Icelandair Group hf.

Condensed Consolidated Interim Financial Statements

1 January - 30 September 2011

ISK

Icelandair Group hf.
Reykjavíkurflugvöllur
101 Reykjavík
Iceland
Reg. no. 631205-1780

Contents

Endorsement and Statement of the Board of Directors and the CEO

The condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 September 2011 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for Interim Financial Statements (IAS 34). The interim financial statements comprise the consolidated interim financial statements of Icelandair Group hf. (the "Company") and its subsidiaries together referred to as the "Group". At period end the subsidiaries numbered eleven which is a reduction of two from the same period in the previous year. The Group operates in the airline and tourism sectors.

Profit for the period from 1 January to 30 September amounted to ISK 4.652 million according to the consolidated interim statement of comprehensive income. Total comprehensive income for the period was ISK 4.920 million. According to the consolidated statement of financial position, equity at the end of the period amounted to ISK 33.277 million, including share capital in the amount of ISK 4,975 million. Reference is made to the consolidated statement of changes in equity regarding information on changes in equity.

Statement by the Board of Directors and the CEO

The condensed consolidated interim financial statements for the nine months ended 30 September 2011 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies.

According to our best acknowledge it is our opinion that the condensed consolidated interim financial statements give a true and fair view of the consolidated financial performance of the Group for the nine month period ended 30 September 2011, its assets, liabilities and consolidated financial position as at 30 September 2011 and its consolidated cash flows for the period then ended.

Further, in our opinion the condensed consolidated interim financial statements and the endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 September 2011 and confirm them by means of their signatures.

Reykjavík, 2 November 2011.

Board of Directors:

Sigurður Helgason, chairman of the board
Finnbogi Jónsson
Herdís Dröfn Fjeldsted
Katrín Olga Jóhannesdóttir
Úlfar Steindórsson
Anna Guðný Aradóttir
Magnús Magnússon

CEO:

Björgólfur Jóhannsson

Consolidated Interim Statement of Comprehensive Income

for the period from 1 January to 30 September 2011

	Notes	Q3 2011 1.7.-30.9.	Q3 2010 1.7.-30.9.	Q1-Q3 2011 1.1.-30.9.	Q1-Q3 2010 1.1.-30.9.
Continuing operations					
Operating income					
Transport revenue		25.158	21.065	49.829	43.081
Aircraft and aircrew lease		4.157	5.275	12.680	14.994
Other operating revenue		6.553	4.742	14.405	11.175
		35.868	31.082	76.914	69.250
Operating expenses					
Salaries and other personnel expenses		5.943	5.232	16.803	15.073
Aircraft fuel		7.757	4.990	17.200	11.634
Aircraft and aircrew lease		2.901	3.429	7.994	9.370
Aircraft handling, landing and communication		2.598	2.215	5.712	4.998
Aircraft maintenance expenses		2.060	1.751	5.393	5.151
Other operating expenses		5.956	4.330	13.270	11.562
		27.215	21.947	66.372	57.788
Operating profit before depreciation and amortisation (EBITDA)		8.653	9.135	10.542	11.462
Depreciation and amortisation		(1.569)	(1.590)	(4.270)	(4.237)
Operating profit before net finance expense (EBIT)		7.084	7.545	6.272	7.225
Finance income		181	40	628	165
Finance expense		(635)	(1.211)	(1.686)	(3.123)
Net finance costs	8	(454)	(1.171)	(1.058)	(2.958)
Share of profit of associates, net of income tax		4	10	14	74
Profit before income tax		6.634	6.384	5.228	4.341
Income tax		(1.270)	(1.187)	(576)	(790)
Profit from continuing operations		5.364	5.197	4.652	3.551
Discontinuing operations					
Loss from discontinued operation, net of income tax	6	0	0	0	(400)
Profit for the period		5.364	5.197	4.652	3.151
Other comprehensive income					
Foreign currency translation differences for foreign operations		246	(1.300)	176	(1.030)
Net loss (profit) on hedge of net investment in foreign operation		94	(71)	57	(20)
Effective portion of changes in fair value of cash flow hedge		33	15	35	263
Other comprehensive income (expense) for the period		373	(1.356)	268	(787)
Total comprehensive income for the period		5.737	3.841	4.920	2.364

The notes on pages 9 to 15 are an integral part of these interim consolidation financial statement

Interim Financial Statements of Icelandair Group hf. 30 September 2011 4 Amounts are in ISK million

