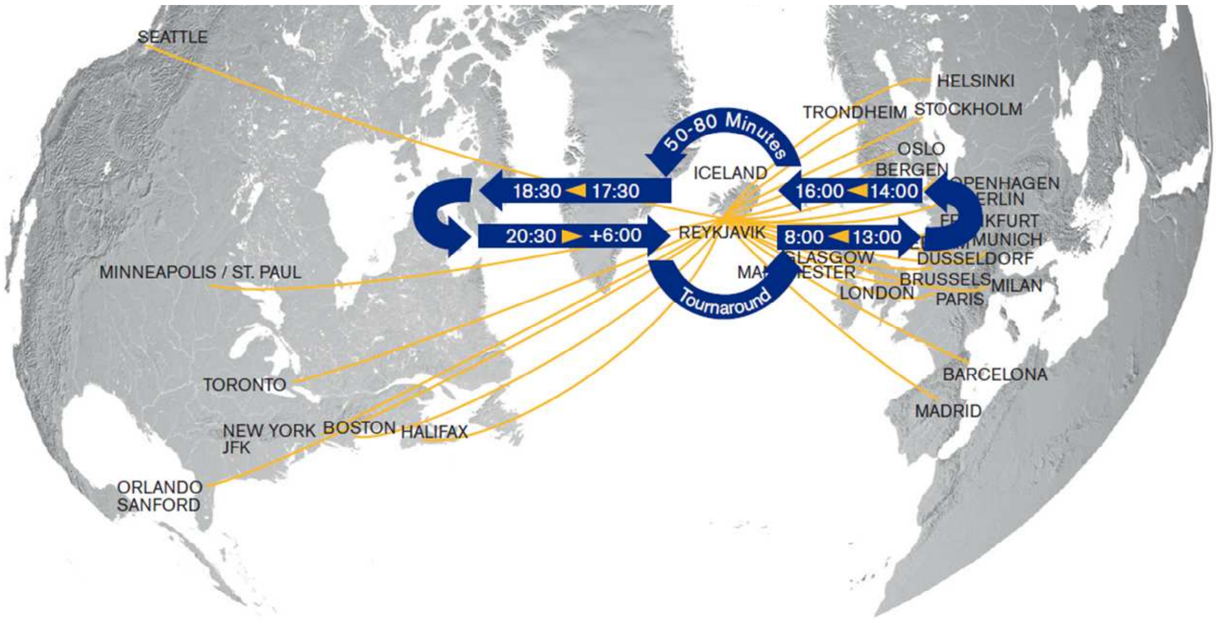
Iceland and a unique and exciting alternative for air travel across the North Atlantic through efficiency and flexibility.

12.2.1.2 Operations

In 2009, Icelandair ehf. carried 1.3 million passengers on its scheduled flights between Iceland, Europe and North America to a total of 25 destinations. In 2010, the company operates a fleet of 13 Boeing 757 aircraft during the summer season for its scheduled operations.

The Icelandair ehf.'s business strategy is based on the geographical position of Iceland on the flight route between northern Europe and North America. By combining in its aircraft, passengers visiting Iceland, passengers departing from Iceland and passengers travelling across the Atlantic via Iceland, Icelandair ehf. has been able to expand its network steadily. Icelandair ehf. has historically connected 15–20 European cities to 5–8 North American cities through the hub in Iceland in its summer schedule. However, 11 destinations in Europe and 4 in North America make up the winter route network for 2010–11. The network is based on a 24-hour rotation with morning and afternoon connections in Iceland.

Item 29. Icelandair ehf. Route Network in 2010



In 2009, Icelandair ehf. introduced Stavanger (Norway), Bergen (Norway) and Seattle (North America) into the network and announced services to Brussels (Belgium) and Trondheim (Norway), beginning scheduled flights in June 2010.

Icelandair ehf. divides its customer base into three main markets:

- *Passengers from Iceland*

  Icelandair ehf. offers Icelandic customers direct scheduled flights to 15–20 destinations in Europe and North America. The routes carrying the most passengers in the network are London, Copenhagen, Oslo, Stockholm and Boston. Demand for travel from Iceland dropped significantly in 2009 following the financial crisis. The Company estimates that passengers from the home market will account for around 20% of Icelandair ehf.'s total passenger numbers in 2010. The Icelandair ehf. frequent flyer program (Vildarklúbbur) has over 150,000 members in Iceland.

- *Passengers to Iceland*

  The number of tourists visiting Iceland grew from 72,000 in 1981 to almost 500,000 in 2009, an increase of about 12% annually.[44] The vast majority of these tourists travel to Iceland with Icelandair ehf. The company has fuelled this increase through the development of a route network with a high frequency of flights to Iceland and through strong marketing efforts in Europe and North America. This market segment has grown both in passenger numbers and proportionally in 2009 as a result of Icelandair ehf. strategy changes due the economic downturn. With the focus firmly on tourism to Iceland, Icelandair ehf. carried a record number of travellers to Iceland in the summer of 2009, and passengers to Iceland accounted for 51% of Icelandair ehf.'s total passenger numbers in 2009.

- *Transatlantic passengers travelling via Iceland*

  Transatlantic traffic is a key factor in Icelandair ehf.'s operation. Due to the immense size of this market and management's estimate of the market share held by Icelandair ehf. (1%), it serves as a gigantic reservoir of passengers. In its "via" marketing, Icelandair ehf. focuses on city pairs with limited direct flights. With its centrally located hub and quick turnaround times at Keflavik International Airport the company is able to offer competitive prices and flying times. Via passengers accounted for 30% of Icelandair ehf.'s total number of passengers in 2009.

12.2.1.3 Marketing Efforts

Icelandair ehf. has experience in selling its products globally on the general consumer market. Among airlines, Icelandair ehf. attracts an unusually high percentage, or about 75% of its customers, from outside its home market. In, 2010 Icelandair ehf. reaches its customers through four main channels:

- *Websites in local languages in all key markets*

  Icelandair ehf. gets approximately 10 million visits per year to the different Icelandair ehf. websites. The Icelandair ehf. website is today the biggest sales channel in the Icelandair ehf. network.

- *Own sales offices in key markets*

  Call-centres are staffed by people who speak the local languages in key markets. Additionally, Icelandair ehf. has agreements with general sales agents in approximately 20 countries all over the world who organise and take care of Icelandair ehf. sales activities in their markets.

- *Sales through more than 12,000 travel agents*

  Icelandair ehf. uses the Amadeus CRS system, which enables travel agents to book tickets with Icelandair ehf. instantly at their offices or on websites.

- *Internet Club*

  600,000 active members receive special offers and information on a regular basis.

[44] See the website of the Icelandic Tourist Board: http://www.ferdamalastofa.is/displayer.asp?cat_id=503

12.2.1.4 Revenue Management and Distribution

The foundation of the distribution of Icelandair ehf.'s products throughout the world is its partnership in the Amadeus booking and distribution engine and numerous interline agreements with other airlines. At the same time, Icelandair ehf. can sell airline tickets and other services with airlines and service providers in all parts of the world.

A key ingredient of a successful airline is its revenue management, the strategy of maximising revenue by controlled booking and pricing. Icelandair ehf. uses a new and advanced revenue management system and has recently added further resources to the management. These implementations have yielded significant revenue improvements.

The company's load factor[45] follows the seasonality in demand. Icelandair ehf. operates more aircraft during the high season and the load factor is highest during the summer peak. In the present economic situation, which has seen worldwide demand dropping, Icelandair ehf. has focused on passenger revenue more than load factors.

12.2.1.5 Flight Operations

Icelandair ehf. operates under an Air Operators Certificate issued by the Icelandic Civil Aviation Authority and is as such considered European Aviation Safety Agency (EASA) compliant. Icelandair ehf. is considered to be an Icelandic carrier and has route rights in accordance with this status.

In addition to aircraft flown on its scheduled network, Icelandair ehf. operates aircraft on behalf of Loftleidir-Icelandic and Icelandair Cargo, thus securing economies of scale. The Group foresees the utilisation of the current aircraft fleet for the next 7–10 years.

Iceland has a long aviation history, and Icelandair ehf. employs experienced aviators. Icelandair ehf.'s current union agreements with its pilots and cabin attendants are valid until the end of 2010.

Icelandair Technical Services provides maintenance and technical services for the Icelandair ehf. fleet and is an integral part of Icelandair ehf. Most of the work is performed at the Service Centre at Keflavik Airport, but maintenance is increasingly carried out abroad because of increased international flight operations.

12.2.1.6 Management

Birkir Hólm Gudnason is the CEO of Icelandair ehf. Mr Gudnason was appointed to his post in June 2008. He finished his BSc degree in business economics and administration in 1998 at Aalborg University, Denmark, and gained an MBA in international business and economics from same university in 2000. He has worked for Icelandair ehf. since then in various management posts in Iceland, the USA and Europe.

12.2.1.7 Recent Changes and Improvements

In reaction to the world wide economic downturn, the banking crisis in Iceland in 2008 and the subsequent turmoil in 2009, Icelandair ehf. has undergone some key changes in the past quarters to strengthen its market position:

- *Trimmed management—streamlined and more efficient organisation*

  Extensive changes were made in Icelandair ehf.'s top management, and the organisation was streamlined significantly with fewer managerial positions.

- *Major cutbacks owing to fuel prices and economic crisis*

  Capacity was cut by 20% from during winter 2007–08 and by approximately 10% in 2009 compared to 2008. The cutbacks meant lay-offs of 380 employees. No major cutbacks have taken place in 2010.

[45] A measure of the amount of utilisation of the total available capacity of a commercial transport vehicle. It is useful for calculating the average occupancy on various routes of airlines.

- *Renovation of fleet with new interiors*

  The interior appearance of the Boeing 757 fleet has been transformed with new seats and personal entertainment systems in all aircraft.

- *New look and a new image of Icelandair ehf.'s services*

  Late in 2008, Icelandair ehf. changed its service concept, launched a new class, Economy Comfort, and made various other changes, such as food services, on–board sales, crew uniforms, etc.

- *Improved day-to-day operations*

  A new network control centre was formed to handle day-to-day route network operations. This has improved punctuality and services.

12.2.1.8 Competition

Icelandair ehf. faces competition in all its markets; however, the company has shown the ability to grow and profit in a competitive environment. Icelandair ehf. is by far the largest operator offering flights between Europe and Iceland. It is one of two airlines that offer scheduled flights between Iceland and North America all year round. Based on this, the management believes that Icelandair ehf. is well positioned to meet increased competition in the market, and it sees an opportunity for Iceland as a travel destination to tap into the large customer base of the foreign airline operators entering the market periodically.

Operating on three different and independent passenger markets (The North Atlantic market, From Iceland market and To Iceland market) gives the company many options in network and revenue management. Apart from marketing and sales efforts, demand for air travel mainly depends on the economy, exchange rates, destination popularity and the cost of flying. Operating in different markets makes the company less vulnerable to fluctuations in demand for any particular market segment. This was firmly established in autumn 2008 and in 2009 when Icelandair ehf. coped successfully with the near collapse of its home market while the To and Via markets flourished.

The company's main competitors in Iceland are Iceland Express and other charter operators. Iceland Express offers daily flights to London and Copenhagen and flights up to twice a week to several other destinations during the peak season as well as offering regular flights to New York. SAS operates a route from Oslo to Iceland several times a week and various carriers, such as Lufthansa, usually operate a few flights to Iceland in the summer peak season. Delta Air Lines recently announced its intention to operate daily flights from JFK in New York to Keflavik commencing in the summer of 2011.

12.2.1.9 Future Strategy

The company's short-term focus is on simplifying processes and products and reducing unit costs within the business model. The improved cost structure has created opportunities, and operational results for the first half of 2010 were better than anticipated in the 2010 budget. Continued emphasis is placed on a lean organisational structure, quick decision making and flexibility as the company works constantly on optimising the route network and looks at new markets.

12.2.2 **Route Network: Icelandair Cargo**

12.2.2.1 Purpose of the Company

Icelandair Cargo is a low-asset company, leasing aircraft and buying capabilities from other sources. The freighters are placed on Icelandair's ehf. Air Operators Certificate (AOC) and crews are leased from Icelandair ehf. Aircraft maintenance, warehousing, cargo handling and part of cargo sales are outsourced.

12.2.2.2 History

Icelandair Cargo was established in late 1999 and is the largest air freight service provider in Iceland.

12.2.2.3 Management

Gunnar Már Sigurfinnsson is the Managing Director of Icelandair Cargo. Mr Sigurfinnsson was appointed to his current position in May 2008. He started at Icelandair Domestic in Vestmannaeyjar, the islands off the south coast of Iceland, in 1986, and in 1994 he became Sales and Marketing Manager for Icelandair Domestic. In 1997, he became Sales Manager for Icelandair ehf. in Germany and was based in Frankfurt. Mr Sigurfinnsson became Director of Sales Planning and Control in 2000, and in 2001 he became General Manager of the Germany, Netherlands & Central Europe region. In 2005 he became the SVP of Sales & Marketing for Icelandair ehf.

12.2.2.4 Operation

The company bases its business on scheduled services between Iceland, Europe and North America supported by charters and wet leases (ACMI). In addition to marketing and selling space on its own freighters, Icelandair Cargo sells the cargo hold space on Icelandair ehf.'s passenger aircraft. Icelandair Cargo has five Boeing 757-200 freighters in its fleet. The company uses 2 cargo aircraft to operate its schedule and three cargo aircraft to operate its ACMI products. The scheduled flights are based on seven flights per week to Liege in Belgium, where five flights operate through East Midlands and one through Humberside (both in the UK) en route to Liege. North America (New York, JFK) is served twice a week from Liege through Iceland. The network of freighter aircraft is enhanced with up to 25 destinations in the Icelandair ehf. passenger network.

12.2.2.5 Market and Current Market Position

Icelandair Cargo is one of the carriers on the To and From Iceland market offering direct services to more than 25 destinations with its own cargo fleet as well as Icelandair ehf. passenger aircraft. The company offers its customers competitive and quick global services through extensive interline and special pro rata agreements with other airlines. The operation is supported by trucking networks in Europe and in the USA. Sales are made by Icelandair Cargo staff in Iceland; New York, USA, takes care of sales for all the Americas. The company has its own subsidiary, Icelandair Logistic, which sees to sales in the Benelux countries, while General Sales Agents (GSAs) oversee other markets. The company has GSAs in all larger and growing markets in Asia and in most countries in Europe.

Approximately 90% of the exports consist of fresh seafood, whereas imports include produce, high-tech products and spare parts. There was a sharp decline in imports into Iceland in 2008 due to the economic crisis, which had an adverse effect on the company's bottom line. As a result, management had to focus on cutting capacity to improve utilisation and put more effort into exports. For a number of years, Icelandair Cargo has carried express freight for TNT, DHL and FedEx to and from Iceland.

12.2.2.6 Recent Changes and Improvements

Since autumn 2008, the Company has increased its focus on the home market instead of focusing on the North American market. The flexibility of the schedule has been increased to meet growing uncertainty in demand:

- Leipzig and Brussels abolished as destinations on cancelation of TNT flights from Liege to New York.
- Reduction in cargo demand met by increasing utilisation of Icelandair ehf.'s passenger flights.

- Available tonne kilometres (ATK) reduced by 45%, leading to a significant lowering of variable cost per flight.

12.2.2.7 Future Strategy

The role of Icelandair Cargo is to be one of the cargo airlines operating to and from Iceland based on its strong network, utilising its strong schedule over the North Atlantic for fill-up freight. Icelandair Cargo is focusing on meeting customer requirements with speed, good services, secure solutions and highly experienced and qualified employees.

12.2.3 **Route Network: Icelandair Ground Services**

12.2.3.1 Purpose of the Company

Icelandair Ground Services (IGS) provides comprehensive airport ground handling services for airlines and passengers at Keflavík International Airport.

12.2.3.2 History

IGS was formed in 2001, but airport and ground operations in Iceland have been a part of the airline operation since the foundation of Icelandair Group's predecessors.

12.2.3.3 Management

The Managing Director of IGS is Gunnar S. Olsen. Mr Olsen was appointed Managing Director when the independent company was formed to handle Icelandair ehf.'s ground services in Keflavík in 2001. He has held various managerial positions within Icelandair Group in Iceland and abroad in recent years.

12.2.3.4 Operation

IGS provides aircraft ground handling services for all types of aircraft, a first-class flight kitchen and bonded stores, a state-of-the-art cargo centre and a restaurant division in the Leifur Eiriksson Air Terminal. All these units are organised and settled as profit-making units.

12.2.3.5 Market and Current Market Position

IGS is a service provider enabling airlines and other customers to obtain all services required through one service provider. IGS competes with two other suppliers of ground handling services at Keflavik Airport (the two suppliers are the companies Vallarvinir ehf. and Sudurflug ehf.) The company has been profitable throughout its history, with the exception of its year of foundation (2001). Icelandair ehf. is by far the largest client of IGS, although the company has also been contracted by other airlines.

12.2.3.6 Recent Changes and Improvements

Since the onset of the global economic turmoil in 2008, the Company has responded by actively reducing the number of employees as well as implementing across-the-board cost reductions, including:

- Number of employees has been reduced by 203 since 2007 representing a 34% decrease that will lead to substantial cost savings going forward.
- Reduction in the number of operating locations and complete overhaul of all computer systems with the aim of increasing efficiency and steadily lowering costs relating to IT and telephones.
- Detailed overview of purchasing methods.
- Renegotiation of lease which has lowered annual rent costs temporarily by 25% on average.

12.2.3.7 Future Strategy

IGS has contracts with most airlines using Keflavik Airport. Opportunities for growth go hand in hand with growth in the number of flights and the number of passengers passing through the airport.

12.3 **Tourism Services**

The business segment Tourism Services comprises the following subsidiaries:

- Air Iceland, a turboprop operator which operates both domestically and internationally to Greenland. The company is in cooperation with the Faroese airline Atlantic Airways and sells seats to the Faroe Islands on flights operated by Atlantic Airways.
- Loftleidir-Icelandic, the capacity solution provider.
- Icelandair Hotels, the domestic hotel chain.
- Iceland Travel, a travel agency, tour operator and destination management company in Iceland.
- Icelease, the aircraft trading arrangement company.
- Icelandair Shared Services (Fjárvakur-fjármálathjónusta ehf.), the accounting and financial support company of the Group.

The main focus of this business segment is international and domestic tourism as well as support functions thereof.

12.3.1 **Tourism Services: Air Iceland (Flugfélag Íslands)**

12.3.1.1 Purpose

Air Iceland is a dynamic airline with the goal of creating a flexible yet powerful airline servicing the West Nordic countries and being responsible for scheduled domestic flights as well as routes from Iceland to Greenland. Air Iceland sells flights to the Faroe Islands all year round on flights operated by the Faroese airline Atlantic Airways.

12.3.1.2 History

Air Iceland was formed in 1997 when Icelandair Domestic merged with Flugfélag Nordurlands; the airline traces its roots back to 1937.

12.3.1.3 Management

The Managing Director of Air Iceland is Árni Gunnarsson. Mr Gunnarsson was appointed to his current position in March 2005. He previously worked as Director of Sales and Marketing at Air Iceland, Managing Director of Ferdaskrifstofa Íslands / ITB, Managing Director of Iceland Travel and as Director of Icelandair Holidays. He worked for the German Tour Operator FTI in Münich as director of Risk Management in 1993–97. Mr Gunnarsson holds an MSc in economics from Augsburg University, Germany.

12.3.1.4 Operations

Air Iceland offers flights to seven destinations within Iceland, thereby covering all major towns as well as a number of the smaller ones. Air Iceland flies from Reykjavík to: Akureyri, Egilsstadir and Ísafjördur. Air Iceland flies from Akureyri to: Grímsey, Thórshöfn and Vopnafjördur.

Air Iceland offers flights to five destinations in Greenland. Air Iceland flies all year round to Kulusuk and to Nerlerit Inaat, both on the east coast of Greenland. During the summer, Air Iceland offer flights to Narsarsuaq, Ilulissat and Nuuk, the capital of Greenland. Air Iceland sells flights to Faroe Islands all year round on flights operated by the Faroese airline Atlantic Airways.

Air Iceland operates six Fokker 50 and two DASH 8-100 aircrafts.

12.3.1.5 Market and Current Market Position

Air Iceland holds a strong position on the Icelandic domestic air transport market and has operated profitably in recent years. Demand has been stable on its main routes and is expected to remain so. The busiest routes are to Egilsstadir and Akureyri. Despite the financial crisis in Iceland in the past months, the frequency of flights on domestic routes has been stable. The total turnover of the company increased in 2009 from the previous year, and the company is showing positive results for the seventh consecutive year.

In 2009, the total number of passengers carried by Air Iceland was approximately 380,000.

12.3.1.6 Recent Changes and Improvements

The company divested its Twin Operations effective from 1 June 2008. A positive result from the sale has materialised, and as a consequence, Air Iceland still bears the fruit of fixed income stemming from the lease of crew and aircraft while it does not bear the risk of their operation.

Air Iceland has renegotiated the vast majority of its fixed contracts with its largest suppliers, including the credit card companies and in relation to servicing the Fokker aircraft.

12.3.1.7 Future Strategy

Air Iceland plans to grow and increase profitability by offering the best possible services to the Icelandic market and the tourism market in Iceland. Demand is good for all destinations in Iceland and in Greenland, the most promising external market. Air Iceland aims to bolster its position as an airline servicing the West Nordic region.

12.3.2 **Tourism Services: Loftleidir-Icelandic**

12.3.2.1 Purpose of the Company

Loftleidir–Icelandic is a capacity solution company for the international passenger airlines and tour operator industries.

12.3.2.2 History

Loftleidir-Icelandic was formed as a subsidiary of Icelandair (Flugleidir—currently Icelandair ehf.) in 2002, although international charter operations had been part of the general operations of the airline and its predecessors for decades. It has developed from being a marketing vehicle operating in the international ACMI (Aircraft Crew Maintenance and Insurance) and charter markets, to become a capacity solution provider. The company has expanded its horizon beyond the aircraft types traditionally operated under the Icelandair AOC.[46]

In early 2006, the Group acquired a majority shareholding in the Latvian charter operator LatCharter Airlines as part of Loftleidir-Icelandic’s strategy of strengthening its position in the Baltic and CIS region and adding the Airbus family into its worldwide ACMI product line. Subsequently, LatCharter (now SmartLynx) was placed directly under the control of the Group and became a sister company of Loftleidir-Icelandic, rather than its subsidiary. Further information on SmartLynx can be found in *Chapter 12.4.2 Discontinued Businesses:* .

12.3.2.3 Management

Gudni Hreinsson has been Managing Director of Loftleidir-Icelandic since 2006. Mr Hreinsson joined Flugleidir in 1997 as a marketing representative in Sales Control and from 2000–03 he worked at The Icelandic Web

[46] Abbreviation for Air Operator Certificates.

Agency. From 2003, he was the Director of Marketing at Loftleidir-Icelandic. Mr Hreinsson holds a bachelor's degree in humanistic informatics and communication from Aalborg University, Denmark.

12.3.2.4 Operation

The company currently operates AM (Aircraft and Maintenance), ACMI (aircraft, crew, maintenance and insurance) and full charter contracts in Europe, Africa, the Middle East and North and South America. Furthermore, Loftleidir-Icelandic has established itself as a business class operator serving one of the most prestigious operators in the USA, A&K (Abercrombie & Kent), by operating first-class flights around the world on which all seats are business class. The Company has four Boeing 757-200 and four Boeing 767-300 aircraft, two of which are operated under Icelandair's AOC.

12.3.2.5 Market and Current Market Position

Despite current difficult market conditions due to the economic slowdown, especially in the wide-body market, wide-ranging aircraft market knowledge has put the company in a good position to place the aircraft in the fleet. Currently, all aircraft are placed on contracts of varying duration. In mid-2003, Loftleidir-Icelandic added its first wide-body aircraft when it introduced a Boeing 767 to its fleet, which opened up new markets. This led to an increase in the proportion of ACMI projects at the expense of all-inclusive projects, which has helped to increase profitability and reduce sensitivity towards external fluctuations. This trend has continued with longer term AM leases becoming ever more prominent in the company's contract portfolio.

The company has had success in establishing itself on the European market and enjoys increasing visibility in both the North and South American markets. Furthermore, the company has been successful in penetrating the CIS (Commonwealth of Independent States) market where demand for western built aircraft continues to grow.

12.3.2.6 Recent Changes and Improvements

The economic downturn has brought new opportunities for Loftleidir Icelandic.

- In 2007, Loftleidir-Icelandic management made a strategic decision to place emphasis on marketing its services to customers operating in those parts of the world where the aviation infrastructure may be considered underdeveloped. Operating in such regions bequeaths more favourable profit margins in line with the increased risk. Additionally these regions that were considered less developed have proven for the most part to be less affected by the global recession.
- The fact that Loftleidir-Icelandic had put so much effort into developing new markets where there remained a requirement for western type aircraft played a vital role in the Groups ability to transfer capacity between sister companies in the autumn of 2008. When Icelandair ehf. prepared for the economic downturn, it became clear that it would face an overcapacity of 1–2 aircraft. These aircraft were subsequently placed by Loftleidir-Icelandic in the Russian Far East and South America.

This illustrates that one of the major strengths of Icelandair Group lies in having different types of companies working in different fields and markets. This gives the Group the ability to turn threats to one subsidiary company into opportunities for another.

12.3.2.7 Future Strategy

Three of the Company's aircraft are located in Venezuela, three in Russia and two in Papua New Guinea. The company is exposed to some counterparty risk due to the concentration of projects in these three countries.

Loftleidir has a contract with SmartLynx regarding the lease of two aircraft, where Loftleidir leases two aircraft from SmartLynx. The contracts are on an arm's length basis and they will not be affected by the divestment of SmartLynx from the Group.

However, Loftleidir-Icelandic currently seeks to use its extensive market knowledge to widen its spectrum of services further, so that continued growth in revenue and profitability can be secured. In addition to the current charter, ACMI and AM operations, the company has increased its brokering activities, both in terms of arranging for third-party dry and wet leases and aircraft brokering.

12.3.3 **Tourism Services: Icelandair Hotels**

12.3.3.1 Purpose of the Company

Icelandair Hotels prides itself on being a reliable quality hotel provider in Iceland, by presenting both an international brand (Hilton Reykjavík) and well established domestic brands (Icelandair Hotels and Edda Hotels).

12.3.3.2 History

The airline Loftleidir started to operate a small hotel at Keflavik Airport in 1962 and built Hotel Loftleidir in 1966 in Reykjavik. After being a part of the airline’s general operations for over 30 years, the hotel arm was turned into a separate and distinct subsidiary in 1998.

12.3.3.3 Management

The Managing Director of Icelandair Hotels is Magnea Thórey Hjálmarsdóttir. Ms Hjálmarsdóttir was appointed in July 2005 having first joined Icelandair Hotels in 1994. She has worked in the hotel industry since 1991 and has held management positions with hotels in Iceland, Switzerland and Japan. She received her MBA from the University of Surrey, England, in 2003

12.3.3.4 Operations

Icelandair Hotels run the Hilton Reykjavík Nordica, 7 Icelandair hotels and 13 Edda hotels. All the hotels, apart from five outside Reykjavik, are fully operated by Icelandair Hotels. They are run in accordance with a franchise agreement which allows them to use the Icelandair Hotels trademark. Edda Hotels is a chain of 13 summer hotels which all sit on the doorsteps of the country’s best natural wonders and historic sites. Most of Edda Hotels’ properties are boarding schools during the winter. Icelandair Hotels rents all the properties that it uses for its operations.

12.3.3.5 Market and Current Market Position

The number of tourists visiting Iceland has grown by more than 88% over the last 10 years according to the Icelandic Tourist Board[47], and Icelandair Hotels has more than doubled its capacity in the last five years. The main competitors of Icelandair Hotels are more centrally located 3 and 4 star hotels in Reykjavik; the main competitors of the countryside hotels are the Foss Hotel chain and Icelandic Farm Holidays. The market has expanded, due to both the growth in tourism in recent years and also increased capacity.

12.3.3.6 Recent Changes and Improvements

The management of the company has taken direct measures in the last 18 months to increase operational efficiencies.

- Measures have been taken to secure the company’s continued strong position by signing on two new hotel properties in the city centre, as well as planning to expand the network in the countryside.
- The management of Icelandair Hotels has renegotiated all contracts with suppliers, and company-wide cost control measures have been put in place.
- To significantly reduce maintenance costs, the management has renegotiated almost all contracts relating to maintenance, resulting in lower costs.

[47] See http://www.ferdamalastofa.is/displayer.asp?cat_id=503

- Effective online and Channel Management—new websites launched as business is shifting from travel agents to on line. Emphasis on own production resulting in direct bookings.
- Reinforced cooperation with biggest clients: Iceland Travel and Icelandair ehf.

12.3.3.7 Future Strategy

With a clear focus on cost and aggressive marketing, Icelandair Hotels expects to return to profitability this year and grow over the next few years. It is looking closely at developments in Reykjavik with the intention of being an active partner in hotel operations in the city centre.

12.3.4 **Tourism Services: Iceland Travel**

12.3.4.1 Purpose of the Company

Iceland Travel is among the largest travel agencies, tour operators and destination management companies in Iceland, offering a wide range of high quality services for travellers from all over the world. Iceland Travel organises various vacation packages, scheduled tours, day tours and activities, as well as planning conferences, events and incentive programs.

12.3.4.2 History

For over 30 years, the company has grown and prospered. Iceland Travel is a member of many domestic and international associations, including the Icelandic Travel Industry Association, the Iceland Convention and Incentive Bureau, the United States Tour Operators Association (USTOA), the Japan Association of Travel Agents (JATA), and many more.

In August 2008, a new outgoing department, VITA,[48] was launched within Iceland Travel. Its goal is to take advantage of opportunities that arise through the company's partnership with Icelandair ehf.

Despite operating under difficult circumstances in Iceland, mainly due to the ongoing economic recession, VITA has grown steadily in its first year, multiplying its number of employees and customers.

12.3.4.3 Management

Managing Director of Iceland Travel is Helgi Eysteinsson. Mr Eysteinsson came to the company in June 2008 after having formerly worked as Sales and Marketing Director for outgoing tour operator, Úrval Útsýn, when the company was owned by Icelandair ehf.'s predecessor, Flugleidir. Mr Eysteinsson received a degree in business administration from The University of Iceland in 1999.

12.3.4.4 Organisation

Iceland Travel has five profit units and two supporting units. Three profit units focus on the leisure market and one focuses on the MICE (Meetings -Incentives -Conferences -Events) market. One profit unit focuses on Icelanders travelling abroad.

12.3.4.5 Operation and Market Position

Iceland Travel produces, markets, distributes and sells package tours to foreign tourists in Iceland. It specialises in advanced services and working with almost all licensed vendors operating in the tourist industry in Iceland, from car rentals to hotels and accommodation providers, professional guides, etc. Iceland Travel's well-educated, experienced and creative team is the key to its high standards of service and successful operation. The aim is to offer high quality services at competitive prices at all times.