Consolidated Interim Statement of Comprehensive Income
for the period from 1 January to 30 September 2011, contd.:

	Notes	Q3 2011 1.7.-30.9.	Q3 2010 1.7.-30.9.	Q1-Q3 2011 1.1.-30.9.	Q1-Q3 2010 1.1.-30.9.
Profit attributable to:					
Owners of the Company		5.355	5.187	4.648	3.147
Non-controlling interest		9	10	4	4
Profit for the period		5.364	5.197	4.652	3.151
Total Comprehensive income (expense) attributable to:					
Owners of the Company		5.728	3.831	4.916	2.360
Non-controlling interest		9	10	4	4
Total comprehensive income for the period		5.737	3.841	4.920	2.364
Earnings per share:					
Basic earnings per share (ISK)		1,07	5,33	0,93	3,23
Diluted earnings per share (ISK)		1,07	5,33	0,93	3,23
Continuing operations:					
Basic earnings per share (ISK)		1,07	5,33	0,93	3,64
Diluted earnings per share (ISK)		1,07	5,33	0,93	3,64

Interim Financial Statements of Icelandair Group hf. 30 September 2011 5 Amounts are in ISK million

Consolidated Interim Statement of Financial Position
as at 30 September 2011

	Notes	30.9.2011	31.12.2010
Assets			
Operating assets		31.271	27.594
Intangible assets		21.390	21.212
Investments in associates		173	178
Long-term cost		732	918
Long-term receivables and deposits		1.798	1.424
Total non-current assets		55.364	51.326
Inventories		1.886	1.580
Trade and other receivables		16.016	13.230
Prepayments		889	950
Receivable due from associated company		1.093	1.344
Marketable securities		3.240	1.306
Cash and cash equivalents		10.121	11.688
Assets classified as held for sale	7	2.771	2.815
Total current assets		36.016	32.913
Total assets		91.380	84.239
Equity			
Share capital		4.975	4.975
Share premium		18.967	19.013
Reserves		4.655	4.387
Retained earnings		4.648	0
Total equity attributable to equity holders of the Company		33.245	28.375
Non-controlling interest		32	28
Total equity		33.277	28.403
Liabilities			
Loans and borrowings	11	16.102	21.356
Long-term payables		4.199	4.745
Deferred income tax liability		1.902	1.267
Total non-current liabilities		22.203	27.368
Loans and borrowings	11	3.416	3.248
Trade and other payables		19.877	14.048
Deferred income		10.776	8.807
Liabilities classified as held for sale	7	1.831	2.365
Total current liabilities		35.900	28.468
Total liabilities		58.103	55.836
Total equity and liabilities		91.380	84.239

The notes on pages 9 to 15 are an integral part of these interim consolidated financial statements

Interim Financial Statements of Icelandair Group hf. 30 September 2011 6 Amounts are in ISK million

Consolidated Interim Statement of Changes in Equity
for the period from 1 January to 30 September 2011

	Attributable to equity holders of the Company						
1 January to 30 September 2010	**Share capital**	**Share premium**	**Other reserves**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
Equity 1.1.2010	975	25.450	6.899	(18.755)	14.569	36	14.605
Total comprehensive income			(787)	3.147	2.360	4	2.364
Share based payments reversed			(100)	100	0		0
Equity 30.9.2010	975	25.450	6.012	(15.508)	16.929	40	16.969
1 January to 30 September 2011							
Equity 1.1.2011	4.975	19.013	4.387	0	28.375	28	28.403
Total comprehensive income			268	4.648	4.916	4	4.920
Cost of share capital increase		(46)			(46)		(46)
Equity 30.9.2011	4.975	18.967	4.655	4.648	33.245	32	33.277

Information on changes in other reserves are provided in note 10.

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Consolidated Interim Statement of Cash Flows for the nine months ended 30 September 2011