[48] Further information can be found on http://www.vita .is

Iceland Travel provides travel and MICE services in Iceland. The focus is on profitable packages and increasing focus on internet sales channels. About 75% of Iceland Travel's customers are contracted customers, foreign travel wholesalers and Icelandic companies and institutions.

VITA's mission is to offer a variety of leisure tours to Icelanders travelling abroad through a high quality service offered at a competitive price. VITA takes advantage of opportunities that arise through the company's partnership with Icelandair ehf., thereby offering a secure and attractive option for Icelanders seeking services and assistance for organised groups and individual tours such as vacation tours, golf and ski trips and city breaks.

12.3.4.6 Recent Changes and Improvements

The management of Iceland Travel has directed its focus towards lowering fixed costs, e.g. rent and office costs.

- The company has focused on lowering salaries and expenses both by amending the work schedules of its employees as well as by reducing the number of summer personnel.
- As demand for Iceland Travel's key products has been declining, it was decided to place emphasis on servicing the incoming cruise ship market. Following intensive sales and marketing efforts, Iceland Travel has gained significant revenue growth from cruise ship operations.

12.3.4.7 Future Outlook and Strategy

Iceland Travel is focusing its attention more effectively on using the Internet as a sales channel, on highlighting products that have the highest margins, such as high-end conference and incentive markets, and on new markets such as the Far East (China).

MICE units will focus more intensively on the events market and will be approaching the domestic corporate market with new services. This will entail a higher quality of service and greater emphasis on sales and marketing, as well as a stronger focus on higher-margin projects and clients. The leisure outlook for 2010 is promising in the opinion of Iceland Travel's management.

Iceland still has a great deal of potential as a destination for tourists, conferences and incentives, as the infrastructure is improving. New hotels, routes, places and activities are being brought to the market, and the knowledge needed to provide a professional service to the market is developing. Iceland Travel's mission is to lead that market growth.

12.3.5 **Tourism Services: Icelease and IG Invest**

12.3.5.1 Purpose of the Company

Icelease and IG Invest are aircraft trading arrangement companies which tie together and utilise the knowledge, experience and business contacts within Icelandair Group in the business of buying, selling and leasing aircraft.

12.3.5.2 History

Icelease was formally founded in early 2005 as a separate business unit specialising in aircraft trading. IG Invest was established in April 2006 as a holding company for Icelease assets.

12.3.5.3 Management

Kári Kárason is the Managing Director of Icelease and IG Invest. Mr Kárason was appointed Managing Director of Aircraft Trading and Leasing on 1 June 2006. He joined the Group in 1994 and was most recently the CFO of Icelease. He holds a cand.oecon degree from the University of Iceland.

12.3.5.4 Operation

Whenever Icelease arranges an aircraft purchase, a new limited liability company a Special Purpose Vehicle (SPV), a.k.a. Special Purpose Company, is set up in co-operation with outside investors. Icelease manages a special holding company, IG-Invest, which again holds the shares of the SPVs. Icelease aims to lease the aircraft to financially sound airlines on a long-term lease agreement that fully covers the aircraft investment company's operations. The SPVs will eventually be sold out of Icelandair Group with the attached leasing contract when market conditions are right, with the aim of yielding a profit. By attaining long-term lease agreements, the company increases the likelihood of being able to exit when the market cycle is favourable. Additionally, Icelease arranges back-to-back aircraft trading, where aircraft are sold immediately upon purchase, thereby eliminating the need for the SPV structure.

The rate of return on aircraft leasing is most sensitive to the purchase price and residual value of an aircraft when it is sold off. Aircraft prices are cyclical due to the fact that supply is mostly fixed while demand changes frequently; also, the residual value of an aircraft is influenced by its age and characteristics, airline preferences and regulations.

Icelease has been involved in 32 aircraft transactions (26 purchases and 6 sales) since its foundation. These deals have so far taken place in Europe and in Asia.

The current portfolio consists of six passenger aircraft and 4 future deliveries of passenger aircraft with an additional three purchase options.

Following the financial restructuring, Icelandair Group will continue to own and manage IG Invest, but it will be controlled by an SPV, a special purpose vehicle, (hereinafter "SPW ehf.") incorporated by the Resolution Committee of Glitnir Bank and Íslandsbanki. However, Icelandair Group has made an agreement with SPW ehf., which will receive economic benefits from IG Invest. The total proceeds to Icelandair Group from the sale of Bluebird Cargo, Travel Service, and the economic benefits of IG Invest to SPW ehf. amount to ISK 7.6 billion. The ISK 7.6 billion in proceeds contributes to reducing the debt of Icelandair Group by ISK 7.6 billion. There is no cash contribution involved in the asset divestment.

If SPW ehf. receives more than ISK 7.6 billion, in addition to interest amounting to REIBOR + 3%, from its assets when it sells them before September 2015 (Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group will receive 50% of any potential yield that is higher than ISK 7.6 billion. On the other hand, if SPW ehf. receives a lower amount than ISK 4.0 billion before September 2015 from the sale (of Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group must pay SPW ehf. ISK 0.5 billion. The contracts state that if SPW ehf. has not sold its assets before September 2015, the banks can extend the period until September 2017.

For further information about the future of IG-Invest, see *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

12.3.5.5 Market and Current Market Situation

Aircraft leasing is a large-scale worldwide branch of financial services. During the past 25 years, the number of aircraft owned by leasing companies has been on the rise. Both the world fleet of aircraft and the proportion of the fleet owned by leasing companies have increased in size. According to IATA, about 35% of the world's commercial fleet is owned by leasing companies.[49] Aircraft are critical assets for airlines and they pay about USD 115 billion annually in leases. Many companies have recognised opportunities to enter the aircraft leasing business. These companies include General Electric, Daimler Chrysler and Royal Bank of Scotland.

[49] For further information, visit: http://www.iata.org/NR/rdonlyres/E8540392-628B-41E8-B094-154209398078/0/OlmosMancilla_Financing.pdf

12.3.5.6 Future Strategy

Icelease is aware that the success of its operations is highly dependent on the market cycle. The company intends to utilise the market cycle to maximise its return on equity. The company seeks long-term leasing contracts on its aircraft, preferably 5–10 year contracts, except in cases when the market is very weak. Having a long-term contract on the aircraft increases the odds that the market will peak while the asset is under contract. In order to be able to sell an asset with an attached leasing contract in a peak market, the company needs to discount it to make up for the difference between current market leasing rates and the contract lease rate. It is difficult to time the market peak, and therefore the company reduces its overall risk by entering into long-term contracts instead of running the risk of a contract expiring when the market is at a low and no lessee can be found.

The company will actively search for equity partners in its aircraft investments. The company ideally wishes to have less than a 50% stake in each investment.

12.3.6 **Tourism Services: Icelandair Shared Services**

12.3.6.1 Purpose of the company

Icelandair Shared Services handles accounting, reporting and salary processing for the companies within Icelandair Group.

12.3.6.2 History

Icelandair Shared Services was established in 2002.

12.3.6.3 Management

The Managing Director of Icelandair Shared Services is Magnús Kr. Ingason. Mr Ingason has been the General Manager of the Company Shared Services since its incorporation at year end 2002. He joined Flugleidir in 1998 and was previously Director of Flugleidir's accounting department. Mr Ingason received his cand.oceon from the University of Iceland in 1993 and became a certified public accountant in 1999.

12.3.6.4 Operations

Icelandair Shared Services operates a support department for finances with the shared services concept as a cornerstone and was one of the largest companies in Iceland specialising in this area of business. This service involves accounting, collection, payments, payroll, tax reporting and preparation of financial statements, in addition to other specialised services for managers of the group.

12.3.6.5 Future Strategy

Icelandair Shared Services aims to continue process-smoothing and simplification with unit-cost reduction as a main target and to push forward timelines for publication of financial data, both internal and external, in order to increase the value of financial information within the Group.

12.4 **Discontinued Businesses**

The Board of Icelandair Group has decided to simplify the Group's business model in order to reflect a change in the business environment. The future focus of Icelandair Group will be on the operations of Icelandair ehf., Icelandic Tourism and the *Hub and Spoke* concept as well as related services. Under the new plan, discontinued businesses will be divested.

All three companies that were acquired in the years 2005–08 were never fully integrated into the operations of Icelandair Group Therefore, there has been no material synergy between the three companies and the Group.

Other subsidiaries of the Group have been part of the business model and partly operate, for example, using the same information systems and the same Aircraft Operation Certificate and under the same flight operation unit. Bluebird Cargo, SmartLynx and Travel Service have never been part of these integrated operations.

Discontinued businesses comprise:

- *Bluebird Cargo*
    - In the Group's consolidated balances sheet for the period ended 30 June 2010 the company was categorised as assets and liabilities held for sale.
    - Bluebird Cargo is part of the Group's consolidated income statement for the period ended 30 June 2010 and directly affects the EBITDA of the Group.
    - The total operating income of Bluebird Cargo for the years 2007, 2008, 2009 and the first six months of 2010 amounted to ISK 2.7 billion, ISK 4.5 billion, ISK 5.1 billion and ISK 2.4 billion, respectively.
- *SmartLynx*
    - In the Group's consolidated balance sheet for the period ended 30 June 2010, the company was categorised as assets and liabilities held for sale.
    - SmartLynx is categorised as a discontinued business and is not part of the Group's consolidated income statement for the period ended 30 June 2010 and does not directly affect the EBITDA of the Group.
- *Travel Service*
    - In the Group's consolidated accounts for the period ended 30 June 2010, the 30% share of the company was categorised as assets and liabilities held for sale.
    - Travel Service is categorised as a discontinued business and is not part of the Group's consolidated income statement for the period ended 30 June 2010 and does not directly affect the EBITDA of the Group.

For further information on the financial restructuring of the Group, see *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

12.4.1 **Discontinued Businesses: Bluebird Cargo**

12.4.1.1 Purpose of the Company

Bluebird Cargo is a transportation services provider, operating a fleet of narrow-body freighter aircraft, an air cargo sales agency, and related peripheral services.

12.4.1.2 History

Founded in the 2000, Bluebird Cargo commenced flight operations in March 2001 with a single Boeing 737-300 freighter aircraft. Services were initially offered on a route from Iceland, via the UK, to Cologne, Germany, in co-operation with the international express parcel company United Parcel Service, UPS. The operation grew steadily by one aircraft per year and by early 2005, Bluebird Cargo was operating five B737-300 freighter aircraft. Bluebird Cargo was acquired by the FL Group in 2005 and subsequently became part of the Icelandair Group.

12.4.1.3 Management

Skúli Skúlason is the General Manager of Bluebird Cargo. Mr Skúlason worked for Flugflutningar, a Cargo GSA company, from 1995 until the company was merged with Bluebird Cargo in 2006, first as Station Manager and then as Managing Director from 1996. Mr Skúlason was appointed Managing Director of Bluebird Cargo in February 2008. He received a degree in mechanical engineering from the University of Iceland in 1991.

12.4.1.4 Operations

In addition to air freight services to and from Iceland, Bluebird Cargo operates aircraft on a wet lease basis. The wet lease part of the operation accounts for approximately two thirds of the total revenue, with the remaining 30% generated by the carriage of general cargo to and from Iceland. The main general cargo clients of Bluebird Cargo are Icelandic freight forwarders, most major international freight forwarders and many large Icelandic exporters.

12.4.1.5 Market and Current Market Position

Bluebird Cargo has carved out a niche operating short-haul freighter flights in time-sensitive markets within Europe. As such, the company enjoys a fairly favourable market position. The target customer group consists of express service companies, post offices and airlines operating their own overnight networks within Europe. Competition within this segment is mostly limited to other European airlines operating freighter aircraft of similar size and capacity, of which there are not many.

12.4.1.6 Future Strategy

The future growth strategy of Bluebird Cargo is based on a two-pronged approach to the market. On the one hand, potential lies in providing aircraft and air freight capacity to the various segments of the air freight industry on a global basis, including wet lease services to other airlines, contract operations for freight forwarders, and dedicated services to express parcel corporations. On the other hand, the company will continue to grow with the Icelandic air freight market, building on the strengths outlined above.

12.4.2 Discontinued Businesses: SmartLynx

12.4.2.1 Purpose of the Company

Smart Lynx is a charter and wet lease airline based in Riga, Latvia. The company has an Air Operators Certificate issued by the Latvian Civil Aviation Authority (LCAA). Latvia is a member of the European Union (EU) and the LCAA is a full member of the European Aviation Safety Agency (EASA). As a result SmartLynx has full traffic rights within the EU.

12.4.2.2 History

The company was founded by a team of Russian and Latvian pilots and engineers in 1996 under the name of LatCharter. At the start, the company operated Russian built equipment such as TU-134 aircraft on ACMI and charter bases within Europe. A decision was made in 2002 to modernise the fleet and introduce Airbus A320 aircraft. The Icelandair Group acquired a majority shareholding in the company in 2006 and subsequently purchased the remaining shares in 2007. In 2007, the company introduced B767-300ER into the fleet. These aircraft were the first wide body aircraft to be registered in Latvia. The company was rebranded as SmartLynx in September 2008.

12.4.2.3 Management

Ómar Benediktsson is the CEO of SmartLynx. Mr Benediktsson was the CEO of Islandsflug from 1997 until 2004 when the company merged with Air Atlanta Icelandic and he became the CEO of the joint company. He was the Managing Director of Island Tours in Germany 1986–92 and was subsequently involved in several companies as an investor and a board member. Mr Benediktsson was one of the founders of Icelandair Group Holding hf. when it was established in October 2006. He holds a degree in business administration from the University of Iceland.

12.4.2.4 Operations

In 2009, SmartLynx had ten aircraft in operation: two B767-300ERs and eight A320-200s. SmartLynx offers three forms of service. The company operates air charter services for tour operators in the domestic market in Latvia, wet-lease projects in Europe and South America and dry-lease projects, including maintenance.

12.4.2.5 Current Market Position

SmartLynx is focused on two different markets: the local outbound tourist market in Latvia and the international ACMI market. The local tourist market in Latvia has collapsed in the last year due to an unprecedented financial crisis in the country. Despite this fact, SmartLynx still has sufficient work for one aircraft operating in Riga. All other aircraft in the SmartLynx fleet are based abroad. Most of these aircraft are operated under the SmartLynx AOC and are leased with crew and maintenance. Two units however are leased with partial maintenance support only.

12.4.2.6 Recent Changes and Improvements

In reaction to the worldwide economic downturn and the banking crisis in Iceland in 2008, Smart Lynx has undergone some key changes in the past 12 months to strengthen its position:

- *Management changes:* Mr Ómar Benediktsson has replaced Mr Gardar Forberg as CEO. Mr Thórir Kristinsson has replaced Mr Marko Halla as VP Maintenance.
- *Commercial restructuring:* Commercial responsibility for the B767 fleet has been transferred to Loftleidir-Icelandic and focus put on Airbus operations. A subsidiary company has been established in Italy in order to take advantage of the current gap in the Italian market following the demise of Alitalia and Myair.
- *Operational developments;* The maintenance department has been restructured following the appointment of Mr Kristinsson and all supplier contracts have been renegotiated to take into consideration the lower utilisation resulting from the drop in demand due to the current economic climate.

12.4.2.7 Future Strategy

Smart Lynx will continue to focus on both the domestic market and projects further afield. It is foreseen that demand in Latvia will be slow for the coming season but it is the opinion of the management that this will be counter-balanced by an increase in demand in other parts of the world, particularly South America and Africa.

SmartLynx has been experiencing financial difficulties since the autumn of 2008. To meet the financial challenges, the company has amended its lease agreements. Guaranteed lease amounts have been lowered to USD 19.7 million at the end of June 2010. The guarantees given by SmartLynx are in regard of lease payments on aircraft. If SmartLynx cannot pay its lessors, the guarantees will fall on Icelandair Group That could happen if SmartLynx could not lease its unused aircraft to another company.

Loftleidir has a contract with SmartLynx regarding the lease of two aircraft, whereby Loftleidir leases two aircraft from SmartLynx. The contracts are on an arm’s length basis and they will not be affected by the divestment of SmartLynx from the Group.

The single largest factor in the decision making process regarding the future of the operations of SmartLynx is the parent guarantee that currently amounts to USD 19.7 million. It is the opinion of the management and the Supervisory Board of Directors of SmartLynx that the most viable way forward is to continue the operations of SmartLynx and re-evaluate the decision on a monthly basis going forward. This opinion is based primarily on financial considerations since a shutdown of the operations of SmartLynx at the current point in time would not rid the parent company of the guarantees it has undertaken.

However, there remains a threshold for which a different route must be taken, e.g. if:

- The financial projections for 2010 do not materialise and become adversely affected by the economic turmoil in Latvia and if further contract cancelations occur.
- If such an event were to arise, it would only take approximately one month to close down the operations of SmartLynx.

The management will continue to work on eliminating the parent company guarantee through negotiations.

12.4.3 **Discontinued Businesses: Travel Service**

12.4.3.1 Purpose of the Company

Travel Service is the biggest Czech private air carrier and one of the fastest growing charter airline companies in Central Europe. Travel Service providing charter flights, scheduled low cost flights under the Smart Wings brand, ACMI leases and private flights. The company has an Air Operators Certificate issued by the Czech Civil Aviation Authority (CCAA). The Czech Republic is a member of the European Union (EU) and the CCAA is a full member of the European Aviation Safety Agency (EASA). As a result Travel Service has full traffic rights within the EU.

12.4.3.2 History

Travel Service was founded in 1997 to service the Czech charter market using TU-154 aircraft. Western equipment was introduced the following year with a Boeing 737-400. A new fleet was introduced in 2000 when Travel Service became the first airline in Eastern and Central Europe to take delivery of new generation B737-800 aircraft. The company continued to grow rapidly, established a subsidiary in Budapest in 2001 and moved into new headquarters at Prague Airport in 2003. In 2004, a new subsidiary, SmartWings, started low-cost flights using the Travel Service fleet.

In 2007, a 50% share of Travel Service, the largest privately owned airline in the Czech Republic, was acquired by Icelandair Group. Travel Service became an associate member of the Group as of November and became a subsidiary and was included in the consolidated interim financial statements as of April 2008.

In 2008, Icelandair Group increased its share in Travel Service by 30% to hold a total of 80% of the share capital in Travel Service. Later that year, Icelandair Group divested a 14% share in Travel Service and held a 66% share at year-end 2008.

In 2009, a share capital increase in Travel Service diluted Icelandair Group’s share in Travel Service to 50.1% from the previous 66%. The Company sold a 20.1% share in Travel Service in November and now holds a 30.0% share in Travel Service.

12.4.3.3 Management

Roman Vik is the CEO of Travel Service. Mr Vik graduated from the University of Economics, Prague. Following graduation, he worked for TOSHIBA Europe as an exclusive representative in the computer technique area until he founded Travel Service airlines in 1997.

12.4.3.4 Operation

The business model of Travel Service is designed to adapt to the changes in local demand by combining the Central European summer leisure market and counter-cyclical ACMI markets around the world.

During the summer months, the primary focus of Travel Service is to provide charter flights in Central Europe, along with scheduled low cost flights under the Smart Wings brand. This operation is based in Prague, Warsaw, Katowice and Budapest. Because of the cyclical nature of the European holiday market, Travel Service redeploys part of the aircraft fleet for seasonal ACMI leases during the winter months. In 2008, aircraft were placed in Canada, Vietnam, Ukraine, Greece, Italy and Tajikistan. The Travel Service fleet in 2009 comprised 13 modern Boeing 737 aircraft (eleven Boeing 737-800s and two Boeing 737-500s) and two modern business jet Cessna 680 Citation Sovereigns. In addition, Travel Service leased one Airbus A320 from its sister company SmartLynx and one B767-300ER from its sister company Loftleidir-Icelandic.

12.4.3.5 Market and Current Market Position

Travel Service operates both in the Central European charter market and in the global ACMI market as well as the Eastern European and Commonwealth of Independent States (CIS) VIP corporate jet segment.

12.4.3.6 Recent Changes and Improvements

During the slowdown of the economy in Europe, many of the main rivals of Travel Service have ceased operating. This is true both in the low-cost and charter business.

- As a result, gaps have appeared in the market and Travel Service has been able to successfully exploit these opportunities. As an example, two aircraft have been placed in the Spanish market following the demise of Futura Airlines, while aircraft are being added to the Smart Wings fleet following the bankruptcy of SkyEurope.
- This type of organic growth has also extended into the neighbouring market of Poland, where a new operation has been set up to better serve that market.

12.4.3.7 Future Strategy

The company is focused on achieving internal growth in its core markets of charter flights in Europe and VIP flights in the CIS market. It is the opinion of the management that the company is well placed to take advantage of the opportunities created by the recent fall in demand and the consequently lower lease rates on aircraft and other elements necessary for the operation.

13 LITIGATIONS

Icelandair Group has no governmental, legal or arbitrational proceedings, including any such proceedings which are pending or threatened, of which the Group is aware, during the period covering the previous 12 months which may have, or have in the recent past had significant effect on the Group and/or the Group's financial position or profitability.

14 OPERATING ASSETS

14.1 Aircraft, Buildings and Equipment

The information on aircraft, buildings and equipment are published in accordance with the audited financial statements as of 31 December 2009, as no material changes have materialised since year end 2009 as is discussed in what follows. Financial information on 30 June 2010 has been reviewed by the auditors of the Group; all financial information on year-end 2009 has been audited.

Item 30. Icelandair Group's aircraft, buildings and equipment as of 31 December 2009

(mISK)	Aircrafts and flight equipment	Buildings	Other property and equipment	Total
Cost				
Balance at 31 December 2008	38,830	3,443	2,798	45,071
Additions during the year	1,941	47	238	2,226
Sales and disposals during the year	-1,555	0	-58	-1,613
Exchange rate difference	1,162	74	18	1,254
Assets classified as held for sale	-8,835	-897	-294	-10,026
Balance at 31 December 2009	**31,543**	**2,667**	**2,702**	**36,912**
Depreciation and impairment losses				
Balance at 31 December 2008	7,043	356	874	8,273
Depreciation for the year	4,055	141	415	4,611
Depreciation for the year of discontinued operations	150	35	43	228
Sales and disposals during the year	-1,085	0	-49	-1,134
Exchange rate difference	371	4	9	384
Assets classified as held for sale	-2,228	-74	-162	-2,464
Balance at 31 December 2009	**8,306**	**462**	**1,130**	**9,898**
Net				
At 1 January 2009	31,787	3,087	1,924	36,798
At 31 December 2009	**23,237**	**2,205**	**1,572**	**27,014**
Depreciation ratios	5–25%	2–6%	13–33%	

No major investments in aircraft or buildings was made in 1H 2010 apart from reclassification of the Siglo[50] aircraft amounting to ISK 4.1 billion. There are no plans for changes in planned material tangible fixed assets, including leased properties, or changes in any major encumbrances thereon. The balance of aircraft, buildings and equipment as of 30 June 2010 was at ISK 30,391 million and is explained in the following table.

Item 31. Aircraft, buildings and equipment—development in the first six months of 2010 (mISK)

Balance 1 January 2010	27,014
Additions in 1H 2010	1,072
Reclassification of Siglo aircraft	4,182
Depreciation	-2,647
Exchange rate difference	770
Balance at 30 June 2010	**30,391**

[50] SIGLO aircraft comprise three Boeing 757-200 aircraft that are part of IG Invest ehf. a subsidiary of Icelandair Group hf.

14.2 **Buildings**

On 30 June 2010, the book value of Icelandair Group buildings amounted to ISK 1,796 million and total lease obligations amounted to ISK 5,729 million. The most significant buildings are listed in the table below.

Item 32. Icelandair Group's material buildings, as of 30 June 2010

	Book Value (mISK)
Hótel Nordica, Sudurlandsbraut 2, Reykjavík	Leased
Hótel Loftleidir, Reykjavik Airport, Reykjavík	Leased
Hótel Hérad, Midvangi 5–7, Egilsstadir	Leased
Icelandair Sales Office, Boston, USA	Leased
Icelandair Sales Office, London, UK	Leased
Icelandair Sales Office, Copenhagen, Denmark	Leased
Icelandair Sales Office, Frankfurt, Germany	Leased
Maintenance hangar at Keflavík Airport	632
Freight centre at Keflavik airport	339
Office building at Reykjavik Airport	271
Service building at Keflavik Airport	204
Hangar 4 and other buildings at Reykjavik Airport	234
Skútuvogur 13A, Reykjavík	116
Total	**1,796**

14.3 **Aircraft and Flight Equipment**

The total fleet of Icelandair Group's subsidiaries is 34 aircraft. The fleet is listed in the table below. The table excludes the aircraft of Bluebird Cargo and SmartLynx as these two companies are classified as assets held for sale in the consolidated balance sheet on 30 June 2010. Information on the assets of Bluebird Cargo and SmartLynx are discussed in *Chapter 14.5 Operating Assets Held for Sale.*

Item 33. Entire fleet of Icelandair Group as of 30 June 2010

	Total	Icelandair	Icelease Icelandair	Icelandair Cargo	Loftleiðir Icelandic	Air Iceland
Boeing 757-200	**21**	9	3	5	4	
Boeing 757-300	**1**	1				
Boeing 767-200	**4**				4	
Fokker F-50	**6**					6
Dash 8-100	**2**					2
Total	**34**	**10**	**3**	**5**	**8**	**8**

On 30 June 2010, the book value of all owned aircraft and flight equipment amounted to ISK 26,781 million. Total lease obligations relating to aircraft and flight equipment were ISK 31,391 million. No material changes have occurred in the value of owned aircraft since 30 June 2010, and no material changes have been on the value of lease obligations since 30 June 2010.

Item 34. Own aircraft as of 30 June 2010

Own Aircraft	
Icelandair	4 - B757-200
Icelandair	1 - B757-300
Air Iceland	6 - Fokker
Air Iceland	2 - Dash
IG Invest/Icelandair	3 - 757-200
Total #	**16**

Item 35. Leased aircraft as of 30 June 2010

Leased Aircraft	
Icelandair	5 - B757-200
Icelandair Cargo	5 - B757-200
Loftleidir - Icelandic	4 - B757-200
Loftleidir - Icelandic	4 - B767-200
Total #	**18**

14.4 Other Operating Assets

The combined value of all operating assets, excluding buildings, aircraft and flight equipment amounts to ISK 1,101 million on 30 June 2010.

Item 36. The most significant operating assets as of 30 June 2010

	Book Value (mISK)
Interiors and equipment at Nordica Hilton Hotel	311
Interiors and equipment at Loftleidir Hotel	92
Interiors at office building at Reykjavík Airport	265
Interiors at Keflavík Airport	124
Airport equipment at Keflavík Airport	211
Artwork and paintings	98
Total	**1,101**

14.5 Operating Assets Held for Sale

The following table shows own aircraft owned by Bluebird Cargo on 30 June 2010, a total of one Boeing 737-300 and two Boeing 737-400. These three aircraft are classified as assets held for sale in the consolidated balance sheet on 30 June 2010. SmartLynx does not own any aircraft.

Item 37. Own aircraft held for sale of 30 June 2010

Own Aircraft	
Bluebird	1 - B737-300
Bluebird	2 - B737-400
Total #	**3**

Bluebird Cargo and SmartLynx together lease 12 aircraft. Bluebird Cargo leases 3 Boeing 737-300 aircraft and one Boeing 737-400 aircraft. SmartLynx leases 8 Airbus 320 aircraft.

Item 38. Leased aircraft held for sale as of 30 June 2010

Leased Aircraft	
Bluebird	3 - B737-300
Bluebird	1 - B737-400
SmartLynx	8 - Airbus 320
Total #	**12**

14.6 Major Encumbrances

In some of the loan and financing agreements of Icelandair Group, there are negative covenants which could place impediments to and constraints on the Company's operations and its assets. Íslandsbanki has a mortgage on all of the Group's buildings listed in Item 32, and different lenders have pledges in all of the Group's own aircraft listed in Item 34. For further information, refer to *Chapter 25.3 Liquidity Risk and Covenants in Loan Contracts.*

In addition to these specific encumbrances, many loan agreements include claims of no encumbrances over any part of present and future assets, no further material borrowings, off-balance-sheet funding or guarantees and no merger, consolidation or joint ventures.

All of these issues need the prior consent of the lender. Further items include prohibition of extraordinary dividends or distributions, share buyback, certain methods of disposal of material assets and negative pledges.

15 THE GROUP

Icelandair Group is the parent company of thirteen subsidiaries listed in the following table, which comprise the Group. They are all included in the consolidated financial statement of the Group as of 30 June 2010. The table sets forth certain information regarding these subsidiaries as of 30 June 2010. The proportion of ownership is the same as the proportion of voting power held. For numbers of employees by subsidiary, see the next chapter. The subsidiaries in turn own 25 subsidiaries that are all included in the consolidated financial statements.

Brand Name *Legal Name* *ID Number* *Address*	*Ownership* *Managing Director* *Operations*

15.1 Continued Operations

Air Iceland	
Flugfélag Íslands ehf.	100%
530575-0209	Árni Gunnarsson
Reykjavik Airport, 101 Reykjavik, Iceland.	Scheduled domestic carrier, sells flights to the Faeroe Islands and operates scheduled flights to Greenland.
Iceland Travel	
Iceland Travel ehf.	100%
410791-1379	Helgi Eysteinsson
Skútuvogur 13a, 104 Reykjavik, Iceland.	Tour operator and travel agency in incoming and outgoing tourism.
Icelandair	
Icelandair ehf.	100%
461202-3490	Birkir Hólm Gudnason
Reykjavik Airport, 101 Reykjavik, Iceland.	International full-service airline with hub in Iceland.
Icelandair Cargo	
Flugleidir-Frakt ehf.	100%
471299-2359	Gunnar Már Sigurfinnsson
Brautarholt 10–14, 105 Reykjavik, Iceland.	Logistics company, leasing and outsourcing space, handling and sales.
Icelandair Ground Services (IGS)	
Flugthjónustan Keflavíkurflugvelli ehf.	100%
551200-3530	Gunnar Olsen
Keflavik Airport, 235 Reykjanesbær, Iceland.	Ground handling for airlines and passengers at Keflavik Airport.
Icelandair Hotels	
Flugleidahótel ehf.	100%
621297-6949	Magnea Thórey Hjálmarsdóttir
Reykjavik Airport, 101 Reykjavik, Iceland.	Markets and operates two hotel chains and a flagship Hilton hotel.
Icelandair Shared Services	
Fjárvakur-fjármálathjónusta ehf.	100%
521202-2620	Magnús Kr. Ingason
Reykjavik Airport, 101 Reykjavik, Iceland.	Handles the accounting, reporting and salary processing for companies within Icelandair Group and also offers services to third parties.

Icelease

Icelease ehf.	100%
670505-0140	Kári Kárason
Reykjavik Airport, 101 Reykjavik, Iceland.	Buying, selling and leasing aircraft. Arrangement of aircraft trading transactions.

IG Invest

IG Invest ehf.	100%
490905-0730	Kári Kárason
Reykjavik Airport, 101 Reykjavik, Iceland.	Buying, selling and leasing aircraft. Arrangement of aircraft trading transactions.

Loftleidir-Icelandic

Loftleidir-Icelandic ehf.	100%
571201-4960	Gudni Hreinsson
Reykjavik Airport, 101 Reykjavik, Iceland.	Capacity provider for the international airline and tour operator industry.

Icecap[51]

Icecap Insurance PCC Limited	100%
670309-9910	Managed by Heritage Insurance Management.
Heritage Hall, Le Marchant Street, St Peter Port, Guernsey, Channel Islands GY1 4HY.	To insure certain risk of Icelandair Group.

15.2 Discontinued Operations

SmartLynx

SmartLynx Airlines SIA	
40003056133	100%
Mazrudas, Marupe settlement	Ómar Benediktsson
Riga District, LV-2167, Latvia.	Operates under a Latvian AOC with a fleet of eight Airbus 320-200 and two Boeing 767-300.

Bluebird Cargo

Bláfugl ehf.	100%
460899-2229	Skúli Skúlason
Lyngháls 4, 110 Reykjavik, Iceland.	Transportation service provider, fleet of freighter aircraft, air cargo sales agency.

Furthermore, on 30 June 2010, the Group held a 30% share in Travel Service, but the company is not a subsidiary of Icelandair Group.

Travel Service	30%
Travel Service A.S	Roman Vik
K letišti 1068/30, 160 08 Praha 6, Czech Republic.	Operates charter flights to and from Prague and Budapest and also owns and operates the low cost airline Smart Wings.

[51] ICECAP insurance PCC Limited is owned by Icelandair Group and was formed in 2001 to facilitate the underwriting of part of the Group's insurances. They include Hull Deductible, various insurances for flight crew and management, employer's liability and travel agency bonds. The ICECAP insurance is managed by Heritage Insurance Management Ltd. in Guernsey.

16 EMPLOYEES

16.1 Number of Employees

The Company believes that one of its principal strengths lies in its employees. Its operations require a wide range of knowledge and specialised personnel within aviation technology, international marketing, finance and management. The average positions for the full years 2007–09 and the first six months of 2010 are presented below.

In the year 2009, a significant reduction was made in the number of employees within the Group. Redundancies were made to meet the changed market conditions and to lower costs going forward. Icelandair and IGS reduced the number of their employees by 15% and 25% respectively, and other subsidiaries reduced their number of employees significantly as is depicted in the table below. It must be noted that SmartLynx and Travel Service increased the number of employees significantly from 2008 to 2009, mainly through hiring new cabin crew members. Both companies, SmartLynx and Travel Service, are categorised as discontinued operations and are shown in a separate table later in this chapter.

Item 39. Average number of employees – Continuing Operations

	2007	2008	2009	1H 2010
Icelandair	1,464	1,368	1,163	1,150
IGS	601	530	400	382
Icelandair Cargo	67	58	52	40
Icelandair Hotels	276	289	249	290
Iceland Travel	92	101	99	99
Loftleidir-Icelandic	9	9	10	11
Air Iceland	316	306	259	250
Icelandair Shared Services	102	97	95	95
Icelandair Group	15	15	15	15
BlueBird	66	75	70	67
Total	**3,007**	**2,848**	**2,412**	**2,399**

Item 40. Average number of temporary employees – Continuing Operations

	2007	2008	2009	1H 2010
Average number of temporary employees	**274**	**287**	**261**	**192**

The vast majority of the Group's employees are based in Iceland, representing around 92% of the Group's employees. Outside of Iceland, the largest group of employees are based in North America and Scandinavia.

Item 41. Geographic breakdown of the average number of employees – Continuing Operations

	2007	2008	2009	1H 2010
Iceland	2,785	2,642	2,233	2,205
Other	222	206	180	194
Total	**3,007**	**2,848**	**2,412**	**2,399**

The largest share of the Group's employees comprises ground crew accounting respectively for 52% of the total number of employees in the first six months of 2010.

Item 42. Average number of employees by function – Continuing Operations

	2007	2008	2009	1H 2010
Pilots	414	385	280	279
Cabin crew	476	404	364	283
Ground crew	1,455	1,436	1,184	1,263
Sales and marketing	213	226	225	231
Administration and other	448	395	359	343
Total	**3,007**	**2,846**	**2,412**	**2,399**

Item 43. Average number of employees – Discontinued Operations

	2007	2008	2009	1H 2010
SmartLynx	137	187	165	139
Travel Service	545	673	661	664
Total	**682**	**860**	**826**	**803**

The employees of SmartLynx and Travel Service are largely based in the Czech Republic (Travel Service) and Latvia (SmartLynx).

Icelandair ehf. plans to increase its flight operations by 17% in 2011 and expects that the increase will create around 200 new jobs in Icelandair ehf. For further information about new destination and the increase in Icelandair ehf. flight operations refer to *Chapter 10.2 Developments in the Global and Local Airline Markets and the Economy*.

16.1.1 **Arrangement for involving the employees in the capital of the Company**

At the date of this Registration Document Icelandair Group has no arrangements in place for involving the employees of the Company in the capital of the Company.

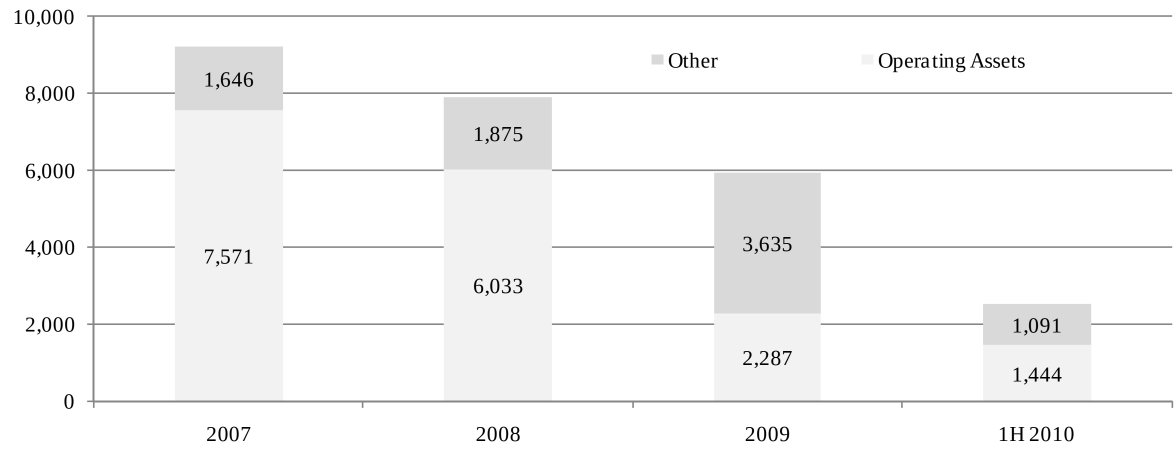
Following the publication of this Registration Document, employees of the Company and shareholders will be offered the opportunity to subscribe to new shares in the Company. The plan is to offer shares for a nominal value of ISK 1,000,000,000 to employees and shareholders for a purchase price of ISK 2.5 per share.

17 INVESTMENTS

17.1 Introduction

The investments of Icelandair Group are mainly in aircraft, flight equipment and aircraft engines. They are presented at cost less accumulated depreciation and impairment loss. When aircraft are acquired, the purchase price is divided between the aircraft itself and engines. Aircraft are depreciated over the estimated useful life of the relevant aircraft until a residual value is met. Engines are depreciated according to flown cycles. When an engine is overhauled, the cost of the overhaul is capitalised and the remainder of the cost of the previous overhaul that has not already been depreciated, if any, is expensed in full.

Item 44. Total investments of Icelandair Group full years 2007–09 and 1H 2010 (mISK)



The principal investments of 2007–10 have been financed with the cash flow of the Group.

The following tables show all material investments within the Group in each of the years 2007–09 and the first six months of 2010, total amount invested and percentage of the total capital expenditure for each year.

17.2 Acquisitions

Between 2007 and 2010, Icelandair Group made one major acquisition when Icelandair Group acquired Travel Service. The following table shows the timeline and amounts regarding the transactions. The acquisition was funded internally from the Group's cash flows.

Item 45. Acquisition of Travel Service

Date of transaction	Action	Holding	Price (mISK)
1 October 2007	Buy	50.0%	960
1 April 2008	Buy	30.1%	1,153
30 December 2008	Sell	-14.0%	-160
30 June 2009	Dilution	-16.0%	0
30 November 2009	Sell	-20.1%	-277
Total		**30.0%**	**1,676**

On 30 June 2010, the remaining 30% share in Travel Service was classified as an asset held for sale in the consolidated balance sheet of Icelandair Group.

17.3 **Acquisitions of Other Assets Held for Sale**

The following table shows when transactions relating to Bluebird Cargo were executed. Bluebird Cargo was categorised as an asset held for sale in the consolidated balance sheet of Icelandair Group on 30 June 2010 and the Group held a 100% share of the Company on 30 June 2010.

Item 46. Acquisition of Bluebird Cargo

Date of transaction	Action	Holding	Price (mISK)
17 August 2005	Buy	100%	4,129
Total			**4,129**

The table below shows when transactions relating to SmartLynx were executed. SmartLynx is categorised as an asset held for sale in the consolidated balance sheet of Icelandair Group on 30 June 2010 and the Group held a 100% share in the Company on 30 June 2010.

Item 47. Acquisition of SmartLynx

Date of transaction	Action	Holding	Price (mISK)
1 June 2006	Buy	100%	960
24 Sept 2007	Buy	Final payment	88
Total			**1,048**

A binding agreement to sell Bluebird Cargo, Travel Service and the economic benefits of IG Invest for a total value of ISK 7.6 billion and SmartLynx for ISK 1 (one) was signed on 12 August 2010 as part of the financial restructuring of Icelandair Group as explained in *Chapter 17.7 Divestments* below. However, the documentation process of the financial restructuring was not concluded and contracts signed until on 21 October 2010.

For further information please see *Chapter 27.5 Asset Divestments and Financial Treatment of Divested Assets*.

17.4 **Current Investments**

In the first half of 2010, total acquisition of operating assets amounted to ISK 1.1 billion and total investments amounted to ISK 2.5 billion.

Item 48. Investments of Icelandair Group in the first six months of the Year 2010

Year	Investment	ISK millions	% of capex
2010 1H	ITS - Spare parts	160	7%
2010 1H	Seats and entertainment systems	135	6%
2010 1H	Engine overhaul - own aircraft	437	19%
2010 1H	Other - IG core	245	22%
2010 1H	Other – non-core	114	10%
2010 1H	**Total acquisition of operating assets**	**1,091**	**100%**
2010 1H	Acquisition of long-term cost (engine leased) IG Core	1,396	
2010 1H	Acquisition of intangible assets IG Core	48	
2010 1H	**Total**	**2,535**	

The single largest contributing factor is the acquisition of long-term costs relating to Icelandair Group's leased engines. It is important to note that acquisitions of long-term costs and of intangible assets are not categorised as capital expenditure (CAPEX) since provision has already been made for the payments in the P&L statement, expensed as aircraft maintenance.

17.5 Historical Investments

Total investments in 2009 amounted to ISK 5.9 billion of which CAPEX amounted to ISK 2.3 billion. Engine overhauls amounted to ISK 840 million, representing around 37% of total CAPEX in 2009, and refurbishment of aircraft seats and the instalment of new entertainment systems in Icelandair ehf. aircraft amounted to ISK 383 million.

The CAPEX in 2008 and 2009 was unusually high due to long-term investments that were made in refurbishing the seats and entertainment systems and the installation of winglets in the fleet of Icelandair ehf. The total one-off investment in 2008 and 2009 due to seats and entertainment systems amounted to ISK 613 million and ISK 383 million respectively.

Item 49. Investments of Icelandair Group in the year 2009

Year	Investment	ISK millions	% of capex
2009	ITS - Spare parts	399	17%
2009	Seats and entertainment systems	383	17%
2009	Engine overhaul - own aircraft	840	37%
2009	Other - IG core	242	11%
2009	Other – non-core	324	14%
2009	Ground handling equipment	99	4%
2009	**Total acquisition of operating assets**	**2,287**	**100%**
2009	Acquisition of long-term cost (engine leased) IG Core	3.025	
2009	Acquisition of long-term cost (engine leased) Non Core	518	
2009	Acquisition of intangible assets IG Core	86	
2009	Acquisition of intangible assets Non Core	6	
2009	**Total**	**5,922**	

Acquisition of long-term costs associated with leased engines amounted to ISK 3,543 million of which long-term costs associated with the core business of Icelandair Group amounted to ISK 3 billion.

Total investments in 2008 amounted to ISK 7.9 billion and were largely attributable to CAPEX investments. Other investments accounted for 39% of capital expenditure, amounting to ISK 2.3 billion in 2008. Other investments mainly stem from investments made by SmartLynx, Travel Service and Bluebird Cargo and were unusually high in 2008, largely attributable to prepaid aircraft acquisitions of aircraft for Travel Service.

As in previous years, engine overhauls were the largest single factor, amounting to ISK 1.6 billion, equalling around 27% of all CAPEX investments in 2008.

Item 50. Investments of Icelandair Group in the year 2008

Year	Investment	ISK millions	% of capex
2008	ITS - Spare parts	439	7%
2008	Seats and entertainment systems	613	10%
2008	Engine overhaul - own aircraft	1,619	27%
2008	Other - IG core	920	15%
2008	Interiors at Nordica	31	1%
2008	Other - non core	2,342	39%
2008	Interiors at KEF airport	13	0%
2008	Ground handling equipment	56	1%
2008	**Total acquisition of operating assets**	**6,033**	**100%**
2008	Acquisition of long-term cost (engine leased) IG Core	1,667	
2008	Acquisition of long-term cost (engine leased) Non Core	43	
2008	Acquisition of intangible assets IG Core	132	
2008	Acquisition of intangible assets Non Core	33	
2008	**Total**	**7,908**	

Total investments in 2007 amounted to ISK 9.2 billion of which acquisition of operating assets accounted for ISK 7.5 billion. Engine overhauls for the core operations of the Group accounted for 13% of the CAPEX in 2007, while other investments and prepaid aircraft acquisitions related to SmartLynx, Travel Service and Bluebird Cargo accounted for 19% of Capex.

Item 51. Investments of Icelandair Group in the year 2007

Year	Investment	ISK millions	% of capex
2007	ITS - Spare parts	586	8%
2007	FIT - aircraft	832	11%
2007	Seats and entertainment systems	622	8%
2007	Engine overhaul - own aircraft	1,008	13%
2007	Other - IG core	947	13%
2007	Interiors at Nordica	72	1%
2007	Other – non-core	1,428	19%
2007	FIS - aircraft	707	9%
2007	FIC - aircraft	1,179	16%
2007	Interiors at KEF airport	125	2%
2007	Ground handling equipment	65	1%
2007	**Total acquisition of operating assets**	**7,571**	**100%**
2007	Acquisition of long-term cost (engine leased) IG Core	1,227	
2007	Acquisition of long-term cost (engine leased) Non Core	0	
2007	Acquisition of intangible assets IG Core	389	
2007	Acquisition of intangible assets Non Core	30	
2007	**Total**	**9,217**	

The investments in FIS, FIT and FIC aircraft amounted to 36% of CAPEX in 2007. The aircraft were acquired from their lessors and sold for a profit within the same year as is depicted in the following table.

Item 52. Sold aircraft in the year 2007

	Year	Selling price (mISK)	Profit (mISK)
FIS - Aircraft	2007	944	246
FIC - Aircraft	2007	1,701	574
FIT - Aircraft	2007	1,124	301
Total		**3,769**	**1,121**

17.6 Future Investments

The company plans to complete the refurbishment of Icelandair ehf.'s aircraft in 2010. The company will finance theses investments with internally generated funds. No other material investments are planned.

The Group has an agreement with Boeing regarding the purchase of four Boeing 787-Dreamliner aircraft to be delivered in the years 2012–14. In note 46 to the consolidated financial statement of Icelandair Group for the year 2009, it is stated that the Group has an agreement with Boeing regarding the purchase of two Boeing 737-800 aircraft to be delivered in 2010. These two Boeing aircraft were for the use of Travel Service and are therefore no longer commitments for future investments for Icelandair Group. The same applies to one Boeing 787-Dreamliner which Travel Service had on order and is therefore no longer a commitment for Icelandair Group.

17.7 Divestments

As a part of the binding agreement on the financial restructuring of Icelandair Group signed on 12 August 2010, the Group divested its shareholding in SmartLynx, Travel Service, Bluebird Cargo along with the economic benefits of IG Invest. However, the documentation process was not concluded and contracts signed until on 21 October 2010. Detailed information on the divested entities and the financial restructuring can be found in *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

The asset divestment is based on the following assumptions:

- Vindabudir ehf. ID No. 680807-2560, a company fully owned by the Resolution Committee of Glitnir Bank, will directly acquire 100% of the share capital of SmartLynx for ISK 1 (one) as SmartLynx has no value. Icelandair Group will continue to guarantee SmartLynx operational leasing obligations.
- The Resolution Committee of Glitnir Bank and Íslandsbanki incorporated an SPV, a special purpose vehicle, (hereinafter "SPW ehf.") which will acquire Travel Service and Bluebird Cargo from Icelandair Group. A binding agreement on the divestment and the incorporation of SPW ehf. was signed on 12 August 2010. However, the documentation process was not concluded and contracts signed until on 21 October 2010. The contract has reservations and SPW ehf. will not take control of the divested companies until these reservations have been fulfilled. For an overview of the reservations refer to *Chapter 27.2 Overview of the Financial Restructuring*.
- Icelandair Group will continue to own and manage IG Invest, but it will be controlled by SPW ehf. However, Icelandair Group has made an agreement with SPW ehf., which will receive economic benefits from IG Invest. The total proceeds to Icelandair Group from the sale of Bluebird Cargo, Travel Service, and the economic benefits of IG Invest to SPW ehf. amount to ISK 7.6 billion. The ISK 7.6 billion in proceeds contributes to reducing the debt of Icelandair Group by ISK 7.6 billion. There is no cash contribution involved in the asset divestment.

- If SPW ehf. receives more than ISK 7.6 billion, in addition to interest amounting to REIBOR + 3%, from its assets when it sells them before September 2015 (Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group will receive 50% of any potential yield that is higher than ISK 7.6 billion. On the other hand, if SPW ehf. receives a lower amount than ISK 4.0 billion before September 2015 from the sale (of Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group must pay SPW ehf. ISK 0.5 billion. The contracts state that if SPW ehf. has not sold its assets before September 2015, the banks can extend the period until September 2017.

For further information on the asset divestment, refer to *Chapter 27.5 Asset Divestments and Financial Treatment of Divested Assets.*

For further information on the balance sheet effects on the consolidated balance sheet of Icelandair Group regarding the divestment, refer to *Chapter 27.2 Pro Forma Balance Sheet.*

Notice is drawn to the fact that the financial data in this sub-chapter is not extracted from the issuer's audited financial statements. The data in this chapter is unaudited and based on management calculations derived from negotiations with the creditors of the Group.

18 PROFIT FORECAST

On 30 April 2010, the Group announced in its investor presentation for Q4 2009 and its annual results for 2009 that the EBITDA projection for the year 2010 was estimated to amount to ISK 7.6 billion.[52]

Q4 2009 Investor Presentation and Company Announcement stated the following:

- The Group projects the EBITDA for 2010 to be ISK 7.6 billion.
- The 2010 results will largely depend on the successful completion of the financial restructuring of the Group.
- The effects of the volcanic eruption remain to be seen and have not yet changed the overall EBITDA goals for 2010.

On 13 August 2010, the Group made public its second quarter and half-year results for the year 2010.[53] In a press release made public the Group announced:

- “The volcanic activity in Eyjafjallajökull had a severe impact on operations, as the Company reported earlier. In our assessment, the negative impact of the flight restrictions amounted to approximately ISK 1.5 billion. In our opinion the Company’s staff showed extraordinary flexibility and nerve, which is best illustrated by the EBITDA from continuing operations in the first half of the year, which exceeded the budget in spite of the impact of the volcanic eruption. As a result, the decision has been made to increase the EBITDA forecast for the year from ISK 7.6 billion to ISK 8.5 billion in 2010, which corresponds to a 12% increase from the previously published forecast. ”

Furthermore, it was stated in the press release that:

- “Despite difficult external conditions, the Company’s total income increased in the first half of the year in excess of added capacity. The improved operation of the Company is reflected in increased EBITDA in the first half of the year by ISK 862 million. The EBITDA ratio was 6.1%, as compared to 4.4% in the first six months of last year.”

The EBITDA projection for the year 2010 was revised upwards from ISK 7.6 billion to ISK 8.5 billion as of the publication of the second quarter and half-year results for the year 2010.

On 21 October 2010 the Company revised its profit forecast again and made public a press release that, among other, stated:

- “The operations of Icelandair Group have been strong this year and the company has outperformed its original financial forecast for the year. To reflect that, Icelandair Group has revised its EBITDA forecast for the year from ISK 8.5 billion to 9.5 billion for the full year. “

Therefore the current EBITDA projection for the year 2010 has been revised upwards from ISK 8.5 to ISK 9.5 billion for the full year.

[52] See https://newsclient.omxgroup.com/cdsPublic/viewDisclosure.action?disclosureId=399884&messageId=481463
[53] See https://newsclient.omxgroup.com/cdsPublic/viewDisclosure.action?disclosureId=413731&messageId=499344

18.1 Basis of the Profit Forecast

Budgets for the year 2010 were prepared at the end of the year 2009. The budget process is based on close co-operation between individual subsidiaries and the management of the Group. Each subsidiary submits its own budget proposal before year end 2009 for the budget year 2010. The management of each subsidiary bases its forecast on the value of external variables (the main principle assumptions are: jet fuel price development, exchange rates, interest rates, inflation rates, etc.) set forth by the Group management team and risk management experts.

However, the management of each subsidiary has direct control of other variables. The principle assumptions are changes in supply of its products, individual pricing of products and availability of services rendered.

The budget for each subsidiary is presented to the Board of Directors of the subsidiary in question for approval. Furthermore, the budget is presented by the management of the subsidiaries to the Group management for approval and finally for the approval of the Board of Directors of the Group.

The budget process is based on a synchronised methodology as every subsidiary puts its budget forward in a standardised manner. This means that the budget for each subsidiary can easily be compared on a similar basis to the budgets of other subsidiaries.

The following table depicts the basis of the currency forecast used for the profit estimate of the Group in the year 2010. Currency fluctuations are beyond the control of management and are based on general market research.

Item 53. Currency forecast for budget purposes. The index shows the exchange rate index.

	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	2010
USD	124.83	124.83	124.83	122.06	122.06	122.06	122.06	122.06	122.06	122.06	122.06	122.06	122.75
EUR	174.77	174.77	174.77	170.88	170.88	170.88	170.88	170.88	170.88	170.88	170.88	170.88	171.85
GBP	198.88	198.88	198.88	194.46	194.46	194.46	194.46	194.46	194.46	194.46	194.46	194.46	195.56
NOK	20.39	20.39	20.39	19.93	19.93	19.93	19.93	19.93	19.93	19.93	19.93	19.93	20.05
SEK	17.29	17.29	17.29	16.91	16.91	16.91	16.91	16.91	16.91	16.91	16.91	16.91	17.00
DKK	23.49	23.49	23.49	22.97	22.97	22.97	22.97	22.97	22.97	22.97	22.97	22.97	23.10
CHF	115.37	115.37	115.37	112.81	112.81	112.81	112.81	112.81	112.81	112.81	112.81	112.81	113.45
CAD	112.00	112.00	112.00	109.51	109.51	109.51	109.51	109.51	109.51	109.51	109.51	109.51	110.13
JPY	1.30	1.30	1.30	1.27	1.27	1.27	1.27	1.27	1.27	1.27	1.27	1.27	1.28
CZK	7.20	7.20	7.20	7.04	7.04	7.04	7.04	7.04	7.04	7.04	7.04	7.04	7.08
LVL	248.67	248.67	248.67	243.14	243.14	243.14	243.14	243.14	243.14	243.14	243.14	243.14	244.53
Index		225			220			220			220		221.25
EUR/USD	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40
GBP/USD	1.59	1.59	1.59	1.59	1.59	1.59	1.59	1.59	1.59	1.59	1.59	1.59	1.59
GBP/EUR	1.14	1.14	1.14	1.14	1.14	1.14	1.14	1.14	1.14	1.14	1.14	1.14	1.14
USD/CZK	17.35	17.35	17.35	17.35	17.35	17.35	17.35	17.35	17.35	17.35	17.35	17.35	17.35

Likewise, interest rate levels and the inflation rate are beyond the control of management.

Item 54. Interest rate and inflation forecast for budget purposes

	LV/WI	NVT/CPI	USD	EUR	GBP	ISK	SEK	CHF	CAD	JPY
2010	3.5	5.5	1.1850	1.4100	1.4341	7.0000	1.3025	0.7075	1.3892	0.7063
2011		2.9	1.2875	1.6790	1.9597	6.5000	1.6475	0.7825	1.3360	0.5638
2012			1.9280	2.2990	2.7350	6.5000	2.4280	1.1090	1.9950	0.6260
2013			2.4115	2.6090	3.1915	6.5000	2.8090	1.4140	2.4210	0.7250
2014			2.7785	2.8460	3.4865	6.5000	3.0620	1.6800	2.7415	0.8390

It must be stressed that different factors can affect the operations of Group subsidiaries. However, there are several factors that impact all subsidiaries; the principle assumptions are interest rate levels and the inflation rate. All subsidiaries use the same levels for these factors, and they are highlighted in the tables above.

18.2 Management and Auditors statement

The management of the Group and the Board of Directors confirm that the profit forecast made public on 13 August 2010 and the revised forecast which was made public on 21 October 2010, are correct at the date of issue of this Registration Document. The profit forecast was prepared in accordance with the Company's accounting policies and on a basis comparable with those used in the consolidated financial statements of the Company for the financial years ended 31 December 2007, 2008 and 2009.

An auditor's report confirming that the profit forecast has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast is consistent with the accounting policies of Icelandair Group is available in *Chapter 3.2 Statutory Auditor's Statement.*

19 ADMINISTRATIVE MANAGEMENT, SUPERVISORY BODIES AND SENIOR MANAGEMENT

19.1 Board of Directors

The Group's Board of Directors consists of five members, each of whom is elected at the Annual General Meeting for a term of one year. There are three Reserve Board members. The Board of Directors of the Company has supreme authority in the Company's general affairs between Shareholders Meetings and endeavours to keep its organisation and operations on course. The Company's Board of Directors directs company affairs and sets its objective and future vision, dealing with the annual budgets and company's goals presented by the CEO and the strategy to be taken to reach them. The Board of Directors is expected to ensure that the Company's strategy is in accordance with its vision and overall goals. The Company's Board of Directors ensures the sufficient supervision of the accounting and handling of the Company's funds.

The Board of Directors takes decisions on all matters that are deemed extraordinary or significant. The Board of Directors may grant the CEO the authority to resolve such issues. The CEO may also execute such matters if there is no opportunity to wait for the Board of Director's approval without this resulting in a serious disadvantage for the operations of the Company. In such instances, the CEO is to report promptly to the Chairman of the Board of Directors. Only the Company's Board of Directors can grant power of procuration.

The Board of Directors appoints the Company's CEO and decides on the terms of his or her employment or entrusts the Chairman of the Board of Directors with this task.

The working procedures of the Board of Directors state that Board Members are to familiarise themselves with the provisions of law, the Company's Articles of Association, general securities regulations and regulations on the handling of inside information and insider trading

A shareholders' meeting was held on 15 September 2010. A new Board of Directors was elected during the meeting. A proposal for a vote of no confidence on the auditing firm was withdrawn. The Company made public the following announcement on 15 September:

"*The following have been elected to the Board of Directors of Icelandair Group:*
Audur Finnbogadóttir, ID No.: 200767 3739
No. of votes: 466,559,586
Finnbogi Jónsson, ID No.: 180150-2429
No. of votes: 466,559,586
Katrín Olga Jóhannesdóttir, ID No.: 010862-7369
No. of votes: 466,542,492
Sigurdur Helgason, ID No.: 010546-2069
No. of votes: 466,709,586
Úlfar Steindórsson, ID No.: 030756-2829
No. of votes: 597,754,244

Alternate Board members, chosen without election:
Herdís Dröfn Fjeldsted, ID No.: 210971-4329
Magnús Magnússon, ID No.: 160965-4799
Vilborg Lofts, ID No.: 121256-3129

The Board of Directors has met and chosen Sigurdur Helgason as Chairman of the Board and Finnbogi Jónsson as Deputy Chairman."

19.1.1 Members of the Board of Directors:

- ***Sigurdur Helgason***
  - Born 1946.
  - Chairman of the Board of Directors since August 2009.
  - **Business address:** Icelandair Group Head Office, Reykjavik Airport, 101 Reykjavík, Iceland.
  - **Former assignments/positions:** Mr Helgason has had various positions within Flugleidir Group (currently known as Icelandair Group). He was Director of Cash Management (1974–80), Senior Vice President of Finance (1980–83) General Manager for The Americas (1983–85) and President & CEO of Flugleidir/FL-Group/Icelandair ehf. (1985-2005). He was also a member of the IATA board of Governors (2004–05).
  - **Principal education:** Cand.oceon degree from the University of Iceland. MBA from the University of North Carolina, Chapel Hill.
  - **Previous assignments/positions in the past five years:**
    - *Member of the Board of* Caldris ehf. (2010).
    - *Chairman* of the Icelandic International Development Agency (ICEIDA) (2008).
  - **Current assignments/positions:**
    - *Member of the Board of* Finnair Plc.
    - *Chairman of the Board of* Skildingur ehf., Icelandair Special Children's Fund and Einar Jónsson Art Museum.
  - **Own holding of shares:** 1,000 shares.
  - **Holdings of financially related parties**: None.
  - **Call or put options:** None.
  - **Additional information:** Mr Helgason is a representative on the Board of Directors on behalf of Íslandsbanki.
- ***Audur Finnbogadóttir***
  - Born 1967.
  - Member of the Board of Directors since September 2010.
  - **Business address:** Smáraflöt 28, 210 Gardabær, Iceland.
  - **Former assignments/positions:** Ms Finnbogadóttir was CEO of MP Bank hf. (1999–03), a Member of the Board of the Fulbright Institute (2000–03), Deputy Member of the Board of the Icelandic Financial Service Association (2000–03) and MP Bank hf. (2000–03).
  - **Principal education:** MBA from Reykjavik University, BSc in international business from the University of Colorado at Boulder.
  - **Previous assignments/positions in the past five years:**
    - *Member of the Board of* Arion Bank (2009), Landsnet (2009) and RÚV ohf. (2010).