	Notes	2011 1.1.-30.9	2010 1.1.-30.9
Cash flows from operating activities			
Profit for the period		4.652	3.151
Adjustments for:			
Depreciation and amortisation		4.270	4.237
Depreciation and amortisation of discontinued operations		62	131
Other operating items	16	2.844	3.762
Working capital from operations		11.828	11.281
Net change in operating assets and liabilities	17	1.365	661
Net cash from operating activities		13.193	11.942
Cash flows used in investing activities:			
Acquisition of operating assets		(7.391)	(1.299)
Proceeds from the sale of operating assets		767	82
Acquisition of intangible assets		(130)	(66)
Prepaid aircraft acquisition, increase		0	(29)
Cash of subsidiaries held for sale, change		(128)	7
Capitalization of long-term cost		(1.205)	(1.712)
Long-term receivables, change		(478)	254
Receivable due from associates, change		313	0
Marketable securities, change		(1.857)	0
Net cash used in investing activities		(10.109)	(2.763)
Cash flows used in financing activities:			
Proceeds from shares issued and sold in prior year		2.601	0
Repayment of long term borrowings		(7.286)	(2.785)
Proceeds from short term borrowings		0	(645)
Net cash used in financing activities		(4.685)	(3.430)
(Decrease) increase in cash and cash equivalents		(1.601)	5.749
Effect of exchange rate fluctuations on cash held		34	(276)
Cash and cash equivalents at 1 January		11.688	1.909
Cash and cash equivalents at 30 September		10.121	7.382
Investment and financing without cash flow effect:			
Aquisition of operating assets		660	0
Change in trade and other payables		460	0
Proceeds from long term borrowings		(1.120)	0

Information on interest paid and received are provided in note 18.

The notes on pages 9 to 15 are an integral part of these interim consolidated financial statements

Interim Financial Statements of Icelandair Group hf. 30 September 2011 8 Amounts are in ISK million

Notes

1. Reporting entity

Icelandair Group hf. (the "Company") is a public limited liability company incorporated and domiciled in Iceland. The condensed consolidated interim financial statements of the Company as at and for the nine months ended 30 September 2011 comprise the Company and its subsidiaries (together referred to as the “Group”) and the Group´s interests in associates. The Group is primarily involved in the airline transportation and tourism industry (see note 5).

The Group´s consolidated financial statements as at and for the year ended 31 December 2010 are available upon request from the Company's registered office at Reykjavíkurflugvöllur in Reykjavík, Iceland or at website address, www.icelandairgroup.is and at The Icelandic Stock Exchange website, www.omxgroup.com.

2.

The condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting* . They do not include all of the information required for a full annual financial statements, and should be read in conjunction with the consolidated financial statements of the Group as at and for the year ended 31 December 2010.

These condensed consolidated interim financial statements were approved for issue by the Board of Directors on 2 November 2011.

3. Basis of preparation and significant accounting policies

The accounting policies and methods of computation applied by the Group in these condensed interim consolidated financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended 31 December 2010.

The condensed consolidated interim financial statements are prepared in Icelandic kronas, which is the Group's functional currency, rounded to the nearest million. They are prepared on the historical cost basis except that derivative financial instruments are stated at their fair values.

4. Estimates

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended 31 December 2010.

5. Operating segment

Segment information is presented in the interim consolidated financial statements in respect of the Group's business segments, which are the primary basis of segment reporting. The business segment reporting format reflects the Group's management and internal reporting structure and is divided into two segments, Route network and Tourism services.

As a part of the Group's restructuring plan, the Board of Directors redefined the business model, leading to subsidiaries being divided between core and non-core operations. Accordingly the main focus of the Group will be on scheduled airline operations and tourism evolving around Iceland, and related services. The subsidiaries Bluebird Cargo ehf., IG Invest ehf. and 67% share in Icelease ehf. were divested at year end 2010 and are therefore only included in the segment reporting for 2010. Smartlynx Latvia and the 30% share in Travel Service are defined as non-core operations, leading to reclassification of these companies as discontinued and held for sale.

Route network

Six companies are categorised as being part of the Route Network focus of the Group: Icelandair, Icelandair Cargo, Loftleidir, Air Iceland, Icelandair Ground Services and Icelandair Shared Services. Bluebird Cargo, Icelease and IG Invest are also included in 2010 amounts.

Tourism services

Two companies are catagorized as being part of the Tourism Services focus of the Group: Iceland Travel and Icelandair Hotels.

Information on reportable segments for the nine months ended 30 September

	Route network		Tourism services		Total	
	2011	**2010**	**2011**	**2010**	**2011**	**2010**
External revenue	68.654	63.457	7.985	5.722	76.639	69.179
Inter-segment revenue	14.332	13.699	120	90	14.452	13.789
Segment revenue	82.986	77.156	8.105	5.812	91.091	82.968
Segment EBITDAR	14.930	17.650	1.051	909	15.981	18.559
Segment EBITDA	9.997	11.463	444	356	10.441	11.819
Reportable segment profit before income tax	5.149	6.246	216	350	5.365	6.596
Segment assets	67.356	71.548	4.088	2.994	71.444	74.542

Reconciliation of reportable segment income

	2011	**2010**
Total profit for reportable segments	5.365	6.596
Elimination of discontinued operations	0	(400)
Unallocated amounts:		
Other corporate expenses	(151)	(2.329)
Share of profit of equity accounted investees	14	74
Consolidated profit before income tax	5.228	3.941

Other material items 30 September 2011

	Reportable segment totals	**Adjust- ments**	**Consolid- ated totals**
Segment EBITDAR	15.981	101	16.082
Segment EBITDA	10.441	101	10.542

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6. Discontinued operation

SmartLynx is classified as discontinued and is therefore not part of the continuing operations. SmartLynx's off balance sheet obligations outside Icelandair Group were ISK 1.2 billion at the end of September 2011, payable in 2011 and 2012. The results of the discontinued operation are specified as follows:

	2011 1.1.-30.9	2010 1.1.-30.9
Results of discontinued operation		
Revenue	6.033	6.894
Expenses	(6.173)	(7.472)
Results from operating activities	(140)	(578)
Financial expenses	0	(142)
Results from operating activities, net of income tax	(140)	(720)
Reversal of provision	140	320
Loss for the period	0	(400)
Basic loss per share	0,00	(0,41)
Diluted loss per share	0,00	(0,41)
Cash flows used in discontinued operation		
Net cash used in operating activities	(27)	(770)
Net cash used in investing activities	(381)	(416)
Net cash from financing activities	408	1.186
Net cash used in discontinued operation	0	0

7. Assets and liabilities classified as held for sale

Assets and liabilities classified as held for sale consist of the assets and liabilities of SmartLynx (classified as discontinued opertation, see note 6), and the remaining 30% share in Travel Service.

Assets and liabilities classified as held for sale are specfied as follows:

	30.9.2011	31.12.2010
Assets classified as held for sale		
Operating assets	1.008	1.012
Intangible assets	16	20
Other non-current assets	602	682
Investments in other companies	500	500
Inventories	117	71
Trade and other receivables	302	436
Cash and cash equivalents	226	94
	2.771	2.815
Liabilities classified as held for sale		
Non-current loans and borrowings	0	1
Current loans and borrowings	328	517
Trade and other payables	1.324	1.700
Deferred income	179	147
	1.831	2.365

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Notes, contd.:

8. Finance income and finance expense

Finance income and finance expense are specified as follows:

	2011 1.1.-30.9	2010 1.1.-30.9
Interest income on bank deposits	82	36
Other interest income	546	129
Finance income total	628	165
Interest expenses on loans and borrowings	1.070	2.550
Other interest expenses	90	105
Net foreign exchange loss	526	468
Finance costs total	1.686	3.123
Net finance costs	(1.058)	(2.958)

9. Income tax

Income tax expense is recognised based on management´s best estimate of the income tax rate for the year applied to the pre-tax income of the interim period. The Group´s consolidated effective tax rate in respect of continuing operations for the nine months ended 30 September 2011 was 11 percent (nine months ended 30 September 2010; 18 percent). The change in effective tax rate was caused mainly by ISK 1.8 billion adjustment of tax deductible expenses from 2010.

10. Equity

Other reserves are specified as follows:

	Share option reserve	Hedging reserve	Translation reserve	Total reserves
Equity 1.1.2010	100	(302)	7.101	6.899
Changes during the period	(100)	263	(1.050)	(887)
Equity 30.9.2010	0	(39)	6.051	6.012
Equity 1.1.2011	0	(28)	4.415	4.387
Changes during the period	0	35	233	268
Equity 30.9.2011	0	7	4.648	4.655

11. Loans and borrowings

This note provides information on the contractual terms of the Group´s interest-bearing loans and borrowings, which are measured at amortised cost.