- *Chairman of the Board of* Nordlenska Matarbordid ehf. (2010).
- CEO of the Employees of Kópavogur Pension Fund (2010).

- **Current assignments/positions:**
  - *CEO of* A Verdbréf hf.
  - *Member of the Board of* A Verdbréf hf. and The Enterprise Investment Fund.
- **Own holding of shares:** None.
- **Holdings of financially related parties**: Ms Finnbogadóttir is a Member of the Board of Directors for The Enterprise Investment Fund which has entered into a binding agreement with Icelandair Group regarding a subscription of 1.2 billion New Shares in the Company at the price of ISK 2.5, for a total consideration of ISK 3 billion in cash.
- **Call or put options:** None.
- **Additional information:** None.

+ ***Finnbogi Jónsson***
  - Born 1950.
  - Member of the Board since September 2010.
  - **Business address:** Lágmúli 9, 7th floor, 108 Reykjavík, Iceland.
  - **Former assignments/positions:**
    - *CEO* of Idnthróunarfélag Eyjafjardar hf. (1982–86), Síldarvinnslan hf. (1986–99) and Íslenskar sjávarafurdir hf. (1999-2000).
    - *Chairman of the Board of* Iceland Seafood Corporation, Virgina, USA (1999-2000), Gelmer-Iceland Seafood in France (1999-2000), Iceland Seafood Ltd, United Kingdom (1999-2000), Iceland Seafood Gmbh, Germany (1999-2000), Iceland Seafood Spain (1999-2000). Iceland Seafood kk, Japan (1999-2000), Saesilfur hf. (2000–04), Hradfrystistöd Thórshafnar hf. (2001–05), Silfurstjarnan hf. (2001–04), Íslandslax (2001–04), SR-Mjöl hf. (2002–03), Hugin hf. (2003–05 and Samherji hf (2000–05).
    - *Member of the Board of* SÍF hf. (1987–93), Landsvirkjun (1989–95), Icelandic (2001–09*)*, Coldwater Seafood Corporation, Connecticut, USA (1993–99), Nord Morue/Delpierre, France (1990–99), Íslandsbanki (2000–01) and PRIMEX hf. (2000–05).
  - **Principal education:** Civil economics and physical engineering degrees from the University of Lund, Sweden.
  - **Previous assignments/positions in the past five years:**
    - *CEO of* SR-Mjöl hf. (2006) and the New Business Venture Fund (2010).
    - *Member of the Board of* The Trade Council of Iceland (2007), Vistorka hf. (2008) and Innovit ehf. (2009).
  - **Current assignments/positions:**

- *Chairman of the Board of* Frumtak slhf., Frumtak GP ehf., AGVA-Nordurland ehf. and Gogo Holding slhf.

- *Member of the Board of* StjörnuOdda ehf. and Nikita ehf.

- *Deputy Member of the Board of* Iceland Innovation ehf.

- *CEO of* The Enterprise Investment Fund GP ehf. and The Enterprise Investment Fund slhf.

o **Own holdings:** None.

o **Holdings of financially related parties:** Mr Jónsson is CEO for The Enterprise Investment Fund which has entered into a binding agreement with Icelandair Group regarding a subscription of 1.2 billion New Shares in the Company at the price of ISK 2.5, for a total consideration of ISK 3 billion in cash.

o **Call or put options:** None.

o **Additional information:** None

+ ***Katrín Olga Jóhannesdóttir***

o Born 1962.

o Member of the Board since August 2009.

o **Business address:** Ármúli 25, 108 Reykjavík, Iceland.

o **Former assignments/positions:** Mrs Jóhannesdóttir was VP of Sales and Marketing, and VP of Residential Markets for Síminn hf., Managing Director of Navision Iceland and Senior Consultant at VSO ehf.

o **Principal education:** Cand. oceon degree from the University of Iceland. MSc in business economics from Odense University.

o **Previous assignments/positions in the past five years:**

- *Member of the Board of* Sirius IT/Denmark (2010), and Icepharma hf. (2007)

o **Current assignments/positions:**

- *Chief Strategy Officer* with Skipti hf.

- *Member of the Board of* Já Upplýsingaveitur ehf., Skjá Midlar ehf., Reykjavik University, the Central Bank of Iceland and the Icelandic Chamber of Commerce.

o **Own holding of shares:** None.

o **Holdings of financially related parties:** None.

o **Call or put options:** None.

o **Additional information:** None.

- ***Úlfar Steindórsson***
  - Born 1956.
  - Member of the Board since September 2010.
  - **Business address:** Nýbýlavegur 8, 200 Kópavogur, Iceland.
  - **Former assignments/positions:** Mr Steindórsson was CFO of P. Samúelsson hf. (1989–92), CFO of Vinnslustödin hf. (1992–95), Managing Director and Programme Director of Stöd 3/Íslenska sjónvarpid hf. (1995–96), Managing Director of Union Islandia, Barcelona, Spain (1996–99), Managing Director of the Innovation Fund (1999-2002) and Chairman of the Board of Directors of PRIMEX ehf. (2002–04).
  - **Principal education:** Cand. oceon degree from the University of Iceland and MBA from Virginia Commonwealth University.
  - **Previous assignments/positions in the past five years:**
    - *Member of the Board of Directors of* Íslenski hugbúnadarsjódurinn (2002). Íslandsbanki hf. (2006) and Brú Fjárfestingafélag (2007).
  - **Current assignments/positions:**
    - *CEO* Toyota Iceland hf.
    - *Chairman of the Board of* Bergey-fasteignafélag ehf., Bílaverkstædi Borgthors ehf., Eignarhaldsfélagid Bifreidar ehf., Eignarhaldsfélagid BÍLAÚTLEIGAN ehf., Eignarhaldsfélagid Pizzasmidjan ehf., M. Kristinsson ehf., TK bílar ehf., Pizza-Pizza ehf. and Sólning Kópavogi ehf.
    - *Member of the Board of* AB 257 ehf., Blue Lagoon International LTD, Bláa Lónid ehf., Eldvörp ehf., Hraunsetrid ehf., Johan rönning hf., Krókslód ehf., Motormax ehf., S. Gudjónsson ehf., Skorri ehf., TMH Iceland ehf., and Toyota Iceland hf.
    - *Deputy member of the Board of* Jú ehf.
  - **Own holdings:** None.
  - **Holdings of financially related parties:** None.
  - **Call or put options:** None.
  - **Additional information:** None.
- ***Magnús Magnússon***
  - Born 1965.
  - Deputy Member of the Board since August 2009.
  - **Business Address:** Austurstræti 16, 155 Reykjavík, Iceland.
  - **Former assignments/positions:** Director of Corporate Banking at Bunadarbanki Islands hf. (2000), Director at Lysing hf. (2002) and self-employed consultant (2005). .
  - **Principle education:** BSc in business from the University of Iceland. Master's degree in business from the Handelshöyskole in Norway.

- Previous assignments/positions in the past five years:
    - Various Board positions with subsidiaries of Landsbanki Íslands hf.
- **Current assignments/positions:**
    - *Managing Director of* Corporate Banking at Landsbanki Íslands hf.
    - *Chairman of the Board of* Exista ehf.[54], Flugnes ehf., Vignthór ehf., ÖM eignarhaldsfélag ehf., Öryggismidstöd Íslands ehf. and Magnus fjárfestingafélag ehf.
    - *Member of the Board of* Flugey ehf., Flugvík ehf., HLÍ 8 hf., L1013 ehf., Mynni ehf., Lysi ehf. and RLÍ8 ehf.
    - *Deputy Member of the Board of* Icelandair Group, Landsbankinn – Fjárfesting hf., SMI ehf. and Skinnidnadur rekstrarfélag hf.
- **Own holding of shares:** None.
- **Holdings of financially related parties:** Magnús Magnússon is Managing Director of Corporate Banking at Landsbanki Íslands hf. which owns a 23.84% stake in the Company before the issue of the New Shares. After the New Shares have been issued, Landsbanki Íslands hf. will hold 6% of the share capital in the Company.
- **Call or put options:** None.
- **Additional information:** None.
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+ ***Herdís Dröfn Fjelsted***
    - Born 1971.
    - Deputy Member of the Board since September 2010.
    - **Business address:** Lágmúli 9, 7th floor, 108 Reykjavík.
    - **Former assignments/positions:** Mrs Fjelsted was a traffic agent for IGS, a subsidiary of Flugleidir hf. (1994-2002) and internal services for SPRON (2004).
    - **Principal education:** BSc in business with specialising in international marketing, a Certified Stockbroker and is about to complete an MSc in corporate finance from Reykjavik University.
    - **Previous assignments/positions in the past five years:**
        - *Senior Investment Analyst* for Thule Investments 2004–10
        - *Member of the Board of* Parspro.com ehf. (2010) and FS10 ehf. (2010).
        - *Deputy Member of the Board of* Betware (2006), Lífeind (2007), Íslenska Lífmassafélagid hf.(2008) and Theriak ehf. (2010).
    - **Current assignments/positions:**
        - *Investment Manager for* The Enterprise Investment Fund.

[54] Exista changed from being a public limited company (hf.) to become a private limited company (ehf.) at a shareholders' meeting on 28 May 2010. Source: www.exista.com.

  - *CEO of* Vera ráðgjöf ehf.
  - *Chairman of the Board of* Wave Operations Ltd.
- **Own holdings:** None.
- **Holdings of financially related parties:** Mrs Fjelsted is a member of the Investment Team of The Enterprise Investment Fund which has entered into a binding agreement with Icelandair Group regarding a subscription of 1.2 billion New Shares in the Company at the prize of ISK 2.5, for a total consideration of ISK 3 billion in cash.
- **Call or put options:** None.
- **Additional information:** None.

+ ***Vilborg Lofts***
  - Born 1956.
  - Deputy Member of the Board since September 2010.
  - **Business address:** Safamýri 67, 108 Reykjavík, Iceland.
  - **Former assignments/positions:** Mrs Lofts was Assistant Managing Director at Íslandsbanki Asset Management 1985-2001.
  - **Principal education:** Cand. oceon degree from the University of Iceland, MBA in finance from the Cass University in London (former City University Business School) and Master's in Project Management (MPM) from the University of Iceland.
  - **Previous assignments/positions in the past five years:**
    - Human Resource Manager at Íslandsbanki 2006–08, independent consultant 2006–08.
  - **Current assignments/positions:**
    - *Director* of the School of Health Sciences at the University of Iceland.
    - *Chairman of the Board of* Kreditkort hf.
    - *Member of the Board of* The Enterprise Investment Fund.
  - **Own holdings:** None.
  - **Holdings of financially related parties:** Mrs Lofts is a Member of the Board of Directors for The Enterprise Investment Fund which has entered into a binding agreement with Icelandair Group regarding a subscription of 1.2 billion New Shares in the Company at the price of ISK 2.5, for a total consideration of ISK 3 billion in cash.
  - **Call or put options:** None.
  - **Additional information:** None.

19.2 Group Management

The Executive Management Team, under the leadership of the CEO, Björgólfur Jóhannsson, comprises the CEO, the Deputy CEO and the CFO. Executive Managers are people who establish that the Company has the appropriate expertise and experience for the management of its business. The following section lists the current Executive Managers and their activities over the last five years.

19.2.1 Selected Members of the Group Management

- ***Björgólfur Jóhannsson***
  - Born 1955.
  - CEO of Icelandair Group since January 2008.
  - **Business address:** Icelandair Group Head Office, Reykjavik Airport, 101 Reykjavík, Iceland.
  - **Former assignments/positions:** Member of the Board of Úthafssjávarthang ehf.
  - **Principal education:** Cand. oecon in business administration from the University of Iceland and Certified Auditor.
  - **Previous assignments/positions in the past five years:**
    - *CEO* of Síldarvinnslan hf. (2005), Icelandic Group hf. (2007), The Federation of Icelandic Fishing Vessel Owners (LÍÚ) (2008) and Bidleikur ehf. (2009)
    - *Member of the Board of* Icelandic USA inc. (2007), Icelandic Asia inc. (2007), Jeka Fish A/S (2007), Fiskval hf. (2006-2007) and Grenó ehf. (2009)
  - **Current assignments/positions:**
    - *Chairman of the Board of* Grenó ehf.
    - *Member of the Board of* the Icelandic Chamber of Commerce and Gjögur hf.
  - **Own holding of shares:** None.
  - **Holdings of financially related parties:** None.
  - **Call or put options:** None.
  - **Additional information:** Mr Jóhannsson is a Member of the Board of Icealandic Chamber of Commerce on behalf of Icelandair Group.
- ***Sigthór Einarsson***
  - Born 1968.
  - Deputy CEO of Icelandair Group since May 2008.
  - **Business address:** Icelandair Group Head Office, Reykjavik Airport, 101 Reykjavík, Iceland.
  - **Former assignments/positions:** Various managerial positions with Flugleidir hf. (later FL-Group hf.) and Icelandair Group.
  - **Principal education:** Economic engineer from Darmstadt University, Germany.

- **Previous assignments/positions in the past five years:**
  - *Managing Director* of Loftleidir-Icelandic (2006).
  - *COO* of Icelandair Group (2008).
- **Current assignments/positions:**
  - *Chairman of the Board of* Tannanes ehf.
  - *Member of the Board of Directors of* International Society of Transport Aircraft Trading (ISTAT).
- **Own holding of shares:** 103,703 shares.
- **Call or put options:** None.
- **Additional information**: None.

✚ ***Bogi Nils Bogason***

- Born 1969.
- CFO of Icelandair Group since October 2008.
- **Business address:** Icelandair Group Head Office, Reykjavik Airport, 101 Reykjavík, Iceland.
- **Former assignments/positions:** Auditor, partner and board member at KPMG hf. in Iceland until 2004.
- **Principal education:** BSc business and Cand. Oceon in business from the University of Iceland and a licensed chartered accountant.
- **Previous assignments/positions in the past five years:**
  - *CFO* of Icelandic Group hf. (2006) and Askar Capital hf. (2008).
  - *Member of the Board of Directors* Jeka Fish A/S (2006), Icelandic USA Inc. (2006), Icelandic Group UK, plc. (2006), Icelandic Iberia (2006), Icelandic Norway A/S (2006), Avant hf. (2008)
- **Current assignments/positions:** *Member of the Board of Directors*, Möskvi ehf.
- **Own holding of shares:** None.
- **Call or put options:** None.
- **Additional information:** None.

✚ ***Birkir Hólm Gudnason***

- Born 1974.
- CEO of Icelandair ehf. since May 2008.
- **Business address:** Icelandair Head Office, Reykjavik Airport, 101 Reykjavík, Iceland.
- **Former assignments/positions:** Director of Sales for Icelandair ehf. in Iceland.

- **Principal education:** BSc in business economics and administration and an MBA in international business and economy, from the University in Aaalborg, Danmark.
- **Previous assignments/positions in the past five years:**
  - *Director of Sales* for Icelandair ehf. in North America (2006) and for Central Europe (2008).
  - *Member of the Board* of the Danish-Icelandic Chamber of Commerce (2008) and the Norwegian-Icelandic Chamber of Commerce (2008).
- **Current assignments/positions:**
  - *Member of the Board* of **Amadeus Ísland ehf.**
- **Own holding of shares:** None.
- **Call or put options:** None.
- **Additional information:** None.

+ ***Gudni Hreinsson***

- Born 1971.
- Managing Director of Loftleidir-Icelandic ehf since 2006.
- **Business address:** Icelandair Head Office, Reykjavik Airport, 101 Reykjavík, Iceland.
- **Former assignments/positions:** Managing Director of the Icelandic Web Agency hf.
- **Principal education:** BA in humanistic informatics & communication from Aalborg, Danmark.
- **Previous assignments/positions in the past five years:**
  - *SVP of Sales and Marketing* at Loftleidir-Icelandic (2006).
- **Current assignments/positions:**
  - *Member of the Board of Directors of* Ormsgil ehf**.**
- **Own holding of shares:** None.
- **Call or put options:** None.
- **Additional information:** None.

+ ***Gunnar Már Sigurfinnsson***

- Born 1965.
- Managing Director of Icelandair Cargo ehf. since 2008.
- **Business address:** Icelandair Cargo Head Office, Brautarholt 10-14, 105 Reykjavík, Iceland.

- **Former assignments/positions:** Icelandair Domestic in Vestmannaeyjar, Sales and Marketing Manager for Air Iceland, Sales Manager for Icelandair ehf. in Germany, Netherlands and Central Europe Regions.
- **Principal education:** Degree from the University of Iceland.
- **Previous assignments/positions in the past five years:**
  - *SVP of Sales and Marketing* at Icelandair ehf. (2008).
  - *Member of the Board of* the Icelandic Tourist Board (2008), Iceland Naturally Europe (2008) and Icelanda Naturally USA (2008).
- **Current assignments/positions:**
  - *Chairman of the Board of Directors and CEO of* Fluglind ehf**.**
- **Own holding of shares:** None.
- **Call or put options:** None.
- **Additional information:** None.

19.3 Corporate Governance

Icelandair Group holds the view that effective corporate governance principles are essential to assure shareholders and other stakeholders that the Company is doing its best to ensure sound and effective control of the Company's affairs and a high level of business ethics. Exercising good corporate governance will, in the long run, build a solid Company that returns shareholders satisfactory profit on their investment. Corporate governance serves to ensure an open and transparent relationship between the Company's management, its Board of Directors, its shareholders and other stakeholders.

The *Guidelines on Corporate Governance* issued by the Iceland Chamber of Commerce, NASDAQ OMX Iceland and the Confederations of Icelandic Employers, along with the Company's Articles of Association, and rules for Issuers of Securities listed on the NASDAQ OMX Iceland make up the framework for Icelandair Group Corporate Governance practices.

The management of the Company has decided that the Company will be fully compliant with the *Guidelines on Corporate Governance* (the Guidelines) published by the Iceland Chamber of Commerce, NASDAQ OMX Iceland and the Confederation of Icelandic Employers after the Annual General Meeting in 2011. The Company is already in compliance with the Guidelines in most major aspects. Below is a list of aspects that the Company is in the process of implementing, although the Company has not had enough time to implement these regimes before the date of this Registration Document:

- The Company did not post information in accordance with Article 1.2 of the Guidelines on candidates to the Board of Directors for the last Annual General Meeting.
- Minutes of shareholders' meetings are not yet accessible on the Company's website.
- Copies of the Company's share registry were not available to shareholders at the last shareholders' meeting.
- The Company has not yet issued a governance statement.

- The Board has not evaluated its work, size, composition and practices, nor has it evaluated the performance of the CEO or others responsible for the day-to-day management of the company and its development.
- The Board has not yet established a Nomination Committee.
- The Board is not in compliance with Article 2.4 of the Guidelines. Members of the Board Audur Finnbogadóttir, Finnbogi Jónsson, Herdís Dröfn Fjelsted and Vilborg Lofts are all considered related persons because of their position with the Enterprise Investment Fund which will be the largest shareholder after the completion of the issuing of the New Shares in the Company. Magnús Magnússon is Managing Director of Corporate Banking for Landsbanki Íslands hf., which owns a 23.84% stake in the Company before the issue of the New Shares. After the New Shares have been issued, Landsbanki Íslands hf. will hold 6% of stake in the Company. The Guidelines stipulate that a majority of the Board shall be independent of company and at least two board members shall be independent of major shareholders. Chairman of the Board Sigurdur Helgason and Board Members Katrín Olga Jóhannesdóttir and Úlfar Steindórsson are not considered related persons according to the Guidelines.
- The Board has established its own written rules of procedure that include most but not all of the items listed in Article 2.8 of the Guidelines. The items listed in Article 2.8 of the Guidelines which the Company has not yet included are:
    - Procedures for annual performance assessments.
    - Gathering and disclosing to the Board information from the CEO and sub-committees.
    - Links to other rules within the company, such as guidelines on good governance and other rules as applicable, e.g. from the Financial Supervisory Authority and NASDAQ OMX Iceland.
- The Board has established a code of ethics and social responsibility that include most but not all of the items listed in Article 2.10 of the Guidelines. The items listed in Article 2.10 of the Guidelines which the Company has not yet included is:
    - The Code of Ethics does not literally encourage compliance with the law but the spirit of the Code indicates that compliance with law is appropriate.
- A job description for the Chairman of the Board has not been established.
- Sub-committees have not established written rules of procedure for themselves.

There are already rules in the Company about procedures for annual performance assessment and gathering and disclosing information to the Board from the CEO and sub-committees but these rules have yet to be adopted in the Board's rules. The Company is adapting the rules for better governance and the Board's rules will soon cover the above-mentioned items.

19.3.1 **Audit Committee**

The Group Audit Committee is appointed by the Company's Board of Directors. The committee consists of a minimum of three members who are autonomous of the Company's day-to-day operations. The members must have relevant experience and expertise regarding audit affairs.

The Group Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. The committee oversees the Company's annual accounts and the Group's consolidated accounts.

The committee is responsible for evaluating the independence and the eligibility of both the Company's auditor and its auditing firm. The committee makes suggestions to the Board of Directors regarding the selection of the Company's auditor.

According to Article 8.8 of the Articles of Association of the Company, committees working on behalf of the Board of Directors are elected in accordance with provisions of the rules of the Board of Directors, and their conclusions are advisory for the Board of Directors which is not bound by the committee's conclusions when resolving matters unless otherwise stipulated by law.

At a Board meeting on 22 September 2010, Audur Finnbogadóttir, Herdís Dröfn Fjelsted, Magnús Magnússon and Vilborg Lofts were elected by the Board of Directors to the Audit Committee. Mrs Finnbogadóttir was elected chairman of the Audit Committee.

According to the Guidelines, the Audit Committee must consist of at least three members, the majority of whom must be independent of the Company. Ms Finnbogadóttir, Ms Fjelsted and Ms Lofts are not considered independent of the Company because of their duties to the Enterprise Investment Fund, and Mr Magnússon is not considered independent because of his duties to Landsbanki Íslands.

19.3.2 **Remuneration Committee**

The main purpose of the Remuneration Committee is to avoid a situation whereby the management controls its own remuneration; furthermore, it ensures that the management's remuneration is structured so as to serve the long-term interests of the shareholders.

The Remuneration Committee provides guidance to the Board of Directors of the Company and executive management concerning the employment terms of the Company's key management staff and gives advice on the Remuneration Policy. The Committee also monitors that the remuneration of key management staff is within the framework of the Remuneration Policy and reports to the Board of Directors annually on this subject in connection with the Company's Annual General Meeting. The Committee also ensures that remuneration and employee terms are in compliance with applicable official rules, regulations and general guidance. The Committee performs evaluations of the management's remuneration, monitors the management's share purchases and takes an independent decision regarding the effect of wages on risk and risk management of the Company.

The members of the Committee must be autonomous of day to day operations of the Company. As stipulated in *Chapter 19.3.1 Audit Committee*, Article 8.8 of the Company's Articles of Association is relevant regarding the actions of the Remuneration Committee.

At a Board meeting on 22 September 2010, Sigurdur Helgason and Finnbogi Jónsson were elected by the Board of Directors to the Remuneration Committee. Mr Helgason was elected chairman of the Remuneration Committee.

According to the Guidelines, the Remuneration Committee may consist of only two members on condition that those two members are independent of the Company. Mr Jónsson is not independent of the Company because of his duties to the Enterprise Investment Fund.

19.3.3 **Remuneration and Benefits**

The table below sets forth a breakdown of the remuneration that the Group paid to the management and Board of Directors in 2009. It also provides information regarding holdings in the Group's shares by these individuals at December 31, 2009. The table includes the Members of the Board of Directors, Chief Executive Officer and the members of the Executive Board. There is no pension liability regarding Members of the Board of Directors, Chief Executive Officer or Executive Board.

No members of the Board of Directors or the Group management have share options in the Company. No other amount has been set aside or accrued by the issuer or its subsidiaries to provide pension, retirement or similar benefits agreed by the Company with any of its Board members or Group management. The share options mentioned in the table below were bound to certain time periods which all expired in 2010. These share options are therefore no longer valid.

Members of the Board of Directors are elected at each shareholder's meeting.

No members of the administrative, management or supervisory bodies have made any service contracts with the Issuer or any of its subsidiaries providing for benefits upon termination of employment.

Item 55. The table depicts salaries and benefits for the year ended 31 December 2009.

Board of Directors:	Salaries and benefits (million ISK)	Share options (million)	Shares held at year-end 2009 (million)	Shares held by related parties (million)
Sigurdur Helgason, Chairman of the Board	1.6 *			
Katrín Olga Jóhannesdóttir	0.8			
Magnús Magnússon, alternative board member	0.1			238.3
Gunnlaugur M. Sigmundsson, former Chairman	4.9			
Ásgeir Baldurs, former board member	1.8			
Einar Sveinsson, former board member	2.3			12.8
Finnur Reyr Stefánsson, former board member	3.0			38.2
Jón Ármann Gudjónsson, former board member	0.8			111.7
Ómar Benediktsson, former board member	1.1			
Pétur J. Eiríksson, former board member	19.1			
Jón Benediktsson, former alt. board member	0.7		0.4	12.8
Kristín Einarsdóttir, former alt. board member	0.2			
Martha Eiríksdóttir, former alt. board member	2.1		0.1	
Sigurdur Atli Jónsson, fomer alt. board member	0.9			
Tómas Kristjánsson, former alt. board member	0.5			20.0
CEOs:				
Björgólfur Jóhannsson, CEO of Icelandair Group hf.	38.7			
Sigthór Einarsson, Deputy CEO of Icelandair Group hf.	25.5	1.0	0.1	
Bogi Nils Bogason, CFO of Icelandair Group	26.3			
Birkir Hólm Gudnason, CEO of Icelandair ehf.	33.2	0.1		
Gudni Hreinsson, CEO of Loftleidir-Icelandic ehf.	25.3			
Gunnar Már Sigurfinnsson, CEO of Icelandair Cargo	21.5			
Managing directors:				
Eight MDs of Group companies	152.4	6.2		

Included in the above mentioned list of shares held by management and directors are shares held by companies controlled by them.

*The Chairman of the Board has forgone his right to a salary so instead the Board agreed to pay the same amount to a charity —the Special Children's Travel Fund.

Members of committees mentioned in this chapter receive ISK 80,000 for each meeting attended.

At the Icelandair Group Extraordinary Annual General Meeting held on 21 May 2010, the following remuneration to board members was approved:

- Each board member receives ISK 160,000 per month.
- The Chairman of the Board of Directors receives ISK 320,000 per month.
- Alternate board members receive ISK 80,000 for each meeting attended.

For information about potential conflict of interest between any duties to the Issuer, general or private, of any of the Members of the Board of Directors, please refer to *Chapter 19.4 Conflict of Interest.*

19.3.4 **Recent Changes to Remuneration to the Members of the Board of Directors and Senior Management**

It was agreed at the 2009 Annual General Meeting that remuneration to Board Members should be decreased by 20%. There are no other recent changes.

19.4 Conflict of Interest

Attention is brought to the fact that all Members of the Board and Group Management are primary insiders, therefore, according to Icelandic laws and regulations, they are bound by certain restrictions to conduct transaction of their shares in accordance with, among other things, the Securities Transactions Act No. 108/2007.

The following Members of the Board of Directors are considered insiders according to the Securities Transactions Act. No. 108/2007 because of ties to the companies mentioned in this paragraph: Finnbogi Jónsson (The Enterprise Investment Fund), Audur Finnbogadóttir (The Enterprise Investment Fund), Herdís Dröfn Fjelsted (The Enterprise Investment Fund), Vilborg Lofts (The Enterprise Investment Fund) and Magnús Magnússon (Landsbankinn hf.). Financial relationships exist between Icelandair Group and these companies. The Enterprise Investment Fund will be the largest shareholder in Icelandair Group following the completion of the issue of the New Shares and will own 30.4% of the Company's share capital. For further information see *Chapter 27.3.1 The Enterprise Investment Fund*. Landsbankinn hf. owned 23.84% of the Company's share capital before the issue of the New Shares, see *Chapter 21.1 Largest Shareholders*. After the issue of the New Shares, Landsbankinn hf. will hold 6% of the Company's share capital, see *Chapter 27.4 Shareholders List after Financial Restructuring.*

Beside the abovementioned, no interest exists regarding private interest, family relations, or any other kind, between members of the administrative, management or supervisory bodies that might conflict with the Company's interests.

19.5 Confirmation and legal proceedings

Sigurdur Helgason, Chairman of the Board of Directors, is one of the shareholders and Chairman of the Board of Directors of Skildingur ehf. On 2 February 2010 the district court in Reykjavík ruled that Skildingur ehf. was obliged to repay a debt to the Resolution Committee of Glitnir Bank, outstanding under a loan agreement with the Bank, in the amount of ISK 1.1 billion.

An agreement was reached between Skildingur ehf. and the Resolution Committee of Glitnir Bank and the matter is now resolved. The case was never appealed to the Supreme Court of Iceland. Mr Helgason is a Member of the Board of Directors of Icelandair Group and is nominated by Íslandsbanki.

Magnús Magnússon, a member of the Board of Directors, is Chairman of the Board of Exista ehf. which has requested a composition agreement with its creditors. On 8 September, the creditors of Exista agreed to the composition agreement and subsequently now own all of the common stock of the company.

Other than the aforementioned, in the past five years none of the Members of the Board of Directors or members of the senior management have been:

- Convicted in relation to a fraudulent offence;
- Associated with companies that have gone into bankruptcy, receivership or liquidation;

- Subject to any official public incrimination and/or sanctions by any statutory or regulatory authority (including any designated professional body) or have ever been disqualified by a court from acting as a director or member of the administrative or supervisory bodies of a company or from acting in the management or conduct of the affairs of a company.

20 RELATED PARTY TRANSACTIONS

When Group companies deliver products or provide services to other Group companies, any such agreement or arrangement is performed at a market price and on market terms. All intra-Group transactions, balance sheet items, revenues and expenses are eliminated upon consolidation of the Group's financial statements and are therefore not included in the Group's consolidated balance sheet or results of operations.

The Board of Directors of the Group believes that the Group's related party transactions described below are conducted on an arm's length basis. Íslandsbanki holds 46.98% of the shares in the Group, however, Íslandsbanki is only authorised to apply up to 30% of its effective voting rights in the Group. Íslandsbanki is the primary commercial bank of the Group, acts as Listing Advisor in respect of this Registration Document and was mandated by the Group to act as the advisor in respect of the New Shares. All transactions with Íslandsbanki have been concluded on an arm's length basis.

20.1.1 Identity of Related Parties

The Group has a related party relationship with its subsidiaries, associates, and with its directors and executive officers.

20.1.2 Transaction with associates

During the year 2009 the Group purchased services from associates amounting to ISK 358 million (2008: ISK 516 million), but the Group did not sell them any services. The Group has not granted any loans to its associates. Transactions with associates are priced on an arm's length basis.

20.1.3 Transactions with management and key personnel

No member of the Board of Directors and no member of Group Management, currently, or during the period that is covered in the historical financial information in this Registration Document have participated directly or indirectly in any transaction with the Group that is, or would have been, unusual or made under unusual conditions. The Group has not granted any loans, provided any guarantees or entered into a guarantee undertaking, to or for the benefit of any member of the Board of Directors.

Item 56. The Company holds thirteen subsidiaries on 27 October 2010

Ownership interest	2008	2009	1H 2010
Air Iceland ehf.	100%	100%	100%
Iceland Travel ehf.	100%	100%	100%
Icelandair ehf.	100%	100%	100%
Icelandair Cargo ehf.	100%	100%	100%
Icelandair Ground Services ehf. (IGS)	100%	100%	100%
Icelandair Hotels ehf.	100%	100%	100%
Bluebird Cargo ehf.	100%	100%	100%
IceLease ehf.	100%	100%	100%
IG Invest ehf.	100%	100%	100%
Loftleiðir - Icelandic ehf.	100%	100%	100%
Smart Lynx, Latvia	100%	100%	100%
Travel Service, Czech Republic	66%	30%	30%
IceCap Ltd., Guernsey	100%	100%	100%
Icelandair Shared Services ehf.	100%	100%	100%

On 25 November 2009, Icelandair Group sold 20.1% of its share in Travel Service. After that transaction, the Group held a 30% share in the Company and accordingly, Icelandair Group no longer controlled Travel Services. As a result, Travel Service is categorised as a discontinued business and is not part of the Group's consolidated income statement. SmartLynx is categorised under discontinued operations in the income statement. See *Chapter 12.4 Discontinued Businesses* for details on the classification of Travel Service, Bluebird Cargo and SmartLynx and *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

21 MAJOR SHAREHOLDERS

21.1 Largest Shareholders

Item 57. 20 Largest shareholders as of 21 October 2010

Shareholder	Number of shares	Percentage of shares	Percentage of votes*
Íslandsbanki hf.	469,772,387	46.98%	29.99%
Landsbanki Íslands hf.	238,348,350	23.84%	30.37%
Sparisjódabanki Íslands hf.	93,572,562	9.36%	11.92%
Alnus ehf.	32,992,831	3.30%	4.20%
Icelandair Group hf.	25,460,000	2.55%	0.00%
Glitnir Bank hf.	20,925,000	2.09%	2.66%
Sigla ehf.	20,000,000	2.00%	2.55%
Saga Capital Fjárfestingarbanki	18,104,159	1.92%	2.45%
Arkur ehf.	17,500,000	1.75%	2.23%
N1 hf.	12,844,611	1.28%	1.63%
Stafir lífeyrissjódur	8,656,512	0.93%	1.18%
Almenni lífeyrissjódurinn	6,571,047	0.66%	0.84%
Kaupfélag Sudurnesja	3,375,000	0.34%	0.43%
Landsbanki Luxembourg S.A.	2,870,961	0.29%	0.37%
DnB NOR Bank ASA	2,000,000	0.20%	0.25%
Landssjódur hf úrvalsbréfadeild	1,924,512	0.20%	0.25%
Jafet Ólafsson	1,843,300	0.20%	0.25%
Íslandssjódir hf, sjódur 6	1,652,712	0.20%	0.25%
Lífeyrissjódur Vestfirdinga	1,561,736	0.20%	0.25%
Hagur eignarhaldsfélag ehf.	1,111,111	0.10%	0.13%
Total		**98.39%**	**92.23%**

*Íslandsbanki is not allowed to utilise more than 23.5% of outstanding share capital as its voting powers are capped at 29.99% of total votes.

The table above lists the holdings and voting rights of the 20 largest shareholders in the Company as of 21 October 2010. Certain relationships between the parties listed above should be noted: (i) according to publicly available information, 95% of the common stock of Íslandsbanki is held by foreign creditors of the Resolution Committee of Glitnir Bank and (ii) Magnús Magnússon is Managing Director of Corporate Banking for Landsbanki Íslands hf., which owns a 23.84% stake in the Company.

The table has not changed at the date of this Registration Document. For information about major shareholders after the financial restructuring, see *Chapter 27.4 Shareholders List after the Financial Restructuring.*

21.2 Voting rights

Each issued share carries one vote. Accordingly, major shareholders do not have voting rights that are different from those of other shareholders. Íslandsbanki holds a 46.98% stake in the company, however, its voting right is limited and the bank can only utilise up to 30% of its shares. According to Article 11.1 of its Articles of Association, Icelandair Group is only allowed to own up to 10% of the Company's share capital. Votes are not attached to shares owned by the Company.

21.3 Shareholder Agreement

To the knowledge of the Board of Directors, there are no shareholder agreements or similar agreements or arrangements between shareholders of the Company that intend to establish joint decision-making with respect to shareholder voting or other shareholder rights in the Company. Furthermore, the Board of Directors is not aware of any agreements or equivalent arrangements that may lead to a change in control of the Company.

Changes in control of the Company will follow the issue of the New Shares.

21.4 Direct or indirect ownership or control by individual shareholders

The Company's management states that, to the extent known to the issuer, the Company is not directly or indirectly owned or controlled by parties other than the listed shareholders.

21.5 Known arrangements which may change control of the issuer

With the change in ownership, a new Board of Directors was elected at a shareholder's meeting held at the beginning of August 2009. At the same shareholders' meeting, approval was given to granting the Board authorisation to increase the share capital of the Group by up to ISK 4 billion.

The Group has mandated Íslandsbanki Corporate Finance to manage the sale of the New Shares. During the months preceding the publication of this Registration Document, the Group conducted a private tender of New Shares. Icelandic institutional and professional investors were invited to subscribe to shares in the Group. As of today, these investors have subscribed to shares of ISK 2,211,000,000 nominal value in the Group. In addition, Íslandsbanki and The Resolution Committee of Glitnir Bank have subscribed to shares of ISK 720,000,000 nominal value in relation to the financial restructuring, see *Chapter27.4 Debt Conversion into Equity* for further details. The composition of the largest shareholders will change significantly following the issue of these shares. A list of the largest shareholders as expected when shares have formally been acquired in accordance with committed subscriptions, see *Chapter27.4*. *Shareholders List after the Financial Restructuring.*

Following the publication of this Registration Document, shareholders and employees of the Group will be offered the opportunity to subscribe to New Shares. The Group intends sell up to ISK 1,000,000,000 nominal value of new shares in this limited offering.

At a shareholders' meeting held on 15 September 2010, it was agreed between Íslandsbanki and Glitnir Bank on the one hand, and The Enterprise Investment Fund (EIF) on the other hand, in light of the binding subscriptions between the EIF and Icelandair Group and future plans for the Group, that Íslandsbanki and Glitnir Bank would vote in favour of candidates for Board membership who were acceptable to the EIF.

21.5.1 FME's Decision Regarding Íslandsbanki

After the financial turmoil that hit Iceland in late 2008, significant changes materialised in the shareholder structure of the Group in 2009. Íslandsbanki was granted an exemption from having to make mandatory bids in the remaining share capital by the Financial Supervisory Authority (FME).

The FME decided to grant Íslandsbanki a conditional exemption from a mandatory takeover bid in accordance with paragraph 5 of Article 100 of the Securities Transactions Act No. 108/2007, despite it having indirect control of the Company following a subsequent enforcement action. Íslandsbanki was, both as a creditor and large shareholder of Icelandair Group, required to dispose of holdings in excess of maximum threshold in accordance with Article 100 of the Securities Transactions Act No. 108/2007 as soon as possible and within 12 months from the date of the decision, with a possibility to extend for 6 months, which was applied for and granted after the 12-months limit expired..

This enforcement action was prompted by the inability of a number of shareholders including leading shareholders in the Company to meet margin calls in respect of loans extended to those parties by the bank. The FME considered that the bank fulfilled conditions that would be granted to a pledge. Those conditions are:

- When the guarantee was granted, conditions did not give rise to reasons that the pledgee could have known that would result to a margin call.
- A margin call is necessary for reasons that concern the pledger.
- A margin call is conducted with intent to re-sell it. The FME grants the creditor time limits for the re-sale.

The exemption was granted with the following conditions.

- In light of the financial restructuring within Icelandair Group, the FME decided to grant Íslandsbanki a generous continuance, i.e. 12 months which was extended to 18 months. Íslandsbanki must sell to the extent that a mandatory takeover is no longer applicable in accordance with Article 100 of the Securities Transactions Act.
- Íslandsbanki was only authorised to apply up to 30% of its effective voting rights in the Company.
- Íslandsbanki, in cooperation with the Company, would inform FME on a regular basis of the progress of the financial reorganisation of the Company.

When the New Shares have been issued, Íslandsbanki's stake in the Company will be less than 30% and the bank will no longer be indirectly in control of the Company. Consequently, the decision discussed above will no longer be applicable.

21.5.2 **FME's Decision Regarding The Enterprise Investment Fund**

On 6 August 2010, the Enterprise Investment Fund (EIF) requested an exemption for an obligatory takeover of Icelandair Group in accordance with Article 100 of the Securities Transactions Act No. 108/2007. The FME decided to grant the EIF the exemption in accordance with paragraph 1.a) of Article 100 of the Securities Transaction Act. The article in question authorises, in exceptional circumstances, exemption from the obligation to make a mandatory bid when an investors owns 30% or more of the outstanding stock of a publicly listed company, and this exemption is applicable if the purpose is to pave the way for financial restructuring of companies experiencing financial difficulties.

This exemption was a condition to the EIF's subscription to 1,200,000,000 shares in the Company at the price of ISK 2.5. As this exemption has been granted by the FME and other conditions of the EIF's undertaking dated 14 June 2010 with Icelandair Group in respect of the subscription have been fulfilled EIF's commitment is now firm and binding. Accordingly, following the issue of the New Shares, the EIF will own 32.5% of the common stock in the Group.[55] The threshold according to Article 100 of the Securities Transactions Act is ownership of 30% of common stock in public companies. The FME granted the EIF exemption from a takeover bid with the following conditions:

- The EIF shall, as soon as possible (and within 12 months), by selling shares, no longer have direct or indirect control of the Group according to Article 100 of the Securities Transactions Act. This exemption will be valid as soon as the EIF becomes a shareholder in the Company.
- The EIF voting rights are capped at 30% of the common stock (i.e. the EIF can utilise up to 30% of the active voting rights). Active voting rights refer to total number of voting shares less those shares held by the EIF that become inactive due to this decision.

The EIF shall, in cooperation with the Company, inform the FME on a regular basis of the progress of the financial reorganisation of the Company. The FME also laid down a condition that the EIF to notify the FME with at least one week notice of any plans to re-sell. All decisions of the FME are available on www.fme.is.[56]

[55] Notice is drawn to the fact that the EIF will own 30.4% of the common stock of the Company after the issue of New Shares, not 32.5% as the FME authorised.
[56] A direct link to the decisions in question is for Íslandsbanki - http://www.fme.is/lisalib/getfile.aspx?itemid=6347 and http://www.fme.is/lisalib/getfile.aspx?itemid=7249; and the EIF - http://www.fme.is/lisalib/getfile.aspx?itemid=7358

22 FINANCIAL INFORMATION

22.1 IFRS

The financial statements of the Company for the years 2007, 2008 and 2009 and any interim statements prepared from 2007 until 30 June 2010 were prepared in accordance with International Financial Reporting Standards (IFRS).

22.2 Explanatory Notes

Detailed information regarding the items in the income statements, cash flow and balance sheets are accessible in the policies and explanatory notes in the relevant financial statements, incorporated into this Registration Document by reference, see Chapter 5 *DOCUMENTS ON DISPLAY AND INCORPORATED BY REFERENCE*.

22.3 Age of Latest Financial Statement

The latest financial statement were made public on 13 August 2010 for the half year ended 30 June 2010.

22.4 Significant Change in the Issuer's Financial or Trading Position

As of the date of this Registration Document, there has been no significant change in the financial or trading position, results of operations or the prospects of the Group or its subsidiaries, taken as a whole, since the end of the last financial period and it is not likely to change for at least the current financial year.

In particular, there has been no significant change in the financial or trading position, results of operations or the prospects of the divested companies (Bluebird Cargo, SmartLynx and Travel Service along with the economic benefits of IG Invest) as a whole as of the date of this Registration Document, and such change is not expected to materialise in the current financial year.

For further information on the financial restructuring of the Group, see *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

22.5 Dividend Policy

No dividend policy is in place for the issuer. The issuer has not paid a dividend for any of the financial years covered by this document.[57] It is important to highlight that covenants in loan agreements can affect the possibilities of the Group to pay out dividends as of the date of this Registration Document. Refer to *Chapter 25.3 Liquidity Risk and Covenants in Loan Contracts* for further information.

Negative covenants exist in some of the loan and financing agreements of Icelandair Group which could place impediments to and constraints on the Company's operations and its assets. Various issues need the prior consent of the lender, included is prohibition of extraordinary dividends or distributions.

[57] Even though there is no dividend policy in place for the Issuer, breaches in covenants may affect the payment of dividends in a hypothetical scenario. For further information on the effect of covenant breaches, see *Chapter 25.3 Liquidity Risk and Covenants in Loan Contracts.*

23 SHARE CAPITAL

23.1 About the Share Capital

The total issued share capital, as of the date of this Registration Document, is ISK 1,000,000,000 in nominal value, divided into an equal number of shares, each with a nominal value of ISK 1.0. The Group's share capital consists of one class of shares, and each issued share carries one vote. The Group holds, as of the date of this Registration Document, 25,460,000 shares in itself (2.55% of the total shares) and 974,540,000 shares are outstanding. All of the Group's shares are fully paid and non-assessable. The ISIN number for the Group's shares is IS0000013464. The shares' trading symbol on the NASDAQ OMX Iceland is ICEAIR. The Group is a company with limited liability, registered in Iceland and operating pursuant to Act No. 2/1995 on Public Limited Companies. All shares in the Group have been issued in accordance with the Act No. 2/1995 on Public Limited Companies.

The Group was founded on 20 December 2005 under the name Icelandair Group ehf. with a total share capital of ISK 500,000 nominal value. At a shareholders' meeting held on 17 February 2006, it was decided to increase the share capital of the Group by ISK 3,500,000 nominal value. After that increment the share capital of the Group was ISK 4,000,000 nominal value. At a shareholders' meeting held on 30 May 2006, it was decided to increase the share capital by ISK 2,996,000,000 nominal value. After that increment the share capital of the Group was ISK 3,000,000,000 nominal value. At a shareholders' meeting held on 15 November the same year it was decided to decrease the share capital by ISK 2,000,000,000 nominal value. At the same shareholders' meeting the Company was altered from being a private limited company (ehf.) to public limited company (hf.), in accordance to Article 107 of the Private Limited Companies Act No. 138/1994. The name of the Company was also changed to Icelandair Group hf.

Icelandair Group Holding hf., which was founded by three qualified investors, Langflug ehf., Naust ehf. and Mr Ómar Benediktsson, in October 2006, set out to acquire all the shares in Icelandair Group Their goal was to purchase Icelandair Group ehf. and they committed themselves to invest 50.5% of the equity in Icelandair Group Holding. At the same time, Glitnir Bank underwrote 49.5% of Icelandair Group's holding as a part of the transaction whereby Icelandair Group Holding hf. bought Icelandair Group hf. from FL Group. The underwritten shares were sold to groups of qualified investors in October 2006, except 18.5% which were sold to Icelandair Group hf. employees, the general public and qualified investors by Glitnir Bank in a share offer from 27 November to 4 December 2006. Following the share offer, Icelandair Group Holding was listed on the Main Market of NASDAQ OMX Iceland on 14 December 2006.

On 29 December 2006, the shareholders of Icelandair Group Holding hf. agreed to the merger of Icelandair Group Holding hf. and Icelandair Group hf., and the merger was effective as of 1 November, 2006. Following the merger, Icelandair Group hf. was listed on the Main Market of NASDAQ OMX Iceland on 12 February 2007 and Icelandair Group Holding was delisted. At a shareholders' meeting held on 6 August 2009, it was decided that the Board of Directors of the Company would be authorised to increase the share capital of the company up to ISK 4,000,000,000 nominal value.

None of the Company's subsidiaries hold any shares in the Company.

The following table illustrates the share capital of Icelandair Group at the end of each year from 31 December 2005 to 30 June 2010 (in number of shares):

31 December 2005	500,000
31 December 2006	1,000,000,000
31 December 2007	1,000,000,000

31 December 2008	1,000,000,000
31 December 2009	1,000,000,000
30 June 2010	1,000,000,000

All shares carry equal rights. The shares carry no special rights and no restrictions are placed on them.

The Company has entered into binding agreements with several new shareholders and agreed debt-to-equity conversions with its largest creditors; a share capital increase is underway involving the issue of New Shares. Information about the issue of the New Shares can be found in *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*.

Icelandair Group made public an announcement dated 25 May 2010 regarding a shareholders' meeting that took place on 21 May 2010. During the meeting, a motion from the Board of Directors was granted authorising the Board of Directors to purchase the Company's own shares up to a maximum of 10% of the common stock in the Company, in accordance with Article 55 of Act No. 2/1995 on Public Limited Companies. According to the consensus, the price of the shares could not be higher than 20% of the average price on the NADSDAQ OMX Iceland Main Market two weeks before the purchase.

Icelandair Group made public an announcement dated 12 August.2010 stating that the Company intends to raise ISK 2.5 billion in additional equity. The Company intends to offer the additional share capital increase mentioned in the announcement to shareholders and employees. Definite time or structure of that offer has not been finalized but plans are to complete the share offering in 2010. As of the date of this Registration Document it is to be viewed strictly as policy of the current board and may therefore be subject to change in the months to come.

For information about the terms, arrangements and procedures for the issuing of the New Shares, please refer to the Securitas Note for Icelandair Group, which together with this Registration Document and a Summary, forms part of the Prospectus. All of the documents are dated 28 October 2010.

23.2 **Convertible Bonds**

On 24 October 2006, Icelandair Group Holding hf. issued bonds in the nominal amount of ISK 2,000,000,000. All rights and obligations attached to the bonds have now been transferred to Icelandair Group. The bonds carried six-month REIBOR interest with a 3.5% margin for a term of five years; the number of bonds issued were at the discretion of the Board, with interest payment dates every six months with the exception that the first interest period would be extended to 15 months, with the option of conversion into shares in the Group at the price of ISK 29.7. The Board of Directors of the Group was authorised to issue new shares in the Group in accordance with the above authorisation to any holders of convertible bonds requesting such issue in compliance with the rules that were stated in the Company's Articles of Association. Shareholders were required to waive their pre-emptive rights to the increase. The authorisation was effective for five years from 24 November 2006.

The Board of Directors never used this authorisation to issue new shares. Íslandsbanki is the owner of all the convertible bonds described in this subsection.

With an agreement between Íslandsbanki and Icelandair Group regarding the financial restructuring of the Company, Íslandsbanki will refinance the convertible bonds. The agreement is part of the restructuring arrangements between Íslandsbanki and the Company, see *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP*, and the convertible bonds will accordingly be cancelled. Consequently, the authorisation to the Board of Directors to issue the convertible bonds in the Company's Articles of Association was removed at the last shareholders' meeting.

24 MEMORANDUM AND ARTICLES OF ASSOCIATION

The following chapters are extracted from the Company's Articles of Association. The Articles may be subject to change according to the Articles themselves and Act No. 2/1995 on Public Limited Companies.

24.1 Object and Purpose

The object of the Company is to own and run airlines and tourism companies, purchase and sell shares, especially shares in other companies working in the field of aviation, travel industry and transport, purchase and sell real estate, lend and other related business. This can be found in the first chapter of the Company's Articles of Association.

24.2 Board of Directors and Management

The Company's Board of Directors consist of five members and three alternate members, elected at the Annual General Meeting for a term of one year. Those who intend to run for the Board of Directors shall notify the Board of Directors of their candidacy at least 5 days before a shareholders' meeting. The notification shall list the name, identification number and address of the candidate along with information about his main employment, other board memberships, education, experience and shareholding in the Company. Candidates shall furthermore list any interest connected to main clients and competitors of the Company and shareholders controlling more than 10% of the Company. Information about candidates for the Board of Directors shall be available for shareholders' review at the Company's offices no later than 2 days before the shareholders' meeting.

The Company's Board of Directors is the supreme authority in the Company's affairs between shareholders' meetings and ensures that the organisation and activities of the Company's operation are generally in correct and good order. The Board of Directors appoints a Managing Director for the Company and decides the terms of his or her employment. The Board of Directors and the Managing Director are responsible for the management of the Company. The Company's Board of Directors ensures that there is adequate supervision of the Company's accounts and the disposal of its assets and adopts working procedures in compliance with Act No. 2/1995 on Public Limited Companies. Only the Board of Directors grants power of procuration. The signatures of the majority of the members of the Board bind the Company.

The Board of Directors elects a Chairman from among its members, and otherwise allocates its obligations among its members as needed. The Chairman calls board meetings. A meeting shall also be held if requested by a member of the Board of Directors or the Managing Director. Meetings of the board are valid if attended by a majority of the members of the Board. However, important decisions shall not be taken unless all members of the Board have had the opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote and in the event of an equality of votes the issue is regarded as rejected. The Managing Director attends meetings of the Board of Directors, even though he or she is not a member of the Board, and has the right to debate and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings of the Board and is to be signed by participants in the meeting. A board member, or the Managing Director, who is not in agreement with a decision by the Board of Directors is entitled to have his or her dissenting opinion entered in the book of minutes. A board meeting is able to make decisions when a majority of board members participate in meetings. If possible, an important decision should not be taken without all members of the Board of Directors having had a chance to discuss the matter.

The Managing Director has charge of the day-to-day operations of the Company and observes the policy and instructions set out by the Company's Board of Directors. Day-to-day operations do not include measures which are unusual or extraordinary. Such arrangements can only be made by the Managing Director in accordance with special authority from the Board, unless it is impossible to await the decision of the Board without seriously damaging the operation of the Company. In such an event, the Managing Director consults with the Chairman, if possible, after which the Board of Directors is immediately notified of the measures. The Managing Director ensures that the accounts and finances of the Company conform to the law and accepted practices and that the disposal of the property of the Company is secure. The Managing Director provides the members of the Board of Directors and Company auditors with any information pertaining to the operation of the Company which they may request, as required by law.

Article 8.8 of the Company's Articles of Association stipulates that all committees working on behalf of the Board of Directors are elected in accordance with provisions of the rules of the Board of Directors. Their conclusions shall only be directive for the Board of Directors which is not bound by their conclusions when resolving matters unless otherwise stipulated by law.

24.3 **Rights, Preferences and Restrictions of Shares**

All shares in the Company that carry votes have equal rights and no privileges are attached to shares in the Company. The Company's own shares are restricted in a way that no voting rights are attached to the shares. All the shares are freely transferable, unless otherwise provided for by law. No restrictions are placed on shareholders' rights to sell their shares. The provisions of the Act on Electronic Registration of Title to Securities No. 131/1997, and rules based on the Act shall govern the change of ownership. Sale of shares to foreign parties shall be governed by Icelandic law as it reads at the relevant time.

The Board of Directors of the Company is authorised to increase the share capital of the Company in accordance with Article 15.1of the Articles of Association. The share capital of the Company may be increased by up to ISK 4,000,000,000 (four billion Icelandic kronur) nominal value with subscription of new shares. This authorisation is valid until 31 December 2010. The nominal value of the shares to which the shareholders may subscribe to one Icelandic krona. The subscription rate may be decided by means of a public invitation to tender for new shares in the meaning of section 1 of Article 43 of the Securities Transactions Act No. 108/2007. Shareholders shall have a pre-emptive right to purchase new shares in proportion to their registered holdings. Exemptions from this are authorised; cf. paragraph 3 of Article 34 of Act No. 2/1995 on Public Limited Companies.

The Board of Directors of the Company may limit the priority rights of shareholders to subscribe to new shares. The new shares shall grant rights within the Company as of the date of registration of the increase of share capital. The Board of Directors shall lay down further rules relating to respite for subscription and payments for shares. A decision of the Board of Directors to increase the share capital must be approved by an increased majority of the board – four out of five members.

According to the Company's Articles of Association, there are no other direct warranties to increase the share capital of the Company. The Articles of Association do not contain an exhaustive list of methods to increase share capital. Act No. 2/1995 on Public Limited Companies contains provisions that authorise a share capital increase in situations other than mentioned above, see Chapter V of the Act No. 2/1995 on Public Limited Companies.

Provisions

- There are no provisions in the Company's incorporation agreement or its Articles of Association that could delay, postpone or prevent a change in the control of the company.
- There are no provisions in the Company's incorporation agreement or its Articles of Association that include limits on the disclosure of shareholder ownership other than Icelandic law.
- There are no provisions in the Company's incorporation agreement or its Articles of Association regarding changes of share capital that are stricter than is required by law.

24.4 Actions Necessary to Change Shareholders' Rights

According to Article 93 of Act No. 2/1995 on Public Limited Companies, the Articles of Association may only be amended at a lawful Annual General Meeting or extraordinary shareholders' meeting, provided that the notice of the meeting clearly indicates that such an amendment is proposed and outlines the main substance of the amendment. A decision is valid only if it has the support of at least 2/3 of the votes cast and the support of shareholders controlling at least 2/3 of the share capital represented at the meeting, provided always that no other force of vote is required by the Articles of Association or statutory law. Article 12 of the Company's Articles of Association is in conformity with Article 93 of the Act No. 2/1995 on Public Limited Companies and adds no conditions regarding change in shareholders' rights

Certain changes in the Articles of Association may only be amended with the consensus of all the shareholders. Article 94 of Act No. 2/1995 on Public Limited Companies stipulates three conditions for which such consensus is required. These conditions are: reducing dividends or other payments to shareholders; increasing shareholders' obligations to the Company; and limiting shareholders' freedom to exercise their right according to their shares in conjunction with Articles 22 and 23 of the Act No. 2/1995 on Public Limited Companies, or if shareholders are forced to sell their shares without the dissolution of the company.

24.5 Shareholders' Meetings

The supreme power of the Company's affairs, within the boundaries set in the Articles of Association and Icelandic legislation, is in the hands of lawful shareholders' meetings. Shareholders, shareholders' agents, the Company's accountants and the managing director, even if he is not a shareholder, have the right to participate in shareholders' meetings. Furthermore, the Board of Directors may invite specialists to attend the shareholders' meeting if their advice or assistance is required. The Board of Directors is authorised to decide that shareholders may participate in shareholders' meetings by electronic means without being physically present. If the Board of Directors feels that the Company has equipment which is sufficiently safe to allow shareholders to participate in shareholders' meetings electronically without being physically present and the Board of Directors decides to use this authorisation it shall be announced in the invitation to the meeting. If a shareholder wishes to participate electronically in shareholders' meeting, the shareholder must submit his questions five days before the meeting.

A shareholders' meeting is lawful without regard to attendance if it is lawfully called for. A shareholder may send an agent to the shareholders' meeting on his behalf. The agent shall submit a written or an electronic power of attorney which shall be dated. The Board of Directors may decide that a shareholders' meeting will only be held electronically. If the Board of Directors feels that the meeting can be held only electronically with suitable equipment and thereby allowing shareholders to participate electronically, the invitation to the meeting shall give clear information regarding the technical equipment and information on how shareholders notify the Company of their electronic participation and where they can receive information, instructions and a password for participation. An inserted password into a computer system is deemed to be equal to the shareholder's signature and is viewed as valid participation in the shareholders' meeting.

An annual general meeting shall be held within eight months from the end of the financial year. Shareholders' meetings shall be called for with a method which is considered to ensure swift access to the meeting on equal grounds. Trustworthy media shall be used which ensure the circulation of the invitation to the public in the European Economic Area. Such media include the NASDAQ OMX information system and Huginonline. The meeting shall also be called for with an advertisement in Icelandic media. The Board of Directors shall call for shareholders' meetings when it deems it necessary, or when the elected auditor or shareholders controlling at least 1/10 of the share capital insist in writing and suggest an agenda for the meeting. Shareholders' meetings shall be called for with a minimum of three weeks' notice.

The invitation to an annual general meeting shall include information regarding place of the meeting, time and draft agenda. Clear and precise rules on participation in and voting at shareholders' meetings and information about where shareholders can get all relevant documentation that will be presented at the meeting. If a proposal on amendments to the Company's Articles of Association is to be addressed at the meeting, the substance of the proposal shall be described in the invitation.

The agenda shall be available for shareholders' review at the Company's office or on the Company's website along with final proposals to be addressed at the meeting, no later than seven days before the meeting. Each shareholder has the right to have certain matters addressed at the shareholders' meeting if he so requests in writing or by electronic means to the Board of Directors of the Company sufficiently well in advance for the matter to be placed on the agenda and presented to shareholders seven days before the meeting. Lawfully proposed additions or amendments may be presented during the shareholders' meeting itself, even though they were not available for the shareholders' review prior to the meeting. Matters which have not been listed on the agenda may not be finally resolved at the shareholders' meeting without the consent of all shareholders in the Company. Those matters may however be resolved as directions to the Board of Directors.

A simple majority of votes will decide matters at shareholders' meetings unless otherwise stipulated in the Company's Articles of Association or Icelandic law. A proposal is rejected if votes are equal. If two or more people receive an equal number of votes in elections, the election shall be determined by the toss of a coin.

25 CAPITAL RESOURCES

25.1 Information on Capital Resources

The following table sets forth the Group's capitalisation and indebtedness as of 30 June 2010. The following table does not reflect the issue of new shares. See *Chapter 23 SHARE CAPITAL* for information relating to the Group's issued share capital and number of outstanding shares. Investors should read this table in conjunction with the Group's consolidated financial information (and the notes thereto) and *Chapter 10 OPERATING AND FINANCIAL REVIEW.*

Item 58. Capitalisation and indebtedness of Icelandair Group as of 30 June 2010

Capitalization and Indebtedness (mISK)		**30 June 2010**
Total current liabilities		**65,713**
Guaranteed*	18,686	
Secured**	5,890	
Unguaranteed/unsecured	41,137	
Total non-current liabilities		**18,976**
Guaranteed*	0	
Secured**	10,532	
Unguaranteed/unsecured	8,444	
Shareholders' equity		**13,128**
Share capital	975	
Share premium	25,450	
Fair value and other reserves	7,368	
Retained earnings	-20,695	
Minority interest	30	
Total capitalization on 30 June 2010		**97,817**

**** Represents a general pledge in unpledged assets of the Group***

***** Represents a direct pledge in certain real estates and aircraft***

The table above does not reflect the issue of approximately ISK 2.2 billion New Shares in Icelandair Group in the share offering at the subscription price indicated in this Registration Document and the intended application of the estimated net proceeds of approximately ISK 5.5 billion. Following the completion of the share offering of the New Shares, the share capital will increase by ISK 2,941,000,000.