	30.9.2011	31.12.2010
Non-current loans and borrowings are specified as follows:		
Secured bank loans	17.553	22.834
Unsecured bonds	1.733	1.770
	19.286	24.604
Current maturities	(3.184)	(3.248)
Total non-current loans and borrowings	16.102	21.356
Current loans and borrowings are specified as follows:		
Current maturities of non-current liabilities	3.184	3.248
Short-term loans from credit institutions	232	0
Total current loans and borrowings	3.416	3.248
Total loans and borrowings	19.518	24.604

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Notes, contd.:

12. Non-current loans and borrowings are specified as follows between currencies and indexation:

	Currency	Nominal interest rates	Year of maturity	Total remaining balance 30.9.2011	Total remaining balance 31.12.2010
Secured bank loan	USD	4,2%	2013-2018	11.922	15.638
Secured bank loan	EUR	5,3%	2017	2.398	3.699
Secured bank loan	ISK	5,9%	2013-2017	2.958	3.227
Secured bank loan, indexed	ISK	7,1%	2012-2028	275	270
Unsecured bond issue, indexed	ISK	5,7%	2012-2023	1.733	1.770
Total interest-bearing liabilities				19.286	24.604

13. Contractual repayments of loans and borrowings

Contractual repayments of loans and borrowings are specified as follows:

	2011	2010
Repayments in 2011 (3 months)(2010: 12 months)	922	3.248
Repayments in 2012	3.296	3.099
Repayments in 2013	4.292	7.820
Repayments in 2014	4.612	4.242
Repayments in 2015	1.102	1.033
Repayments in 2016	1.087	1.083
Subsequent repayments	4.207	4.079
Total loans and borrowings	19.518	24.604

14. Off-balance sheet items

As a lessee the Group has in place operating leases for 17 aircraft at the end of September 2011. The leases are for twelve Boeing 757 aircraft and five Boeing 767 aircraft. The Group also has in place operating leases for storage facilities, accommodations, equipment and fixtures for its operations, the longest until the year 2032. At the end of September 2011 the leases are payable as follows:

	Real estate	Aircraft	Other	Total 30.9.2011
In Q4 2011	284	1.593	63	1.940
In the year 2012	1.224	5.697	185	7.106
In the year 2013	1.177	3.357	31	4.565
In the year 2014	1.168	1.926	7	3.101
In the year 2015	1.116	1.610		2.726
Subsequent	11.949	224		12.173
Total	16.918	14.407	286	31.611

During the period the Group purchased two Dash 8 aircraft. An agreement was also signed for improvement of the aircraft of which ISK 0,4 billion is still outstanding at end of September 2011. The aircraft will be delivered for operation in December 2011 and January 2012.

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Notes, contd.:

15. Group entities

The Company holds eleven subsidiaries at the end of September 2011. Bluebird Cargo ehf., IG Invest ehf. and Icelease ehf. were sold at year end 2010 and are therefore only included in 2010 comparative amounts with turnover of ISK 3,6 billion and EBITDA of ISK 1.1 billion. Addition from last year is A320 ehf., a company owning one Airbus 320 aircraft leased to SmartLynx. The company started operation in June 2011. The subsidiaries included in the consolidated interim financial statements are specified as follows:

	Share
Route network:	
Air Iceland ehf.	100%
Icelandair ehf.	100%
Icelandair Cargo ehf.	100%
IGS ehf.	100%
Icelandair Shared Services ehf.	100%
Loftleiðir - Icelandic ehf.	100%
Tourism services:	
Iceland Travel ehf.	100%
Icelandair Hotels ehf.	100%
Other operation:	
A320 ehf.	100%
IceCap Ltd., Guernsey	100%
Discontinued operation:	
SmartLynx, Latvia	100%

The subsidiaries further own 25 subsidiaries that are all included in the consolidated interim financial statements.

16. Statement of cash flows

Other operating items in the statement of cash flows are specified as follows:

	2011 1.1.-30.9	2010 1.1.-30.9
Expensed long term cost	2.609	3.491
Exchange rate difference and indexation of liabilities and assets	116	(93)
Gain on sale of assets	(303)	(32)
Gain from assets held for sale	(140)	(320)
Share in profit of associates	(14)	(74)
Income tax	576	790
Total other operating items in the statement of cash flows	2.844	3.762

17. Net change in operating assets and liabilities in the statement of cash flows is specified as follows:

Inventories, increase	(306)	(274)
Trade and other receivables, increase	(2.625)	(4.424)
Trade and other payables, increase	2.327	3.704
Deferred income, increase	1.969	1.655
Net change in operating assets and liabilities in statement of cash flows	1.365	661

18. Additional cash flow information:

Interest paid	1.302	1.980
Interest received	506	164

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19. Ratios

The Group's primary ratios are specified as follows:

	30.9.2011	31.12.2010
Current ratio	1,00	1,16
Equity ratio	0,36	0,34
Intrinsic value of share capital	6,69	5,71