The table on capitalisation represents the current portion of long-term loans, plus short-term liabilities excluding aircraft leases. Total non-current liabilities include long-term interest-bearing debt which amounts to approximately ISK 12.5 billion. The remainder consists of prepayments (ISK 2.3 billion) and long term payables (ISK 4.1 billion). Total current liabilities consist of interest bearing loans and borrowings (ISK 26.3 billion), trade and other payables (ISK 16.7 billion), liabilities held for sale (ISK 6.7 billion) and deferred income (ISK 16.1 billion). Aircraft financing constitutes 40% of the total interest-bearing debt and is solely of a long-term nature and financed by foreign banks. Apart from that source of financing, the interest-bearing debt stems from domestic bank borrowing. Further details of the breakdown of loans can be found in the table below.

Item 59. Net indebtedness of Icelandair Group as of 30 June 2010

Net indebtedness (mISK)		**30 June 2010**
a) Cash	7,471	
b) Cash equivalents	0	
c) Trading securities	0	
d) Liquidity (a) + (b) + (c)		**7,471**
e) Current financial receivables		0
f) Current bank debt	19,271	
g) Current portion of long term debt	5,821	
h) Other current financial debt	1,160	
i) Current financial debt (f) + (g) + (h)		**26,252**
j) Net current financial indebtedness (i) - (e) - (d)		**18,781**
K) Non-current bank debt	10,552	
l) Non-current bonds issued	1,971	
m) Other non-current loans	18	
n) Non-current financial indebtedness (k) + (l) + (m)		**12,541**
Net financial indebtedness (j) + (n)		**31,322**

The cash represents the net figure derived from the consolidated cash flow statement of the Group as published on 13 August 2010.

The capital profile above is based on Icelandair Group's Financial Statements as of 30 June 2010 and before the financial restructuring of the balance sheet. A part of the completion of the financial restructuring will be a share capital increase of approximately ISK 9.2 billion (ISK 2,941 million in share capital and ISK 6,212 in share premiums) where approximately ISK 5.5 billion will be paid with cash and approximately ISK 3.6 billion will be debt-to-equity conversion. Additionally, most of the Group's interest-bearing loans will be restructured. *Chapter 27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP* presents the restructuring in detail.

The Group has a total of approximately ISK 31.4 billion in contingent indebtedness in the form of lease obligations due to aircraft financing. The lease obligations are off-balance-sheet items that are not reflected in the balance sheet, but are directly payable through an amortisation schedule, and they are not reflected in the maturity profile of the Group. Furthermore, the Group has a contingent liability stemming from the commitment to acquire four 787-800 Dreamliner aircraft, see note 46 in the consolidated financial statement on 31 December 2009 for further information.

The Group had a total of ISK 6.7 billion in indirect indebtedness at year end 2009, through off-balance-sheet items such as lease obligations and financial guarantees. The only financial guarantee for third parties is the USD 19.6 million guarantees to SmartLynx as of 30 June 2010.

After the divestment of SmartLynx, Icelandair Group will continue to guarantee USD 19.6 million to SmartLynx. The guarantee will gradually expire until 1 January 2014. The guarantees for SmartLynx are in regard of lease payments on aircraft. If SmartLynx cannot pay its lessors, the guarantee will fall on Icelandair Group. That could happen if SmartLynx could not lease its unused aircraft to another company. Loftleidir has a contract with SmartLynx regarding the lease of two aircraft, where Loftleidir leases two aircraft from SmartLynx. The contracts are on an arm's length basis and they will not be affected by the divestment of SmartLynx from the Group.

The expected net indebtedness after the restructuring is shown in the following table. Please note that the financial information on net indebtedness after the financial restructuring is not audited and is based on information from the management of Icelandair Group.

Item 60. The table shows net indebtedness after financial restructuring

Net indebtedness (mISK)		**30 June 2010**
a) Cash	13.175	
b) Cash equivalents	0	
c) Trading securities	0	
d) Liquidity (a) + (b) + (c)		**13.175**
e) Current financial receivables		0
f) Current bank debt	0	
g) Current portion of long term debt	3.181	
h) Other current financial debt	0	
i) Current financial debt (f) + (g) + (h)		**3.181**
j) Net current financial indebtedness (i) - (e) - (d)		**-9.994**
K) Non-current bank debt	22.370	
l) Non-current bonds issued	1.971	
m) Other non-current loans	18	
n) Non-current financial indebtedness (k) + (l) + (m)		**24.359**
Net financial indebtedness (j) + (n)		**14.365**

Item 60 shows the effects of the restructuring on the Company‘s net indebtedness after financial restructuring as of 30 June 2010. The pro forma balance sheet shown in item 69 addresses a hypothetical situation and, therefore, does not represent the company’s actual financial position or results.

The information provided in this chapter is derived from the last published financial information of the Issuer and information related to the financial restructuring which have not been audited and is based on information from the management of Icelandair Group. As of the date of this Registration Document the Issuer declares that there have been no material changes since the last published financial information.

25.1.1 Discussion on Cash Flow

Cash and cash equivalents increased by ISK 5.5 billion during the first half of 2010 compared to ISK 1.8 billion the same period the previous year. Refer to *Chapter 9.2.4 First Half Statements of Cash Flows 2009 and 2010* for information on cash flow 30 June 2010 and 30 June 2009. Refer also to *Chapter 9.1.4 Statement of Cash Flows* for the years 2007–09. This is due to improved cash flow from working capital in operation and a net change in operating assets and liabilities, totalling ISK 9.4 billion compared to ISK 5 billion in 2009. Repayment of borrowings was similar between the years (ISK 1.8 billion), mainly that of aircraft fininacing.

25.1.2 Standstill Agreement

From 1 December 2009, there was an agreement in force stipulating a cash flow standstill between the Company and the major domestic lenders in the amount of ISK 23.9 billion, which is the relevant facility. The collaboration between the parties was based on an understanding which was to cover the period of capital restructuring and included that any overdue payments would be deferred on the same terms as offered by the relevant facility. As a result of this arrangement, no source of liquidity was unused under the agreement apart from a ISK 0.5 billion overdraft facility, the application of which varies depending on seasonality and liquidity needs within each month. A binding agreement on the financial restructuring was signed on 12 August 2010 and the documentation process of the financial restructuring was completed on 21 October 2010. The standstill agreement is no longer in force since the final documentation process has been completed.

25.1.3 **Transferability of Funds**

Historically as well as currently, there are no material, legal or economic restrictions on the ability of subsidiaries to transfer funds to the Company in the form of cash dividends, loans or advances. Hence, there are no restrictions which affect the ability of the Company to meet its cash obligations.

25.1.4 **Treasury Management Policy**

The Company has a policy which covers treasury management. This includes objectives in terms of the manner in which cash and cash equivalents are held, the extent to which borrowings are at fixed rates and the use of financial instruments for hedging purposes. The details of this policy are covered in *Chapter* 2 *RISK MANAGEMENT POLICY*.

The policy includes a description of the preferred levels of liquidity which can be compared to the current level of ISK 7.5 billion and the projected level of approximately ISK 13.2 billion after the capital restructuring.

25.2 **Maturity Profile**[58]

The capital restructuring will have a dramatic effect on the amortisation of liabilities. Total interest-bearing debt will be brought down from ISK 41.7 billion to ISK 27.6 billion, and the ratio of current loans thereof will be reduced from 66% to 10%. The following table compares the current maturity profile with the projected version after the restructuring. The maturity profile after the restructuring is shown in the following table. Please note that the financial information on the maturity profile after the financial restructuring is not audited and is based on information from the management of Icelandair Group.

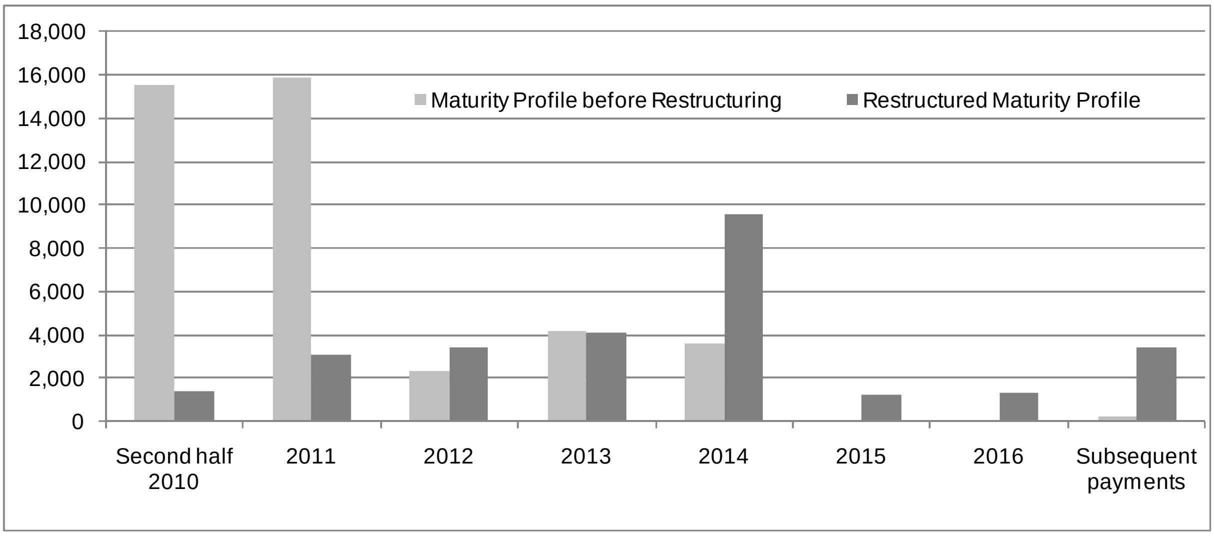
Item 61. Comparison of maturity profiles

(mISK)	Maturity Profile before Restructuring	Restructured Maturity Profile
Second half 2010	15,501	1,407
2011	15,847	3,061
2012	2,321	3,448
2013	4,212	4,088
2014	3,612	9,579
2015	15	1,260
2016	16	1,346
Subsequent payments	183	4,206
Total	**41,707**	**28,394**

The table reflects the excessive burden of the current loan repayment profile and the complications it has placed on the financing administration and liquidity. Once the restructuring has been finalised, the debt level and maturity is expected to be comfortably within the limits of sustainability. The following column chart displays graphically the contrasts between the two profiles.

[58] The financial data on the restructured maturity profile in this chapter is not extracted from the issuer's audited financial statements. The data on the restructured maturity profile in this chapter is unaudited and based on management calculations derived from negotiations with the creditors of the Group.

Item 62. The table represents estimated changes in maturity profile



Item 63. Interest coverage ratio for the years 2007 to 2009

	2007	2008	2009
EBIT	2,337	-7,351	1,483
Interest expense	2,545	3,658	4,152
Interest coverage ratio	**0.9**	**-2.0**	**0.4**

25.3 Liquidity Risk and Covenants in Loan Contracts

Some of the Company's long-term loan agreements contain covenants which have to be honoured at all times, and if violated, they will entail consequences for the servicing of debt and the capital structure as a whole. Please note that the financial information on covenants after the financial restructuring is not audited and is based on information from the management of Icelandair Group. These loans are estimated to amount to around 40% of the total long-term loans after completion of the loan restructuring and include one or more of the following financial covenants:

- Leverage ratio, i.e. Interest bearing debt to EBITDA. It may not exceed 4.0 at the end of the year 2010 and may not exceed 3.5 at the end of the year 2011 and may not exceed 3.25 at the year end 2012 and onwards.
- Fixed Charge Coverage Ratio, i.e. EBIDTA to fixed charges. Fixed charges are defined as interest, distributions, capital expenditure, cash taxes and principal payments. Must not be less than 1.1 at the end of the year 2011. Must not be less than 1.2 from Q3 2012 and onwards.
- Liquidity ratio, i.e. liquid assets to total revenues. Liquid assets are cash and cash equivalent. Must not be less than 6% at the end of the year 2010. Must not be less than 10% from Q1 2011 and onwards.
- Interest cover ratio, i.e. EBIT to net interests must be at least 1.5 at the end of the year 2011.
- Equity ratio, i.e. the ratio of Shareholders' equity to total assets. Must be at least 30% at year-end 2010 and at least 35% at Q3 2013 and onwards.

The covenants differ in terms of ratio requirements between loan agreements, but they all consider violation as a case of default, which would have serious consequences for the operations and financing of the Company. This includes one or more of the following: renegotiations with creditors, accelerated repayments of loans, increased interest rates and loss of financial reputation.

However, such circumstances could be met with a temporary waiver from creditors, and if that is not obtained, with refinancing through the sale of assets and share capital. It is likelier than not that a temporary waiver could be expected if a breach of one or more of the covenants is anticipated to be temporary due to exceptional or extraordinary events.

In some of the loan agreements there are negative covenants which could place impediments to and constraints on the Company's operations. They include claims of no encumbrances over any part of present and future assets, no further material borrowings, off-balance-sheet funding or guarantees and no merger, consolidation or joint ventures. All of these issues need the prior consent of the lender.

Further items include prohibition of extraordinary dividends or distributions, share buyback, certain disposal of material assets and negative pledges.

26 TAXATION

26.1 Certain Icelandic Tax Considerations

The following is a description of the relevant Icelandic tax consequences for shareholders, based on the rules and regulations in force at the date of the Registration Document. It is therefore subject to any changes in law occurring after such date. This discussion is meant to provide general guidelines and does not deal with all aspects that could be important for potential investors. It focuses on individual shareholdings and shareholdings of limited liability companies, and does not cover tax issues in other cases, for instance where shares are held as assets in business operations by individuals or by a partnership. The tax treatment of holders of shares depends in part on their particular circumstances. Each shareholder should therefore consult a tax advisor regarding the tax consequences which may arise for such person as a result of buying or selling shares in the Company, including the applicability and effect of foreign income tax regulations and provisions contained in treaties to avoid withholding tax and double taxation. Foreign parties should obtain information on a possible double taxation treaty with their country of residence. If such a treaty has been made, the party should establish which country has the right to tax.

26.2 Tax Considerations for Residents of Iceland

26.2.1 Taxation of Dividends

For individuals, capital income such as dividends is taxed at the rate of 18%.

Dividends paid to limited liability companies constitute taxable income according to the Income Tax Act No. 90/2003. The same act however permits limited liability companies to deduct from their income, including their dividend income, any sum which they may have been paid in dividends. Such a deduction is conditional on the limited liability company owning at least a 10% share in the Company. In fact, received dividends are therefore not taxable for such shareholders.

The Company is obligated to withhold 18% tax on paid out dividends in the case of individuals and resident companies. Companies may have a deduction of the same amount as the dividends received and consequently there is no effective tax burden for companies (“dividend received deduction”). The 18% withheld by the Company is in accordance with legal responsibilities under current domestic tax law. If the tax which is withheld is higher than levied tax, then the difference will be refunded upon assessment of tax returns.

26.2.2 Taxation on Realization of Shares

Capital gains from the sale or other disposal of shares are taxable in Iceland pursuant to current laws. For individuals, capital gains are taxed as income from capital. The tax rate is 18%. Upon the sale or other disposal of shares, the shareholder’s average acquisition costs for all shares of the same class and type will be used as the tax base on which the capital gain of the sale/disposal is calculated. Individuals can use losses from the sale of shares in limited liability companies within the same calendar year and offset them against capital gains from the sale of shares. Losses from the sale of shares cannot be carried forward and offset against future capital gains from the sale of shares.

In the case of legal entities, capital gains from the sale or other disposals of shares are taxable income according to the Income Tax Act No. 90/2003. The same act however permits limited liability companies to deduct from their income any gains from the sale or other disposals of shares. Such a deduction is conditional on the limited company owning at least a 10% share in the Company.

- Losses from sales of shares cannot be carried forward as losses from regular activities.
- Specific tax consequences may be applicable to certain categories of companies, such as mutual funds and holding companies.
- Residents of Iceland are subject to income tax on their interest income in accordance with Icelandic tax law.

26.3 Tax Considerations for Non-Residents of Iceland

26.3.1 Taxation of Dividends

The Company is obligated to withhold 18% tax on dividends paid to individuals who are not residents of Iceland, absent treaty provisions to the contrary. The Company is obligated to withhold 15% tax on dividends paid to foreign legal entities unless there is a tax treaty in place lowering the percentage. Qualified companies may apply for a reimbursement and/or an advance relief under relevant provisions in double taxation treaties. The Income Tax Act No. 90/2003 however permits limited liability companies which are resident within the EU/EEA area to deduct from their income, including their dividend income, any sum which they may have been paid in dividends. Such a deduction is conditional on the limited company owning at least a 10% share in the Company. Received dividends are therefore not taxable for such shareholders.

26.3.2 Taxation on Realization of Shares

In the case of legal entities, all gains from the sale or other disposal of shares are taxable income according to the Income Tax Act No. 90/2003 and are subject to withholding tax of 15%. The same act however permits limited liability companies which are resident within the EU/EEA area to deduct from their income any gains from the sale or other disposals of shares. Such a deduction is conditional on the limited company owning at least a 10% share in the Company. The capital tax rate for individuals is 18%, absent treaty provisions to the contrary.

Icelandic brokers as well as Icelandic persons acting as intermediaries are required to withhold the tax from the sale price unless they have been furnished with the Director of Internal Revenue’s confirmation of the seller’s exemption from such taxation prior to the transaction. Residents of treaty countries can apply for formal confirmation of their exemption from such taxation from the Director of Internal Revenue.

26.3.3 Stamp Duty on Share Transfers

The shares are subject to a one-time stamp duty within two months from their issue. Stamp duty has been paid for all issued shares. The sale or other disposal of shares is not subject to Icelandic stamp duty.

27 FINANCIAL RESTRUCTURING OF ICELANDAIR GROUP

Icelandair Group announced on 14 and 15 June 2010 that the Enterprise Investment Fund (EIF) and the Pension Fund of Commerce (PFC) had entered into a binding agreement with the Company to the effect that the two funds would invest in Icelandair Group for approximately ISK 4 billion at a share price of approximately 2.5. In the agreement, EIF undertook to contribute approximately ISK 3 billion, thereby acquiring approximately 1.2 billion New Shares in the Company. The PFC undertook to contribute approximately ISK 1 billion, thereby acquiring approximately 400 million New Shares in the Company.

The agreements were concluded with the following conditions:

- Positive results of Icelandair Group due diligence.
- Exemption of the EIF by the Financial Supervisory Authority (FME) from an obligatory take-over of the Company.
- That Icelandair Group raised a minimum ISK one billion in market value through the sale of New Shares to other investors.

All of the above conditions have been met as Icelandair Group announced on 12 August 2010, and investors have subscribed to a total of approximately ISK 5.5 billion at market value in new share capital, which corresponds to approximately 2.2 billion New Shares in Icelandair Group.

The agreement assumes the conversion by Icelandair Group's two largest creditors of debt in the amount of approximately ISK 3.6 billion into shares based on a share price of ISK 5 per share, which corresponds to a subscription to 720 million new shares. The total increase in share capital will thus amount to approximately ISK 2.9 billion New Shares at nominal value.

Icelandair Group plans furthermore to raise approximately ISK 2.5 billion in additional share capital at the same price (2.5) from shareholders and employees in 2010. The timing and structure of that offering will be disclosed later.

27.1 Background of the Financial Restructuring

The Group undertook major cost-cutting measures in the first half of 2008. More than 500 staff redundancies were followed by capacity cuts and renegotiations with suppliers. Furthermore, the top management of many subsidiaries has been changed over the course of the last two years. Around the same time, orders for four Airbus 330 cargo aircraft were cancelled, which lowered the Group's commitments by USD 450 million. The cost-cutting measures taken in 2008 are among the main reasons for the Group's ability to shoulder the downturn in 2008 and early 2009.

However, the balance sheet of the Group was set in a period when the owners and the Board of Directors focused on acquisitions and expansion abroad. The balance sheet was not self-sustaining, in particular due to the high level of indebtedness, and it was a major problem for the Group even before the financial turmoil in Iceland in the autumn of 2008. Although the daily operations of the Group largely went according to plan in 2009, financial expenses were a drain on the cash flow of the Group. It had been evident for some time that the balance sheet needed to be restructured.

The collapse of the banking system in Iceland late in 2008 along with the worldwide recession has also affected the Group's operational landscape, especially as domestic demand dropped significantly. Strain on cash flows followed due to termination of the Group's banking services coupled with severe outflows of cash to meet an ever-growing demand for cash collateral by international financial institutions to replace bank guarantees. As a consequence, it become more challenging for the Group to meet its refinancing needs since its liquidity largely dried up after the financial turmoil of the Icelandic economy in 2008.

To meet these changes, the Board of Directors of the Group has announced its plans to adapt to this new environment. A step in this process is the financial restructuring that was announced to be formally concluded on 12 August 2010. The documentation process of the financial restructuring was not concluded and contracts signed until on 21 October 2010.

27.2 Overview of the Financial Restructuring

The major steps of the financial restructuring of Icelandair Group are listed below:

- New shares issued for cash consideration in the nominal amount of approximately ISK 2.2 billion at the price of ISK 2.5, which equals approximately ISK 5.5 billion in market value.
- Íslandsbanki and the Resolution Committee of Glitnir Bank convert debt in the amount of approximately ISK 3.6 billion into shares based on a price of ISK 5 per share, which corresponds to a subscription to ISK 720 million New Shares.
- Vindabudir ehf. ID No. 680807-2560, a company fully owned by the Resolution Committee of Glitnir Bank, will directly acquire 100% of the share capital of SmartLynx for ISK 1 (one) as SmartLynx has no value. Icelandair Group will continue to guarantee SmartLynx operational leasing obligations.
- The Resolution Committee of Glitnir Bank and Íslandsbanki incorporated an SPV, a special purpose vehicle, (hereinafter "SPW ehf.") which will acquire Travel Service and Bluebird Cargo from Icelandair Group. A binding agreement on the divestment and the incorporation of SPW ehf. was signed on 12 August 2010. However, the documentation process was not concluded and contracts signed until on 21 October 2010. The contract has reservations and SPW ehf. will not take control of the divested companies until these reservations have been fulfilled (see below).
- Icelandair Group will continue to own and manage IG Invest, but it will be controlled by SPW ehf. However, Icelandair Group has made an agreement with SPW ehf., which will receive economic benefits from IG Invest. The total proceeds to Icelandair Group from the sale of Bluebird Cargo, Travel Service, and the economic benefits of IG Invest to SPW ehf. amount to ISK 7.6 billion. The ISK 7.6 billion in proceeds contributes to reducing the debt of Icelandair Group by ISK 7.6 billion. There is no cash contribution involved in the asset divestment.
- If SPW ehf. receives more than ISK 7.6 billion, in addition to interest amounting to REIBOR + 3%, from its assets when it sells them before September 2015 (Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group will receive 50% of any potential yield that is higher than ISK 7.6 billion. On the other hand, if SPW ehf. receives a lower amount than ISK 4.0 billion before September 2015 from the sale (of Travel Service, Bluebird Cargo and the economic benefits from IG Invest), Icelandair Group must pay SPW ehf. ISK 0.5 billion. The contracts state that if SPW ehf. has not sold its assets before September 2015, the banks can extend the period until September 2017.

The financial restructuring is subject to certain conditions being satisfied or waived as soon as practicable and in any event no later than by close of business on 15 December 2010. The material conditions are as follows:

- An approval from competition authorities in Iceland and Latvia for the sale and purchase of the shares in Bluebird Cargo ehf. and SmartLynx respectively;
- Icelandair Group and SPW ehf. shall enter into a shareholders' agreement and a call option agreement and other relevant agreements and arrangements in relation to their shareholding in IG Invest ehf. Icelandair Group and SPW ehf. shall enter into following agreements:
  - Shareholders' agreement in terms of IG Invest ehf. that outlines how IG Invest will be controlled;
  - Service agreement in terms of IG Invest whereas Icelandair Group undertakes to manage IG Invest on behalf of SPW ehf.;
  - SPW ehf. shall have call options on Icelandair Group's shareholding in IG-Invest.
- Icelandair and Vindabúðir ehf. shall enter into an operating agreement in relation to SmartLynx;
- The signing of a conditional guarantee issued by Icelandair Group for the benefit of Íslandsbanki and Glitnir banki in the total amount of ISK 500,000,000;
- Exemptions from the Central Bank of Iceland from the Rules on Foreign Exchange, No. 370/2010 (issued by the Central Bank of Iceland), with regards to the sale and purchase of the shares in Travel Service and SmartLynx;
- A written confirmation from certain creditors of Travel Service and SmartLynx, confirming that (i) the relevant loans are not in default and (ii) Icelandair Group can transfer the title of the shares in Travel Service and SmartLynx;
- Waiver letters in relation to change of control provisions in certain agreements entered into by Bluebird Cargo;
- Amendments to existing general bonds, granted by Icelandair Group and its subsidiaries; and
- New security granted by Icelandair Group. Specifically: (i) share pledge agreement, granting 2nd priority security over shares in IG Invest and (ii) a security interest over a Boeing 757-200 aircraft to Íslandsbanki.

It should be noted that the above conditions are largely formalities which are expected to be satisfied by 15 December 2010.

Notice is drawn to the fact that the financial data in Chapters 27.2–27.6 is not extracted from the issuer's audited financial statements. The data in this chapter is unaudited and based on management calculations derived from negotiations with the creditors of the Group.

27.2.1 **The Future of Icelandair Group**

The future focus of the restructured Group will be on the operations of Icelandair ehf., Icelandic tourism and the *Hub and Spoke* Concept that is a pivotal part of Icelandair ehf.'s business model. [59]

- The Group has simplified its business model to reflect the new strategy.

[59] See *Chapter 10.1.1. General Information About the Group.*

- In the restructuring process, Icelandair Group was advised by DVB bank.
- From now on, Icelandair Group defines itself as an operating company focusing on route network and tourist services, and should not be looked upon as a holding company.
- By placing Travel Service, Bluebird Cargo and SmartLynx under the ownership of Icelandic creditors, the Group's balance sheet will be reduced by ISK 10.2 billion as is explained in *Chapter27.6 Pro Forma Balance Sheet* (below).

Item 64. Subsidiaries of the core Icelandair Group going forward

Item 65. Businesses Divested

The new business structure is based on two business segments. As before, the support functions will work across both business segments and provide support for the subsidiaries and associate companies.

27.3 The Share Offering

As was stated above, investors have subscribed to a total of approximately ISK 5.5 billion at market value in new share capital, which corresponds to approximately 2.2 billion New Shares in Icelandair Group.

The following parties subscribed to the share capital on offer and will pay for the New Shares in cash. The table shows each investor's share in the total share capital of the Company after the issue of approximately 2.2 billion New Shares.

Item 66. New shareholders that have subscribed for 2,221 million New Shares announced on 12 August 2010

New Shareholders	ID Number	Nominal Value (ISK)	Price	Market Value (ISK)	Holding (% of share capital)
The Enterprise Investment Fund slhf..	651109-0510	1,200,000,000	2.5	3,000,000,000	30.4%
The Pension Fund of Commerce........	430269-4459	400,000,000	2.5	1,000,000,000	10.1%
Lífeyrissjóðir Bankastræti 7...............	711297-3919	200,000,000	2.5	500,000,000	5.1%
Virðing hf..	561299-3909	137,000,000	2.5	342,500,000	3.5%
Stefnir ÍS-15...................................	470206-8450	85,000,000	2.5	212,500,000	2.2%
Íslensk verðbréf hf...........................	610587-1519	54,000,000	2.5	135,000,000	1.4%
Stefnir ÍS-5.....................................	430407-9610	45,000,000	2.5	112,500,000	1.1%
Other new shareholders....................	600390-9619	100,000,000	2.5	250,000,000	2.5%
Total..		**2,221,000,000**		**5,552,500,000**	**56.3%**

27.3.1 The Enterprise Investment Fund

On 14 June 2010, the Enterprise Investment Fund, an investment company owned by 16 Icelandic pension funds, entered into a binding agreement with Icelandair Group on an investment of approximately ISK 3 billion in the Group in return for a 30.4% share in the Company after the increase in share capital.EIF subscribed to ISK 1.2 billion in New Shares at the price of ISK 2.5, for a total consideration of ISK 3 billion in cash.

The agreement was concluded with normal reservations regarding the results of due diligence, which have been fulfilled as was made public on 12 August 2010.

27.3.2 The Pension Fund of Commerce

On June 15 2010, the Pension Fund of Commerce (PCF) entered into a binding agreement with Icelandair Group on investing ISK 1 billion in the Group in return for a 10.1% share in the Company after the increase in share capital. PCF subscribes to New Shares in the nominal amount of ISK 400 million at a price of ISK 2.5, for a total of ISK 1 billion in cash.

The agreement with PCF was concluded with the normal reservations regarding the results of due diligence, which have been fulfilled as was made public on 12 August 2010.

27.3.3 Debt Conversion into Equity

Íslandsbanki will convert ISK 2,793,600,000 of debt into equity at the price of ISK 5 per share. Íslandsbanki will receive 558,720,000 New Shares in Icelandair Group following the debt-to-equity conversion. Prior to the conversion, Íslandsbanki holds 469,772,387 shares in the Group. After the debt-to-equity conversion, Íslandsbanki will hold 1,028,492,387 shares in Icelandair Group, which equals 26.1% of total share capital.

Glitnir Bank will convert ISK 806,400,000 of debt into equity at the price of ISK 5 per share. Glitnir Bank will receive 161,280,000 New Shares in Icelandair Group following the debt-to-equity conversion. Prior to the conversion, Glitnir Bank holds 20,925,000 shares in the Group. After the debt-to-equity conversion, Glitnir Bank will hold 182,205,000 shares in Icelandair Group, which equals 4.6% of total share capital.

Item 67. The debt to equity conversions

Debt to equity conversions (ISK)	Debt Converted	Price	Nominal Value
Íslandsbanki hf...	2,793,600,000	5.0	558,720,000
Glitnir Bank hf...	806,400,000	5.0	161,280,000
Total..	**3,600,000,000**		**720,000,000**

27.4 Shareholders List after Financial Restructuring

The following table depicts the largest shareholders of Icelandair Group after the financial restructuring.

Item 68. Largest shareholders of Icelandair Group after the financial restructuring

Shareholders after financial restructuring	ID Number	Nominal Value	Holding (%)
The Enterprise Investment Fund slhf...............	651109-0510	1,200,000,000	30.4%
Íslandsbanki hf...	491008-0160	1,028,492,387	26.1%
The Pension Fund of Commerce.....................	430269-4459	400,000,000	10.1%
Landsbanki Íslands hf....................................	540291-2259	238,348,350	6.0%
Lífeyrissjódir Bankastræti 7............................	711297-3919	200,000,000	5.1%
Glitnir Bank hf..	550500-3530	182,205,000	4.6%
Virding hf...	561299-3909	137,000,000	3.5%
Icebank hf..	600390-9619	93,572,562	2.4%
Stefnir ÍS-15..	470206-8450	85,000,000	2.2%
Íslensk Verdbréf hf..	610587-1519	54,000,000	1.4%
Stefnir ÍS-5..	430407-9610	45,000,000	1.1%
Other shareholders.......................................		277,381,701	7.0%
Total..		**3,941,000,000**	**100%**

27.5 Asset Divestments and Financial Treatment of Divested Assets

The Board of Icelandair Group has decided to simplify the Group's business model in order to reflect a change in the business environment. The future focus of Icelandair Group will be on the operations of Icelandair ehf., Icelandic Tourism and the *Hub and Spoke* concept as well as related services. Under the new plan, discontinued businesses will be divested.

Discontinued businesses comprise:

- *Bluebird Cargo*
    - In the Group's consolidated balance sheet for the period ended 30 June 2010, this company was categorised as assets and liabilities held for sale.
    - Bluebird Cargo is a part of the Group's consolidated income statement for the period ended 30 June 2010 and directly affects the EBITDA of the Group.
    - Bluebird Cargo will be a part of the consolidated income statement of the Group until the transaction is finalised, but Bluebird Cargo will not be a part of the consolidated balance sheet of the Group when the Group publishes its third quarter 2010 results.
- *SmartLynx*
    - In the Group's consolidated balance sheet for the period ended 30 June 2010 the company was categorized as assets and liabilities held for sale.
    - SmartLynx is categorized as discontinued business and is <u>not</u> a part of the Group's consolidated income statement for the period ended 30 June 2010 and does <u>not</u> directly affect the EBITDA of the Group.
- *Travel Service*
    - In the Group's consolidated accounts for the period ended 30 June 2010, the 30% share of the company was categorised as assets and liabilities held for sale.
    - Travel Service is categorised as a discontinued business and is <u>not</u> a part of the Group's consolidated income statement for the period ended 30 June 2010 and does <u>not</u> directly affect the EBITDA of the Group.

27.6 Pro Forma Balance Sheet

The pro- forma balance sheet below shows the effects of the restructuring on the Company‘s balance sheet as of 30 June 2010. The pro forma financial information addresses a hypothetical situation and, therefore, does not represent the company's actual financial position or results.

The pro forma financial information listed herein is compiled by the management of Icelandair Group hf. and are is only for information purposes. The pro forma information are not audited and has been prepared for illustrative purposes only.

The pro-forma consolidated balance sheet on 30 June 2010 is based on the following assumptions:

- Sale of Bluebird Cargo, Travel Service and the economical benefits of IG Invest for a total of ISK 7.6 billion. The ISK 7.6 billion in proceeds is contributed by reducing debt of Icelandair Group hf. amounting to ISK 7.6 billion. There is no cash contribution involved in the asset divestment.

- Vindabudir ehf. ID No. 680807-2560, a company fully owned by the Resolution Committee of Glitnir Bank, will directly acquire 100% of the share capital of SmartLynx for ISK 1 (one) as SmartLynx has no value. Icelandair Group will continue to guarantee SmartLynx operational leasing obligations
- Debt-to-equity conversion by Íslandsbanki and the Resolution Committee of Glitnir Bank in the amount of ISK 3.6 billion.
- New share capital from investors amounting to ISK 5.5 billion.
- Refinancing of ISK 11.9 billion of short- term debt into long- term debt.

Item 69. Pro -forma Balance Sheet for Icelandair Group hf. 30 June 2010 (mISK)

Assets:	30.6.2010	Restructuring	30/06/2010 Pro-forma
Operating assets	30,391	53	30,444
Intangible assets	23,781	(605)	23,176
Investments in associates	635	(472)	163
Prepaid aircraft acquisitions	1,179	(1,179)	0
Long-term cost	1,318		1,318
Long-term receivables and deposits	3,365	(1,789)	1,576
Deferred tax asset	439	(437)	2
Total non-current assets	***61,108***	***(4,429)***	***56,679***
Inventories	1,619		1,619
Trade and other receivables	13,332	1,371	14,703
Assets classified as held for sale	12,824	(12,824)	0
Prepayments	1,463		1,463
Cash and cash equivalents	7,471	5,704	13,175
Total current assets	***36,709***	***(5,749)***	***30,960***
Total assets	**97,817**	**(10,178)**	**87,639**
Equity:			
Share capital	975	2,941	3,916
Share premium	25,450	6,212	31,662
Reserves	7,368		7,368
Accumulated deficit	(20,695)	1,236	(19,459)
Total equity attributable to equity holders of the Company	13,098	10,389	23,487
Non-controlling interest	30		30
Total equity	**13,128**	**10,389**	**23,517**
Liabilities:			
Loans and borrowings	12,541	11,818	24,359
Prepayments	2,303	(2,303)	0
Long-term payables	4,132		4,132
Total non-current liabilities	**18,976**	**9,515**	**28,491**
Loans and borrowings	26,252	(23,071)	3,181
Trade and other payables	16,682		16,682
Liabilities classified as held for sale	6,708	(6,708)	0
Deferred income	16,071	(303)	15,768
Total current liabilities	**65,713**	**(30,082)**	**35,631**
Total liabilities	**84,689**	**(20,567)**	**64,122**
Total equity and liabilities	**97,817**	**(10,178)**	**87,639**

The table depicts the consolidated balance sheet of Icelandair Group hf. for the first six months of 2010 in the, column labelled “30/06/2010”. The column labelled “Restructuring” shows the changes to each line item of the consolidated balance sheet following the financial restructuring. The last column, labelled “30/06/2010 Pro forma” shows the pro forma consolidated balance sheet of Icelandair Group hf. on 30 June 2010, taking into account the amendments to the balance sheet stemming from the financial restructuring.

The restructuring of the Group’s balance sheet is explained in *chapter Chapter* 27.2 *Overview of the Financial Restructuring*. The effects of the restructuring on every balance sheet item are presented in the column labelled “Restructuring”.

“Assets classified as held for sale” is the book value of the shares in Travel Service, Bluebird Cargo, and SmartLynx in addition to the price premium which is involved in the divestments of Travel Service and Bluebird Cargo.

Cash and cash equivalents increase by ISK 5.7 billion due to the capital injection of ISK 5.5 billion in addition to intra- group debt that will be settled with IG Invest.

The share offering increases the Company’s share capital of by approximately ISK 9.2 billion (ISK 2,941 million in share capital and ISK 6,212 million in share premium) where approximately ISK 5.5 billion is paid with cash and approximately ISK 3.6 billion is debt -to -equity conversion.

Change in accumulated deficit is ISK 1.2 billion, which is the after tax profit and revised foreign currency translations differences, from the sale of Travel Service, Bluebird Cargo, SmartLynx and the economic benefits from IG Invest. The sale price of the assets amount to ISK 7.6 billion and the book value amounts to ISK 6.1 billion. Net after tax effects on accumulated deficit amount to ISK 1.2 billion.

Non-current loans and borrowings increase by ISK 11.9 billion as the term structure of short- term loans is changed so as they will be classified as long- term loans.

Current loans and borrowings decrease by ISK 23.1 billion. The sale of the shares in Bluebird Cargo, Travel Service and the transfer of the economic benefits from IG invest decreases debt by ISK 7.6 billion. The debt to equity swap amounts to ISK 3.6 billion. The change of short term loan terms decreases current loans by ISK 11.9 billion.

“Liabilities classified as held for sale” is the debt on Bluebird Cargo’s and SmartLynx’s balance sheets.

27.6.1 **Auditor’´s Review Report**

We have reviewed the accompanying pro forma consolidated balance sheet of Icelandair Group hf. as of 30 June 2010. This consolidated financial information is the responsibility of the Company’s management. Our responsibility is to issue a report on this pro forma financial information based on our review.

Our review is limited and thus provides less assurance than an audit and accordingly, we do not express an audit opinion.

The pro forma financial information is not audited, but are nevertheless prepared in accordance with IFRS. Furthermore, the pro forma financial information is prepared on a basis which is consistent with the accounting principles used by Icelandair Group.

Based on our review, nothing has come to our attention that causes us not to believe anything other than that the pro-forma information have been prepared properly. We herby confirm that :

- the pro forma financial information has been properly compiled on a basis that is consistent with the accounting principles used by the companies of Icelandair Group hf.;

- the adjustments are appropriate for the purposes of the pro forma financial information as disclosed;.
- financial information is prepared in accordance with IFRS.

We consent to the inclusion of this letter and the reference in the Registration Document to be issued by Icelandair Group hf. in the form and context in which it appears.

Reykjavík, 28 October 2010

On behalf of KPMG Endurskodun hf.

Jón S. Helgason

State authorised public accountant and member of The Institute of State Authorized Public Accountants in Iceland

Icelandic ID No. 050269-3619

and

Gudný Helga Gudmundsdóttir

State authorised public accountant and member of The Institute of State Authorized Public Accountants in Iceland

Icelandic ID No. 221168-4029.

III.

Securities Note

CONTENTS

1 RISK FACTORS

1.1 General

Investing in shares entails numerous risks, as the decision to invest is based on expectations, not promises. Investors must rely primarily on their own judgement regarding any decision to invest in any company's shares, bearing in mind the business environment in which the company operates, anticipated profits, external conditions and the risk inherent in the investment itself. Prospective investors are advised to contact experts such as licensed financial institutions to assist them in their assessment of the shares in the Company as an investment option. Investors are furthermore advised to consider their legal status, including taxation issues that may concern the purchase or sale of shares in the Company and seek external and independent advice in that respect.
The risks and uncertainties described below may materially affect the Company and any investment made in its shares. If any combination of these events occurs, the trading price of the shares could decline and investors might lose part or even all of their investment. Additional risks and uncertainties that do not currently exist, that are not presently considered material, or of which the Company is unaware, may also impair the business and operations of the Company. These risks and uncertainties could have a material adverse impact on the business, income, profits, assets, liquidity and share price of the Company.

Prior to making any investment decision regarding shares in the Company, please consider all the information in this Securities Note and the Registration Document, which is a part of the Prospectus dated on 28 October 2010.

1.2 Risk related to Shares Investment

1.2.1 Stock Returns

Empirical evidence is generally considered to lend support to the fact that in the long run stock returns exceed those of bonds and alternative securities. Yield on stocks consists of dividend payments, on one hand, and the change in share prices on the other, profit or loss resulting from the difference between the price per share when bought and sold. However, stock investment is considered to be a riskier than that of alternative securities. Stock prices are prone to greater volatility and payments of dividends are often uncertain, as is the effect of such payments on the share price. The risk involved in investing in individual companies can be spread by disbursing the risk by investing in different registered companies of different character and markets. Such a strategy can even out individual firm level risk and constrain it close to the average stock market level of risk and returns.[1] Hence, stock investment will always be under the risk and influence of external market related disturbances, e.g. currency exchange fluctuations, changes in general interest rates, market mood, news, speculation, investors´ sentiment, risks accompanying political developments, changes in the economic outlook, etc. Those who intend to invest in the Company should know that there is no guarantee of a return on their investment in the future and investors should bear in mind that even though stocks can provide a good return in general, there is always a risk that an investment in the shares of individual companies will decline in value. It is therefore suggested that prospective investors pay close attention to diversifying their risk and seek investment advice.

1.2.2 Ownership and Control

The structure of shareholder ownership can be a risk factor for investors. The share price could be adversely affected if a potentially large shareholder decides to sell a substantial number of shares or in the case of additional shares being sold in a share capital increase. Note that company ownership can change rapidly and without prior warning. Further a principal-agent problem of ownership and control is a theoretically and practically known phenomenon within large corporations which is based on the concentration of ownership. A high concentration of ownership tends to be at the cost of minority shareholders' rights whereas a low

[1] Investment theory offers the Capital Asset Price Model, CAPM to explain this as a case where the measurement of risk, the beta coefficient, equals one, which is a benchmark of market risk and expected market returns.

concentration and a lack of leading investors could render administrative complications and lead to ill fated decision processes.

Due to the fact that the Company's shares are traded on the NASDAQ OMX Iceland Main Market, those investing in them will thereby become subject to public regulation relating to securities transactions, such as rules relating to takeover bids, public disclosure of ownership stakes, etc.

1.2.3 Dilution

Current shareholders face dilution unless they participate in the issuing of the New Shares. When new shares are issued, the proportional shareholding of those who already hold shares in the Company will be reduced accordingly unless they acquire the New Shares pro rata to their existing holdings. The purpose of increasing capital is generally to reshape the capital structure to increase company value by financing new profitable projects and reduce the loan ratio. Shareholders may therefore be faced with increased risk to their investment alongside dilution of their existing shares depending on how the added capital will be disbursed. Furthermore, it is open for future shareholder meetings to consider continued equity financing.

1.2.4 Trading in the Secondary Market

Trading with the shares in the secondary market needs to be active and the volume sufficient for investors to profit from their investment. The possibility exists that investors will not be able to sell their shares easily or only at a discount to comparable securities from other issuers.

1.2.5 Liquidation Risk

According to the Bankruptcy Act No. 21/1991, shares are a subordinated claim on the assets of companies. Therefore, in the event of company liquidation, shareholders will receive what is left after all other claims have been met.

1.2.6 Changes in Law

The terms and conditions of the Share capital are based on Icelandic law in force as of the date of this Securities Note. No assurance can be given as to the impact of any possible judicial decision or change to Icelandic law or administrative practice after the date of this Securities Note.

2 PERSONS RESPONSIBLE

2.1 Issuer's Statement

The CEO and the Board of Directors of Icelandair Group hf., ID No. 631205-1780, registered office Reykjavik Airport, 101 Reykjavík, Iceland, hereby declare that having taken all reasonable care to ensure that such is the case, the information contained in the Prospectus is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import.

Reykjavík, 28 October 2010

Reykjavik Airport, 101 Reykjavík, Iceland:

Sigurdur Helgason,

Chairman of the Board of Directors,

Icelandic ID No. 010546-2069

And

Björgólfur Jóhannsson,

CEO,

Icelandic ID No. 280855-3409.

3 THE LISTING ADVISOR

The Listing Advisor, Íslandsbanki, ID No. 491008-0160, registered office Kirkjusandur 155, Reykjavík, Iceland, has been the advisor to the Issuer in the preparation of this Securities Note. The Listing Advisor has not independently verified the information contained herein.

Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Listing Advisor as to the accuracy or completeness of the information contained in this document or any other information provided by the Issuer in connection with the issuing of the New Shares, which is expected to be no later than 3 November 2010.

The Listing Advisor has in consultation with the management and the Board of the Directors of Icelandair Group construed this Securities Note and is acting in reliance on the information provided by the management and Board of Directors of Icelandair Group.

Íslandsbanki is the largest shareholder in Icelandair Group with a 46.98% share of the common stock and a voting right which is limited at 30%. Íslandsbanki is also the owner of all of the Groups convertible bonds; the bank will refinance the convertible bonds in connection with the restructuring of Icelandair Group and the convertible bonds will accordingly be cancelled. Íslandsbanki is the Groups largest creditor and with an agreement which was made between Íslandsbanki and Icelandair Group, regarding the financial restructuring of the Group, certain assets of the Group will be transferred to a separate holding company owned by Íslandsbanki and Glitnir Bank. Notice is drawn to the fact that after the financial restructuring is completed with the issue of the New Shares Íslandsbanki´s stake in the common stock will be 26.1%.

4 NOTICE TO INVESTORS

The Securities Note is compiled in accordance with Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 (“the Prospectus Directive”). The Prospectus Directive has been implemented into Icelandic law.

Only the Issuer is entitled to procure information about conditions described in this Securities Note. Information procured by any other person is of no relevance in relation to the Securities Note and cannot be relied on.

This Securities Note is not an offer to sell or a request to buy Shares in the Company.

The Securities Note is not being distributed, and must not be mailed or otherwise distributed or sent in or into any country in which distribution would require any additional registration measures or other measures to be taken, other than as applicable under Icelandic law and regulations, or would be in conflict with any law or regulation in such country. On the other hand the Securities Note may be passported in accordance with the provisions of the Prospectus Directive into other jurisdictions within the European Economic Area. The purpose of this Securities Note is to have available information about the Securities in conformity with Prospectus Directive. Any exposure or distribution of the content of this Securities Note, which has been created in accordance to Articles 44 and 45 of the Securities Transactions Act No. 108/2007, is forbidden. Therefore, any exposure or distribution of the content of this Securities Note, for any other purpose, is forbidden, without a prior written consent of the Issuer. Binding subscription for New Shares in the Company is in the form of a private tender offer with professional investors.

No person is authorised to give information or to make any representation in connection with the New Shares other than as contained in the Securities Note or the Registration Document, which together with a Summary form part of the Prospectus, which are all dated 28 October 2010. If any such information is given or made, it must not be relied upon as having been authorised by the Company or any of the Company’s respective affiliates or advisers. Neither the delivery of the Securities Note or the Registration Document, nor any sale made hereunder shall under any circumstances imply that there has been no change in the Company’s affairs or that the information set forth in the Securities Note or Registration Document is correct as of any date subsequent to 28 October 2010.

This Securities Note should by no means be viewed or construed as a promise by the Company, or other parties of future success either in operations or return on investments. Investors are reminded that investing in securities entails risk, as the decision to invest is based on expectations and not promises. Investors must rely primarily on their own judgement regarding any decision to invest in the Company’s securities, bearing in mind inter alia the business environment in which the Company operates in, anticipated profits, external conditions and the risk inherent in the investment itself. Prospective investors are advised to contact experts, such as licensed financial institutions, to assist them in their assessment of the securities issued by the Company as an investment option. This Securities Note does not constitute legal, financial or tax advice. Investors are furthermore advised to consider their legal status, including taxation issues that may concern the purchase or sale of the Company’s securities and seek external and independent advice in that respect.

This Securities Note, Registration Document and Summary, which together form the Prospectus and are all dated on 28 October 2010, have been prepared to provide clear and thorough information on the consolidated company Icelandair Group Investors are encouraged to acquaint themselves thoroughly with this Securities Note. They are advised to pay particular attention to *Chapter1 RISK FACTORS* of this Securities Note. The Prospectus is available for viewing at the Company’s registered office at Reykjavik Airport, 101 Reykjavík, Iceland. It will also be available on the Company’s website: http://icelandairgroup.com/.

Notwithstanding a special statement to the contrary, references to any laws, acts or regulations are references to acts passed by the Icelandic parliament and regulations issued by Icelandic governmental agencies unless otherwise clear from the context.

The admission to trading will proceed pursuant to Icelandic law and regulations. NASDAQ OMX Iceland has, in its authority under agreement between it and the Icelandic Financial Supervisory Authority, scrutinised and approved this Securities Note, which is published in English only.

In the event of any significant new factor, material mistake or inaccuracy relating to information included in this Securities Note, which could be capable of affecting the assessment of the New Shares, the Issuer will, in accordance with Article 46 of the Securities Transaction Act No. 108/2007, publish a supplement to the Prospectus which will be published with the same process as the Prospectus. The supplement shall be approved within seven business days and published in the same manner as the Prospectus. In the event of the above mentioned, the Issuer will also issue an announcement that will be made public.

On 15 September, an extraordinary shareholders meeting was convened. The agenda of the meeting was to elect a new Board of Directors and vote on proposals for a vote of no confidence in the Company's auditing firm and the election of a new auditing firm. The proposals were withdrawn and subsequently the only item on the agenda for the meeting was the election of a new Board of Directors. The following persons were elected:

Board members:

- Audur Finnbogadottir.
- Finnbogi Jónsson.
- Katrín Olga Jóhannesdóttir.
- Sigurdur Helgason.
- Úlfar Steindórsson.

Alternate board members:

- Herdís Dröfn Fjelsted.
- Magnús Magnússon.
- Vilborg Lofts.

The Company has also stated its plans to have an additional share offer to employees and shareholders in 2010. Details on that share offer have not been decided as of the date of this Securities Note.

5 REFERENCES

References to “Icelandair Group”, “the Issuer”, “we”, “us”, “the Group” or “the Company” in this Securities Note shall be construed as referring to Icelandair Group hf., Icelandic ID No. 631205-1780, unless otherwise clear from the context.

References to “the New Shares” in this Securities Note shall be construed as referring to 2,941,000,000 new shares in Icelandair Group hf., admitted to trading on the Main Market of NASDAQ OMX Iceland and subscribed for by professional investors, unless otherwise clear from the context.

References to “FME” in this Securities Note shall be construed as referring to the Financial Supervisory Authority in Iceland, unless otherwise clear from the context.

References to the “European Union” or “EU” in this Securities Note shall be construed as referring to the member states of the European Union, unless otherwise clear from the context.

References to “the ISD” in this Securities Note shall be construed as referring to the Icelandic Securities Depository, i.e. Verdbréfaskráning Íslands hf., incorporated under the laws of Iceland, ID No. 500797-3209, unless otherwise clear from the context. Eignarhaldsfélagid Verdbréfathing hf., incorporated under the laws of Iceland, ID No. 650602-4390, the sole owner of Verdbréfaskráning Íslands hf., is currently fully owned by NASDAQ OMX Group inc., which is the world´s largest exchange company.

References to “NASDAQ OMX Iceland” in this Securities Note shall be construed as referring to NASDAQ OMX Iceland hf., incorporated under the laws of Iceland, ID No. 681298-2829, part of the NASDAQ OMX Group inc.; it shall also refer to the former names of NASDAQ OMX Iceland such as OMX Nordic Exchange Iceland hf. and OMX ICE, unless otherwise clear from the context.

Reference to “the Main Market NASDAQ OMX Iceland” in this Securities Note shall be construed as referring to the Main Market at NASDAQ OMX Iceland hf., it shall also refer to the former names of the Main Market of NASDAQ OMX Iceland such as OMX ICE Main Market, unless otherwise clear from the context.

References to “the Prospectus” in this Securities Note shall be construed as referring to the Prospectus dated 28 October 2010, comprising of a Summary, a Registration Document and a Securities Note, which are all issued on the same date, unless otherwise clear from the context.

References to “the Listing Advisor” and “Íslandsbanki” in this Securities Note shall be construed as referring to Íslandsbanki hf., ID No. 491008-0160, unless otherwise clear from the context.

References to “Glitnir Bank” shall be construed as referring to Glitnir Bank hf., incorporated under the laws of Iceland, ID No. 550500-3530. On 8 October 2008 in accordance with the authority provided to the FME by Act. No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc., the FME appointed the Resolution Committee of Glitnir Bank. On this date the Resolution Committee took over all authority of the Board of Directors of Glitnir Bank hf. in accordance with the articles of Act No. 2/1995 on Public Limited Companies, including oversight of all treatment of its assets, as well as the handling of all other business. References to “the Resolution Committee of Glitnir Bank” shall be construed as referring to the Resolution Committee of Glitnir Bank hf., unless otherwise clear from the context.

References to “SPW ehf.” in this Securities Note shall be construed as referring to a special purpose vehicle, incorporated under the laws of Iceland, ID No. 530910-0590 whose registered office is at Sóltún 26, 105 Reykjavík, unless otherwise clear from the context. SPW ehf. common stock is divided between two shareholders who are Íslandsbanki with 71.1% and Glitnir Bank who holds the remaining 28.9% share in the company.

6 KEY INFORMATION ON THE ISSUER

6.1 Working Capital Statement

The Chairman of the Board of Directors and the CEO on behalf of the Issuer declare that in their opinion the Issuer's working capital is sufficient for the Issuer's present requirements and the next 12 months. The Company has announced that following the sale of 2,941,000,000 New Shares in the Company it intends to have an additional share offer to employees and shareholders. The offering will amount up to ISK 1,000,000,000 nominal value for a purchase price of ISK 2.5 per share.

6.2 Capitalisation and Indebtedness

6.2.1 Information on Capital Resources

The following table sets forth the Group's capitalisation and indebtedness as of 30 June 2010. The following table does not reflect the issue of new shares. Investors should read this table in conjunction with the Group's consolidated financial information (and the notes thereto).

Item 1. Capitalisation and indebtedness of Icelandair Group as of 30 June 2010

Capitalization and Indebtedness (mISK)		30 June 2010
Total current liabilities		**65,713**
Guaranteed*	18,686	
Secured**	5,890	
Unguaranteed/unsecured	41,137	
Total non-current liabilities		**18,976**
Guaranteed*	0	
Secured**	10,532	
Unguaranteed/unsecured	8,444	
Shareholders' equity		**13,128**
Share capital	975	
Share premium	25,450	
Fair value and other reserves	7,368	
Retained earnings	-20,695	
Minority interest	30	
Total capitalization on 30 June 2010		**97,817**

**** Represents a general pledge in unpledged assets of the Group***

***** Represents a direct pledge in certain real estates and aircraft***

The table above does not reflect the issue of approximately ISK 2.2 billion New Shares in Icelandair Group in the share offering at the subscription price indicated in this Securities Note and the intended application of the estimated net proceeds of approximately ISK 5.5 billion. Following the completion of the share offering of the New Shares, the share capital will increase by ISK 2,941,000,000.

The table on capitalisation represents the current portion of long-term loans, plus short-term liabilities excluding aircraft leases. Total non-current liabilities include long-term interest-bearing debt which amounts to approximately ISK 12.5 billion. The remainder consists of prepayments (ISK 2.3 billion) and long term payables (ISK 4.1 billion). Total current liabilities consist of interest bearing loans and borrowings (ISK 26.3 billion), trade and other payables (ISK 16.7 billion), liabilities held for sale (ISK 6.7 billion) and deferred income (ISK 16.1 billion). Aircraft financing constitutes 40% of the total interest-bearing debt and is solely of a long-term nature and financed by foreign banks. Apart from that source of financing, the interest-bearing debt stems from domestic bank borrowing. Further details of the breakdown of loans can be found in the table below.

Item 2. Net indebtedness of Icelandair Group as of 30 June 2010

Net indebtedness (mISK)		**30 June 2010**
a) Cash	7,471	
b) Cash equivalents	0	
c) Trading securities	0	
d) Liquidity (a) + (b) + (c)		**7,471**
e) Current financial receivables		0
f) Current bank debt	19,271	
g) Current portion of long term debt	5,821	
h) Other current financial debt	1,160	
i) Current financial debt (f) + (g) + (h)		**26,252**
j) Net current financial indebtedness (i) - (e) - (d)		**18,781**
K) Non-current bank debt	10,552	
l) Non-current bonds issued	1,971	
m) Other non-current loans	18	
n) Non-current financial indebtedness (k) + (l) + (m)		**12,541**
Net financial indebtedness (j) + (n)		**31,322**

The cash represents the net figure derived from the consolidated cash flow statement of the Group as published on 13 August 2010.

The capital profile above is based on Icelandair Group's Financial Statements as of 30 June 2010 and before the financial restructuring of the balance sheet. A part of the completion of the financial restructuring will be a share capital increase of approximately ISK 9.2 billion (ISK 2,941 million in share capital and ISK 6,212 in share premiums) where approximately ISK 5.5 billion will be paid with cash and approximately ISK 3.6 billion will be debt-to-equity conversion. Additionally, most of the Group's interest-bearing loans were restructured.

The Group has a total of approximately ISK 31.4 billion in contingent indebtedness in the form of lease obligations due to aircraft financing. The lease obligations are off-balance-sheet items that are not reflected in the balance sheet, but are directly payable through an amortisation schedule, and they are not reflected in the maturity profile of the Group. Furthermore, the Group has a contingent liability stemming from the commitment to acquire four 787-800 Dreamliner aircraft, see note 46 in the consolidated financial statement on 31 December 2009 for further information.

The Group had a total of ISK 6.7 billion in indirect indebtedness at year end 2009, through off-balance-sheet items such as lease obligations and financial guarantees. The only financial guarantee for third parties is the USD 19.6 million guarantees to SmartLynx as of 30 June 2010.

After the divestment of SmartLynx, Icelandair Group will continue to guarantee USD 19.6 million to SmartLynx. The guarantee will gradually expire until 1 January 2014. The guarantees for SmartLynx are in regard of lease payments on aircraft. If SmartLynx cannot pay its lessors, the guarantee will fall on Icelandair Group. That could happen if SmartLynx could not lease its unused aircraft to another company. Loftleidir has a contract with SmartLynx regarding the lease of two aircraft, where Loftleidir leases two aircraft from SmartLynx. The contracts are on an arm's length basis and they will not be affected by the divestment of SmartLynx from the Group.

The expected net indebtedness after the restructuring is shown in the following table. Please note that the financial information on net indebtedness after the financial restructuring is not audited and is based on information from the management of Icelandair Group.

Item 3. The table shows net indebtedness after financial restructuring

Net indebtedness (mISK)		**30 June 2010**
a) Cash	13.175	
b) Cash equivalents	0	
c) Trading securities	0	
d) Liquidity (a) + (b) + (c)		**13.175**
e) Current financial receivables		0
f) Current bank debt	0	
g) Current portion of long term debt	3.181	
h) Other current financial debt	0	
i) Current financial debt (f) + (g) + (h)		**3.181**
j) Net current financial indebtedness (i) - (e) - (d)		**-9.994**
K) Non-current bank debt	22.370	
l) Non-current bonds issued	1.971	
m) Other non-current loans	18	
n) Non-current financial indebtedness (k) + (l) + (m)		**24.359**
Net financial indebtedness (j) + (n)		**14.365**

Item 3 shows the effects of the restructuring on the Company‘s net indebtedness after financial restructuring as of 30 June 2010.

The information provided in this chapter is derived from the last published financial information of the Issuer and information related to the financial restructuring which have not been audited and is based on information from the management of Icelandair Group. As of the date of this Securities Note the Issuer declares that there have been no material changes since the last published financial information.

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6.3 Interest of Natural and Legal Persons Involved

Attention is drawn to the fact that Íslandsbanki, which is handling the current issue and acts as Listing Advisor to the Issuer, directly holds 469,772,387 shares in the Company which amounts to 46.98% of the total number of shares in the Company. Glitnir Bank, which is held by foreign creditors, owns 20,925,000 shares in the Company which amounts to 2.09% of the total number of shares in the Company. Glitnir Bank holds, according to publicly available information, 95% of the common stock of Íslandsbanki

For further information about Íslandsbanki’s and Glitnir Bank’s debt conversion into equity, see *Chapter 8.1.2 Debt-to-Equity Conversions.*

6.4 Reasons for the Issue and Use of Proceeds

The Group undertook major cost-cutting measures in the first half of 2008. More than 500 staff redundancies were followed by capacity cuts and renegotiations with suppliers. Furthermore, the top management of many subsidiaries has been changed over the course of the last two years. Around the same time, orders for four Airbus 330 cargo aircraft were cancelled, which lowered the Group’s commitments by USD 450 million. The cost-cutting measures taken in 2008 are among the main reasons for the Group’s ability to shoulder the downturn in 2008 and early 2009.

However, the balance sheet of the Group was set in a period when the owners and the Board of Directors focused on acquisitions and expansion abroad. The balance sheet was not self-sustaining, in particular due to the high level of indebtedness, and it was a major problem for the Group even before the collapse of the banking system in Iceland. Although the daily operations of the Group largely went according to plan in 2009, financial expenses were a drain on the cash flow of the Group. It had been evident for some time that the balance sheet needed to be restructured.

The collapse of the banking system in Iceland late in 2008 along with the worldwide recession has also affected the Group's operational landscape, especially as domestic demand dropped significantly. Strain on cash flows followed due to termination of the Group's banking services coupled with severe outflows of cash to meet an ever-growing demand for cash collateral by international financial institutions to replace bank guarantees. As a consequence, it become more challenging for the Group to meet its refinancing needs since its liquidity largely dried up after the collapse of the Icelandic banking system in 2008.

To meet these changes, the Board of Directors of the Group announced its plans to adapt to this new environment. A step in this process was the financial restructuring and binding agreements were signed on 12 August 2010. The Group addressed its refinancing and liquidity needs by entering into a standstill agreement[2] with Íslandsbanki and Glitnir Bank. Further steps to mitigate the refinancing needs are taken with the sale of assets, by the conversion of debt into equity, and by changing the term structure of loans. The total proceeds from the equity share issue will be used to increase cash on hand in the Company.

Icelandair Group announced on 14 and 15 June 2010 that the Enterprise Investment Fund (EIF) and the Pension Fund of Commerce (PFC) had entered into a binding agreement with the Company to the effect that the two funds would invest in Icelandair Group for ISK 4 billion at a share price of ISK 2.5. In the agreement, EIF undertook to contribute ISK 3 billion, thereby acquiring 1.2 billion new shares in the Company. The PFC undertook to contribute ISK 1 billion, thereby acquiring 400 million new shares in the Company.

The agreements were concluded with the following conditions:

- Positive results of Icelandair Group due diligence
- Exemption of the EIF by the Financial Supervisory Authority (FME) from an obligatory take-over of the Company
- That Icelandair Group raised a minimum ISK one billion in market value through the sale of New Shares to other investors

All of the above conditions have been met as Icelandair Group announced on 12 August 2010, and investors have subscribed to a total of ISK 5,552,500,000 at market value in new share capital, which corresponds to 2,221,000,000 New Shares in Icelandair Group. The net proceeds from the share offering will be ISK 9,000,831,250; the net cash proceeds from the share offering will be ISK 5,400,831,250.

The agreement assumes the conversion by Icelandair Group's two largest creditors of debt in the amount of ISK 3.6 billion into shares based on a share price of 5 per share, which corresponds to a subscription to 720 million New Shares. The total increase in share capital will thus amount to 2,941,000,000, New Shares at nominal value.

In addition, debt in the amount of ISK 7.6 billion, together with assets in a corresponding amount, will be transferred to a separate holding company to be owned by Icelandic creditors. Assets pertaining to what the Board of Directors has defined as core operations, which mainly consist of Icelandair ehf., Air Iceland, Iceland Travel (Vita), Icelandair Cargo, Icelandair Hotels, Icelandair Ground Services, Loftleidir-Icelandic hf. and Icelandair Shared Services (Fjárvakur – fjármálathjónusta ehf.), will remain in Icelandair Group.

Icelandair Group plans furthermore to raise approximately ISK 2.5 billion in additional share capital from shareholders and employees at the same price as the current offering. The timing and structure of that offering will be disclosed later.

[2] For information about the standstill agreement please refer to *chapter 25.1.2 Standstill Agreement* in the Registration Document.

7 INFORMATION CONCERNING THE SECURITIES ADMITTED TO TRADING

7.1 Total Share Capital

The total issued share capital, as of the date of this Securities Note, is ISK 1,000,000,000 in nominal value, divided into an equal number of shares each with a nominal value of ISK 1.0. The Group's share capital consists of one class of shares and each issued share carries one vote. The shares have been created in conformity with Act No. 2/1995 on Public Limited Companies.

After the New Shares issue is concluded, the total number of issued shares in the Company will be 3,941,000,000, all of the same class and all issued in ISK.[3]

7.2 Type and Class of Shares

The Company's share capital consists of one class of shares, each share having a nominal value of ISK 1.0. The ISIN number of the shares is IS0000013464. The shares' ticker symbol in the trading system of the NASDAQ OMX Iceland hf. is ICEAIR.

7.3 Applicable Law and Jurisdiction

The New Shares issue is subject to laws in Iceland. The Company is a public limited company, registered in Iceland and operates pursuant to Act No. 2/1995 on Public Limited Companies. All shares in the Company have been issued in conformity to the Act No. 2/1995 on Public Limited Companies and other relevant domestic legislation. Any dispute arising in relation to the issue of the New Shares shall be brought before the district court in Reykjavík.

7.4 Form

The Company's shares are all issued electronically at the ISD, which is located at Laugavegur 182, 105 Reykjavík, Iceland. All shares are registered in a book-entry form, under the name and Icelandic ID No. of the relevant shareholders or their nominees.

The electronic registration of securities is governed by the Act on Electronic Registration of Titles to Securities, No. 131/1997 and Regulation No. 397/2000, which is issued in accordance with that Act. A printout from the ISD on the ownership of shares in the Company is considered a valid proof of registration of the shares. Registry of title in a securities depository constitutes full proof of title to shares in the Company and adequate basis for entry in the register of shares. Dividends and announcements shall at any given time be sent to the party registered in the Company's share register as owner of the shares in question. The Company shall be in no way liable if payments or announcements do not reach their recipients because a change of address has not been notified.

7.5 Share Rights

Information about the Company's share rights can be found in the articles in section 2 of the Company's Articles of Association.

All the shares of the Company carry equal rights. The Company's shares carry no special rights and no general restrictions are placed on them. A party acquiring a share in the Company cannot exercise its right as a

[3] Attention is drawn to the fact that according to Article 11.1 of the Company's Articles of Association, votes are not attached to shares owned by the Company. That provision in the Articles of Association is in accordance with paragraph 3 of Article 82 of Act No. 2/1995 on Public Limited Companies.

shareholder unless its name has been registered in the share registry or it has announced and proven its ownership of the share.

Owners of the Company's share capital have the right to vote at shareholders' meetings, the right to receive dividends when declared, enjoy pre-emptive rights to new shares, unless waived, and the right to a share in any surplus in case of liquidation, all according to share ownership, statutes and the Company's Articles of Association in effect at any given time. Shareholders in the Company are not required to suffer redemption of their shares except as provided by law. The shares in the Company may be pledged or sold without restriction, except as otherwise provided by law.

In the case of an increase in share capital, shareholders enjoy pre-emptive rights to new shares, in proportion to their holdings in the Company and within the time limits specified in decision to increase the share capital. If a shareholder does not exercise his or her pre-emptive rights in full, other shareholders shall be entitled to increase their subscription rights. A shareholders' meeting may, by a 2/3 majority vote, decide to waive pre-emptive rights on increases in share capital, provided that there is no discrimination. In the case of a share capital increase that follows the conversion of convertible bonds into stock or according to a stock option plan for key managers, which could be implemented into the Company's Article of Association, shareholders could be burdened to waive their pre-emptive rights to the increase. At the date of this Securities Note the Company's Articles of Association do not contain provisions regarding convertible bonds or a stock option plan for key managers.

Article 15.1 (d) of the Articles of Association of the Company, stipulates that the Board of Directors of the Company is authorised to increase the share capital of the Company in the following manner: a) The share capital of the Company may be increased by up to ISK 4,000,000,000 (four billion Icelandic kronur) nominal value with subscription of new shares. b) This authorisation is valid until 31 December 2010. c) The nominal value of the shares which the shareholders may subscribe to is one krona. The subscription rate may be decided with by means of invitation to tender new shares. d) The Board of Directors of the Company may limit the priority rights of shareholders to subscribe to new shares. e) Shareholders may pay, partially or in full, for the shares that they subscribe to, by means of set-off of indebtedness, as may be further decided by the Board of Directors. A specialised report due to payment by means of set-off of indebtedness shall not be prepared. Instead the Board of Directors shall prepare a statement regarding the value of the payment, in accordance with Article 6 c of Act No. 2/1995 on Public Limited Companies. f) The new shares shall grant rights within the Company as of the date of registration of the increase of share capital. The Board of Directors shall lay down further rules relating to respite for subscription and payments for shares. A decision of the Board of Directors to increase the share capital shall be approved by an increased majority of the board—four out of five members. The Board of Directors has not laid down any rules relating to respite for subscription and payments for shares as of the date of this Securities Note.

The Company has now raised subscriptions and converted debt into equity for a total of 2,941,000,000 New Shares based on this authorisation. The Company has also stated in a press release made public by the Company the 12 August 2010 that it intends to raise ISK 2.5 billion in additional equity. The Company plans to offer shareholders and employees exclusively to subscribe to new shares at the same price as the current private tender.

The Company and its subsidiaries are subject to legal restrictions on the amount of dividends that can be paid to shareholders according to the Act No. 2/1995 on Public Limited Companies. There are no special restrictions or procedures regarding dividend payments to non-resident shareholders. There is no dividend policy in place for the Company. The Company has not paid dividends for the financial years ended 31 December 2007, 2008, 2009 and 1H 2010.

Rights to electronic shares must be registered at the ISD if they are to enjoy legal protection against legal executions and disposal by means of an agreement. It is forbidden to issue share certificates for registered rights according to an electronic share or endorse them, and such transactions are void. Registration of the ownership of an electronic share at the ISD, subsequent to a Securities Depository final entry, formally gives a registered owner legal authorisation to the rights for which he is registered. Priority of incompatible rights is determined by the chronological order of requests from the Banks' Data Central (*Reiknistofa bankanna*) reaching the Securities Depository. No redemption provisions, conversion provisions or special restrictions regarding dividends have been attached to the securities.

7.6 Dividend rights

Upon paying dividends, Icelandair Group practice is to pay dividends to those parties, registered as shareholders, in the shareholders' register at the third business day after the Annual General Meeting with ex-date the next business day after the AGM, unless the Company has received notification of the assignment of the dividend upon the transfer of the shares. Considering clearance procedures on the NASDAQ OMX Main Market (T+3), trades with the Company's shares need to take place at the date of the AGM if parties are to be eligible for payment of dividends.[4]

Dividends are deposited in shareholders' bank accounts, which they have specified as their accounts for dividends payments and are linked to their custody accounts.

Shareholders can collect their dividends at Icelandair Group office within four years after the due date of payment. Four years after the due date, the right to collect the dividend payments lapses in accordance with Act No. 150/2007, on the Lapse of Debts and other Claim Rights.

Icelandair Group has no special restriction or procedures regarding dividend payment for non-resident shareholders.

Icelandair Group does not have any policy regarding dividend payments. The Company has not paid dividend for any of the financial years covered in the Prospectus.

An annual general meeting shall be held within eight months from the end of the financial year.

7.7 New Issues

At a shareholders' meeting held on the 6 August 2009, the shareholders of the Issuer granted the Board of Directors the authority to increase the Issuer's share capital by up to 4,000,000,000 nominal value for the purpose of strengthening the Company's financial position.

Icelandair Group announced on 12 August 2010 that investors had subscribed to a total of ISK 5,552,500,000 at market value in new share capital, which corresponds to 2,221,000,000 New Shares in Icelandair Group. Íslandsbanki and Glitnir Bank will also convert debt in the amount of ISK 3.6 billion into shares based on a share price of ISK 5.0 per share, which corresponds to 720,000,000 New Shares. The total increase in share capital will thus amount to 2,941,000,000 New Shares at nominal value.

On 9 September 2010, the Board of Directors used the authorisation from the shareholders' meeting on 6 August and approved the issue of New Shares in the amount of 2,941,000,000 in accordance with Article 15 of the Articles of Association. The total share capital of the Company will be 3,941,000,000 after the issue of the New Shares.

Furthermore, the Board of Directors decided on the Board meeting on 9 September to authorise Íslandsbanki and Glitnir Bank to pay in full for shares in the nominal value of ISK 720,000,000 by means of a set-off of indebtedness in accordance with Article 15.1(e) of the Company's Articles of Association. The Board of Directors prepared a statement regarding the value of the payment, in accordance with Article 6 (c) of Act No. 2/1995 on Public Limited Companies. In the statement the Board of Directors declared that the debt-to-equity conversion is in accordance with Article 5 of the Act No. 2/1995 on Public Limited Companies and takes note of the Annual Accounts Act No. 3/2006 and international accounting standards. Article 5 of the Act No. 2/1995 on

[4] Dividend proposals by NASDAQ OMX Iceland: http://nasdaqomx.com/digitalAssets/58/58629_Dividend_proposal_at_AGM.pdf.

Public Limited Companies states that payment with other valuables than cash shall have financial value and cannot be in the form of duty to complete a task or provide services. The Board of Directors concluded that the debt-to-equity conversion is in full compliance with Article 5 of the Act No. 2/1995 on Public Limited Companies. The Board of Directors declared that no new information had come to light that could alter the original evaluation of the debt-to-equity conversion.

Íslandsbanki and Glitnir Bank will convert debt in the amount of ISK 3,600,000,000 into new shares at the price of ISK 5 per share. The Board concluded that the conversion has been appropriately evaluated and according to Article 6 (c) of the Act No. 2/1995 on Public Limited Companies. It was the evaluation of the Board of Directors that no new information had come to light that could affect the original evaluation of the debt-to-equity conversion. Refer to *Chapter 8.1.2 Debt-to-Equity Conversions* for more detailed description of the debt-to-equity conversion.

No further authorisations or approvals are needed to issue the New Shares.

The New Shares will be issued electronically at the ISD no later than 3 November 2010, and they will be admitted to trading no later than on 5 November 2010.

7.8 Transferability of the Shares

There are no limitations on the transferability of the Issuer's shares, and shareholders may pledge their shares unless prohibited from doing so by law. Only general legislative rules apply to the transfer of shares in the Company. Nevertheless, it should be noted that individual shareholders may have agreed that their shares are subject to certain restrictions, see *Chapter 9.4 Lock-up Agreements*.

7.9 Mandatory Takeover Bids and/or Squeeze-out and Sell-out rules

7.9.1 Mandatory Bid

The Issuer is subject to Chapter X of the Securities Transactions Act No. 108/2007, legislation which is based on Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (the *Takeover Directive*). Under the Securities Transactions Act, if a party, directly or indirectly, acquires control of the Issuer, it is obliged to make an offer, within four weeks, to the other shareholders to acquire their shares at a price not less than the highest price paid for the shares by the acquirer or its concert parties during the previous six months. ″Control″ means that the party and any party acting in concert with it has acquired (i) in total at least 30% of the voting rights in the Company, (ii) under an agreement with other shareholders, the right to control at least 30% of the voting rights in the Company, (iii) the right to appoint or dismiss the majority of the Board of Directors of the Company.

The FME decided to grant Íslandsbanki a conditional exemption from a mandatory takeover bid in accordance with paragraph 5 of Article 100 of the Icelandic Securities Transaction Act No. 108/2007, despite becoming in indirect control of the Company following a subsequent enforcement action. Íslandsbanki was, both as a creditor and large shareholder of Icelandair Group, required to dispose of holdings in excess of maximum threshold according to Article 100 of the Icelandic Securities Transactions Act No. 108/2007 as soon as possible and within 12 months from the date of the decision, with a possibility to extend for 6 months, which was applied for and granted after the 12 months limit expired. .

This enforcement action was prompted by the inability of a number of shareholders—including leading shareholders in the Company—to meet margin calls in respect of loans extended to these parties by the bank. The FME considered that the bank fulfilled conditions that would be granted to a pledge, those conditions are:

- When the guarantee was granted, conditions did not give rise to indications that the pledgee should have known would be likely to result in a margin call.

- A margin call is necessary for reasons that concern the pledger.
- A margin call is conducted with intent to re-sell. The FME grants the creditor time limits for the re-sale.

The exemption was granted with the following conditions.

- In light of the financial restructuring within Icelandair Group, the FME decided to grant Íslandsbanki a generous continuance, i.e. 12 months which was extended to 18 months. Íslandsbanki shall sell to the amount that mandatory takeover is no longer applicable in accordance with Article 100 of the Icelandic Securities Transactions Act.
- Íslandsbanki was only authorised to apply up to 30% of its effective voting rights in the Company.
- Íslandsbanki, in cooperation with the Company, would inform FME on a regular basis of the progress of the financial reorganisation of the Company.

When the New Shares have been issued, Íslandsbanki's stake in the Company will be less than 30% and the bank will no longer be indirectly in control of the Company. Consequently, the decision discussed above will no longer be applicable.

On 6 August 2010 the Enterprise Investment Fund (EIF) requested an exemption for an obligatory takeover of Icelandair Group in accordance with Article 100 of the Securities Transactions Act-No. 108/2007. The FME decided to grant the EIF the exemption in accordance with section 1.a) of Article 100 of the Securities Transactions Act. The article in question authorises, in exceptional circumstances, exemption from the obligation to make a mandatory bid when an investor owns 30% or more of the outstanding stock of a publicly listed company. This exemption is applicable if the purpose is to pave the way for financial restructuring of companies experiencing financial difficulties.

This exemption was a condition to the EIF's subscription to 1,200,000,000 shares in the Company at the price of ISK 2.5. As this exemption has been granted by the FME, and other conditions of the EIF's undertaking dated 14 June 2010 with Icelandair Group in respect of the subscription have been fulfilled, EIF's commitment is now firm and binding. Accordingly, following the issue of the New Shares, the EIF is allowed to own 32.5% of the common stock in the Group.[5] The threshold according to Article 100 of the Securities Transactions Act is ownership of 30% of common stock in public companies. The EIF was authorised by the FME to own 32.5% of the common stock of Icelandair Group. The FME granted the EIF exemption from a takeover bid with the following conditions:

- The EIF shall, as soon as possible (and within 12 months), by selling shares, no longer have direct or indirect control of the Group according to Article 100 of the Securities Transactions Act. This exemption will be valid as soon as the EIF becomes a shareholder in the Company.
- The EIF voting rights are capped at 30% of the common stock (i.e. the EIF can utilise up to 30% of the active voting rights). Active voting rights refer to total number of voting shares less than those shares held by the EIF that become inactive due to this decision.
- The EIF shall, in cooperation with the Company, inform the FME on a regular basis of the progress of the financial reorganisation of the Company. The FME imposed the condition on the EIF to notify the FME with at least one week's notice of any plans to re-sell.

All decisions of the FME are available on www.fme.is.[6]

[5] Notice is drawn to the fact that the EIF will own 30.4% of the common stock of the Company after the issue of New Shares and not 32.5% as the FME authorised.
[6] Direct links to the decisions in question are, for Íslandsbanki - http://www.fme.is/lisalib/getfile.aspx?itemid=6347 and http://www.fme.is/lisalib/getfile.aspx?itemid=7249; and the EIF - http://www.fme.is/lisalib/getfile.aspx?itemid=7358.

7.10 Squeeze-out / Sell-out

Under Article 24 of Act No. 2/1995 on Public Limited Companies, a shareholder holding more than 90% of a company's capital and controlling an equivalent proportion of its voting rights may decide that other shareholders in the company shall be subject to mandatory redemption of their shares. In cases where a shareholder owns more than 90% of the share capital in a company and controls corresponding voting powers, each individual minority shareholder may require redemption from the shareholder. No single shareholder holds more than 90% of the share capital or voting rights of Icelandair Group.

Shareholders are not obligated, neither by the Company's Articles of Association nor changes to them, to accept their shares being redeemed, except as provided by law.

7.11 Public Takeover Bids by Third Parties

The Company's shares were listed and admitted to trading on the OMX ICE Main Market (currently known as NASDAQ OMX Iceland Main Market) on 12 February 2007. Since its listing, no takeover bid has been made in respect of shares in the Company.

7.12 Tax Issues

7.12.1 General

The following is a description of the relevant Icelandic tax consequences for shareholders, based on the rules and regulations in force at the date of this Securities Note. It is therefore subject to any changes in law occurring after such date. The following discussion is meant to provide general guidelines and does not deal with all aspects that could be important for potential investors. It focuses on individual shareholdings and shareholdings of limited liability companies, and does not cover tax issues in other cases, for instance where shares are held as assets in business operations by individuals or by a partnership. The tax treatment of holders of shares depends in part on their particular circumstances. Each shareholder should therefore consult a tax advisor regarding the tax consequences which may arise for such person as a result of buying or selling shares in the Company, including the applicability and effect of foreign income tax regulations and provisions contained in treaties to avoid withholding tax and double taxation. Foreign parties should obtain information on a possible double taxation treaty with their country of residence. If such a treaty has been made, the party should establish which country has the right to tax. The following chapters do not address foreign tax laws.

7.12.2 Tax Considerations for Residents of Iceland

Taxation of Dividends

For individuals, capital income such as dividends is taxed at the rate of 18%.

Dividends paid to limited liability companies constitute taxable income according to the Income Tax Act No. 90/2003. The same act however permits limited liability companies to deduct from their income, including their dividend income, any sum which they may have been paid in dividends. Such a deduction is conditioned to that the limited company owning at least a 10% share in the Company. In fact received dividends are therefore not taxable for such shareholders.

The Company is obligated to withhold 18% tax on paid out dividends in the case of individuals and resident companies. Companies may have a deduction of the same amount as the dividends received if the companies own at least 10% share in the Company and consequently there is no effective tax burden for such companies ("dividend received deduction"). The 18% withheld by the Company is in accordance with its legal responsibilities under law respecting withholding taxes. If the withholding tax is higher than levied tax, then the difference will be refunded upon assessment of tax returns.

Taxation on Realization of Shares

Capital gains from the sale or other disposal of shares are taxable in Iceland pursuant to current laws. For individuals, capital gains are taxed as income from capital. The tax rate is 18%. Upon the sale or other disposal of shares, the shareholder's average acquisition costs for all shares of the same class and type will be used as the tax base on which the capital gain of the sale/disposal is calculated. Individuals can use losses from the sale of shares in limited liability companies within the same calendar year and offset them against capital gains from sale of shares. Losses from the sale of shares cannot be carried forward and offset against future capital gains from the sale of shares.

In the case of legal entities capital gains from the sale or other disposals of shares are taxable income according to the Income Tax Act. The same act however permits limited liability companies to deduct from their income any gains from sale or other disposals of shares. Such a deduction is conditional on the limited company owning at least a 10% share in the Company.

- Losses from sales of shares cannot be carried forward as losses from regular activities.
- Specific tax consequences may be applicable to certain categories of companies, such as mutual funds and holding companies.
- Residents of Iceland are subject to income tax on their interest income in accordance with Icelandic tax law.

7.12.3 Tax Considerations for Non-residents of Iceland

Taxation of Dividends

The Company is obligated to withhold 18% tax on dividends paid to individuals who are not residents of Iceland, absent treaty provisions to the contrary. The Company is obligated to withhold 15% tax on dividends paid to foreign legal entities unless there is a tax treaty in place lowering the percentage. Qualified companies may apply for a reimbursement and/or an advance relief under relevant provisions in double taxation treaties. The Income Tax Act No. 90/2003 however permits limited liability companies which are resident within the EU/EEA area to deduct from their income, including their dividend income, any sum which they may have been paid in dividends. Such a deduction is conditional on the limited company owning at least a 10% share in the Company. Received dividends are therefore not taxable for such shareholders.

Taxation on Realization of Shares

In the case of legal entities all gains from the sale or other disposal of shares are taxable income according to the Income Tax Act and are subject to withholding tax of 15%. The same act however permits limited liability companies which are resident within the EU/EEA area to deduct from their income any gains from the sale or other disposals of shares. Such a deduction is conditional on the limited company owning at least a 10% share in the Company. The capital tax rate for individuals is 18% absent treaty provisions to the contrary.

Icelandic brokers as well as Icelandic persons acting as intermediaries are required to withhold the tax from the sale price unless they have been furnished with the Director of Internal Revenue's confirmation of the seller's exemption from such taxation prior to the transaction. Residents of treaty countries can apply for formal confirmation of their exemption from such taxation from the Director of Internal Revenue.

7.12.4 Stamp duty

The Company's shares are subject to stamp duty in Iceland, which the Issuer shall pay within two months of the issue of the shares. Stamp duty has been paid on all issued shares. The sale or other disposal of shares is not subject to Icelandic stamp duty.

8 TERMS AND CONDITIONS OF THE OFFERING

8.1 Details and Process of the Issue

This Securities Note is constructed in connection with the issue of 2,941,000,000 New Shares in Icelandair Group. The New Shares are all of the same class and bear the same rights and are identical to the existing shares in Icelandair Group. The New Shares issue will be allocated to professional investor and also in the form of debt-to-equity conversions to Íslandsbanki and Glitnir Bank.

No portion of the New Shares will be offered in a public tender.

8.1.1 Professional Investors

Professional investors have subscribed for New Shares in the total of 2,221,000,000 in Icelandair Group at the price of ISK 2.5 per share. A list of the largest new shareholders is available in *Chapter 9.2 Private Tender.* All terms and conditions of the private tender have already been negotiated and therefore no additional terms or conditions are applicable at the date of issue of the New Shares. The price is final and will not be subject to change in the issue of the New Shares. The subscription is binding for both parties and cannot be withdrawn by either party. All subscriptions have been received and terms and conditions have been finalised on the date of this Securities Note and therefore cannot be revoked or subject to change in any form or manner.

The price along with the terms and conditions was made public by Icelandair Group on 12 August 2010.

8.1.2 Debt-to-Equity Conversions

Íslandsbanki will convert ISK 2,793,600,000 of debt into equity at the price of ISK 5 per share. Íslandsbanki will receive 558,720,000 new shares in Icelandair Group following the debt-to-equity conversion. Prior to the conversion, Íslandsbanki held 469,772,387 shares in the Group. After the debt-to-equity conversion, Íslandsbanki will hold 1,028,492,387 shares in Icelandair Group, which equals 26.1% of total share capital.

Glitnir Bank will convert ISK 806,400,000 of debt into equity at the price of ISK 5 per share. Glitnir Bank will receive 161,280,000 new shares in Icelandair Group following the debt-to-equity conversion. Prior to the conversion, Glitnir Bank held 20,925,000 shares in the Group. After the debt-to-equity conversion, Glitnir Bank will hold 182,205,000 shares in Icelandair Group, which equals 4.6% of total share capital.

8.1.3 Payment / Share delivery

Investors participating in the offer must pay with cash in accordance with the subscription agreement no later than 12.00 pm on 1 November 2010. If payment is not received on the due date, it may be collected in a manner provided for by Icelandic law. The Issuer also reserves the right to cancel unilaterally unpaid subscriptions on the due date instead of collecting the debt and to reallocate the subscription at the Company's discretion. Shares subscribed and paid for will be delivered to each investor no later than 5 November 2010.

9 ADMISSION TO TRADING AND DEALING ARRANGEMENTS

9.1 Admission to Trading

An application has been made for the New Shares to be admitted to trading on the regulated market of NASDAQ OMX Iceland, which is an EU regulated market within the meaning of Directive 2004/39/EC on Markets in Financial Instruments ("MiFID"), which has been implemented through the Securities Transaction Act No. 108/2007. NASDAQ OMX Iceland is authorised pursuant to the Act on Stock Exchanges No. 110/2007 to operate a regulated market under the supervision of the Icelandic Financial Supervisory Authority (FME). The FME is a governmental agency responsible for, among other things, supervising Icelandic securities market laws. Furthermore, pursuant to the Act on Stock Exchanges No. 110/2007, NASDAQ OMX Iceland is required to have rules of its own, governing the trading on NASDAQ OMX Iceland.

The New Shares will be delivered electronically through the depository agent, the Icelandic Security Depository, Laugavegur 182, Reykjavík, Iceland. The earliest date on which the New Shares will be admitted to trading on the NASDAQ OMX main market is 5 November 2010.

9.2 Private Tender

As noted in *Chapter 6.4 Reasons for the Issue and use of Proceeds*, the Company has already made arrangements with several professional investors for subscription for the New Shares. The subscriptions are detailed in the table below:

Item 4. New shareholders that have subscribed for 2,221 million New Shares announced on 12 August 2010.

New Shareholders	ID Number	Nominal Value (ISK)	Price	Market Value (ISK)	Holding (% of share capital)
The Enterprise Investment Fund slhf..	651109-0510	1,200,000,000	2.5	3,000,000,000	30.4%
The Pension Fund of Commerce........	430269-4459	400,000,000	2.5	1,000,000,000	10.1%
Lífeyrissjódir Bankastræti 7..............	711297-3919	200,000,000	2.5	500,000,000	5.1%
Virding hf.......................................	561299-3909	137,000,000	2.5	342,500,000	3.5%
Stefnir ÍS-15..................................	470206-8450	85,000,000	2.5	212,500,000	2.2%
Íslensk verdbréf hf...........................	610587-1519	54,000,000	2.5	135,000,000	1.4%
Stefnir ÍS-5.....................................	430407-9610	45,000,000	2.5	112,500,000	1.1%
Other new shareholders...................	600390-9619	100,000,000	2.5	250,000,000	2.5%
Total..		**2,221,000,000**		**5,552,500,000**	**56.3%**

The shareholders in the Company that have registered stock before the issue of the New Shares will hold after the issue of the New Shares 43.6% of the common stock in the Company.

Notice is drawn to the fact that four members of the Company´s Board of Directors have duties to the Enterprise Investment Fund slhf. They are: Audur Finnbogadóttir, Finnbogi Jónsson, Herdís Dröfn Fjelsted and Vilborg Lofts.

9.3 Market making

Following the issue of the Securities Note, Icelandair Group projects to reach an agreement with market maker/makers in order to facilitate the trading. At the date of the issue of this Securities Note no such agreement has been made by the Issuer.

9.4 Lock Up Agreement

According to an agreement between The Enterprise Investment Fund (EIF), which is the largest purchaser of the New Shares, and Íslandsbanki and Glitnir Bank, the two banks have agreed not to sell their current share holdings in the Company for a period of 24 months from the date of the issue of the New Shares. The agreement contains the following exemptions:

a) Each of Íslandsbanki and Glitnir Bank may at their own discretion sell shares in the Company amounting up to ISK 40 million in nominal value every three months.
b) Each of Íslandsbanki and Glitnir Bank may sell their current shareholding to professional investors, either as a whole or in parts. If the holding is sold in parts, the underlying stock in each transaction shall not be less than 3% of the share capital of the Company.
c) There are no sale limitations on either party—neither Íslandsbanki nor Glitnir Bank—should the total number of shares in their possession go below 3% of the common stock in the Company.

9.5 Expense of the Issuer

The commission for placing 2,941,000,000 new shares is ISK 124,168,750. In addition the cost for preparing the Prospectus, registering the shares, paying stamp duty and other costs is ISK 25,000,000. The charges from NASDAQ OMX Iceland total ISK 2,500,000.

The total cost for the issue of the New Shares will therefore be ISK 151,668,750. All cost of the issue of the New Shares will fall on the Company.

9.6 Dilution

On the date of this Securities Note, the total number of shares in Icelandair Group is ISK 1,000,000,000 in nominal value, divided into an equal number of shares, each with a nominal value of ISK 1.0.

The issue of the New Shares increases Icelandair Group´s share capital by 2,941,000,000 shares. The total number of shares in Icelandair Group after the issue of the New Shares will be 3,941,000,000 shares. Assuming that existing shareholders do not take part in the issue of the New Shares at all, the resulting proportional dilution of their shares will be 74.6%.