Icelandair Group hf.

Consolidated Financial Statements
for the year 2011
ISK

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

Contents

Endorsement and Statement by the Board of Directors and the CEO

Operations in the year 2011

The financial statements comprise the consolidated financial statements of Icelandair Group hf. (the "Company") and its subsidiaries together referred to as the "Group". The Group operates in the airline and tourism sectors.

According to the consolidated statement of comprehensive income, profit for the year 2011 amounted to ISK 4.452 million. Total comprehensive income for the year amounted to ISK 3.934 million. According to the consolidated statement of financial postition, equity at the end of the year amounted to ISK 32.291 million, including share capital in the amount of ISK 4.975 million. Reference is made to the notes to the consolidated financial statements regarding information on changes in equity.

The Board of Directors proposes a ISK 800 million dividend payment to shareholders in the year 2012.

Share capital and Articles of Association

The share capital amounted to ISK 5.000 million at the end of the year, from which the Company held treasury shares in the amount of ISK 25 million. The share capital is divided into shares of ISK 1, each with equal rights within a single class of shares listed on the Icelandic Stock Exchange (OMX Iceland). The Company can purchase up to 10% of the nominal value of the shares of the Company according to the Company's Act.

The Company's Board of Directors comprises five members and three alternative members elected on the annual general meeting for a term of one year. Those persons willing to stand for election must give formal notice thereof to the Board of Directors at least five days before the annual general meeting. The Company's Articles of Association may only be amended at a legitimate shareholders' meeting, provided that amendments and their main aspects are clearly stated in the invitation to the meeting. A resolution will only be valid if it is approved by at least 2/3 of votes cast and is approved by shareholders controlling at least 2/3 of the share capital represented at the shareholders' meeting.

The number of shareholders at the end of the year 2011 was 1,269, a decrease of 209 from the beginning of the year. Three shareholders held more than 10% of outstanding shares each at year end 2011, Íslandsbanki hf. with 20.9% share, Framtakssjódur Íslands slhf. with 19.0% share and Lífeyrissjódur Verslunarmanna with 14,4% share.

Information on matters related to share capital is disclosed in note 28.

Corporate Governance

The Group’s management if of the opinion that practicing good Corporate Governance is vital for the existence of the Group and is in the best interests of the shareholders, Croup companies, employees and other stakeholders and will in the long run produce satisfactory profits on shareholders’ investment.

The framework for Corporate Governance practices within the Group consists of the provisions of law, the parent company’s Articles of Association, general securities regulations and the Icelandic Corporate Governance guidelines issued in 2009 by the Iceland Chamber of Commerce, Nasdaq OMX Iceland and the Confederations of Icelandic Employers. Corporate Governance practices ensure open and transparent relationships between the Company´s management, its Board of Directors, its shareholders and other stakeholders.

Corporate Governance exercised in Icelandair Group hf. ensures sound and effective control of the Company´s affairs and a high level of business ethics.

The Board of Directors has prepared a Corporate Governance statement in compliance with the Icelandic Corporate Governance guidelines which are described in full in the Corporate Governance Statement in the Financial Statements.

It is the opinion of the Board of Directors that Icelandair Group hf. complies with the Icelandic guidelines for Corporate Governance.

Endorsement and statement by the Board of Directors and the CEO, contd.:

Statement by the Board of Directors and the CEO

The annual consolidated financial statements for the year ended 31 December 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 knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the financial year 2011, its assets, liabilities and consolidated financial position as at 31 December 2011 and its consolidated cash flows for the financial year 2011.

Further, in our opinion the consolidated 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 annual consolidated financial statements of Icelandair Group hf. for the year 2011 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements will be approved at the annual general meeting of Icelandair Group hf.

Reykjavík, 9 February 2012

Board of Directors:

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

CEO:

Björgólfur Jóhannsson

Independent Auditors' Report

To the Board of Directors and Shareholders of Icelandair Group hf.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Icelandair Group hf., which comprise the consolidated statement of financial position as at 31 December 2011, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Icelandair Group as at 31 December 2011, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 9 February 2012

KPMG ehf.

Alexander Eðvarðsson
Guðný H. Guðmundsdóttir

Consolidated Statement of Comprehensive Income for the year 2011

	Notes	2011	2010
Continuing operation			
Operating income			
Transport revenue	9	62,215	53,944
Aircraft and aircrew lease		16,749	19,972
Other operating revenue	9	17,970	14,099
		96,934	88,015
Operating expenses			
Salaries and other personnel expenses	10	22,809	20,415
Aircraft fuel		22,014	14,927
Aircraft and aircrew lease		10,290	11,866
Aircraft handling, landing and communication		7,121	6,103
Aircraft maintenance expenses		7,174	6,475
Other operating expenses	10	17,113	15,651
		86,521	75,437
Operating profit before depreciation and amortisation (EBITDA)		10,413	12,578
Depreciation, amortisation and impairment losses	12	(5,678)	(6,324)
Operating profit (EBIT)		4,735	6,254
Gain on disposals in relation to financial restructuring		0	4,245
Profit before net finance costs		4,735	10,499
Finance income		883	255
Finance costs		(2,107)	(3,787)
Net finance costs	13	(1,224)	(3,532)
Share of loss of associates, net of tax	20	(11)	(391)
Profit before tax		3,500	6,576
Tax income (expense)	23	584	(1,458)
Profit from continuing operations		4,084	5,118
Discontinued operation			
Profit (loss) from discontinued operation, net of tax	7	368	(562)
Profit for the year		4,452	4,556
Other comprehensive income			
Foreign currency translation differences of foreign operations		470	(615)
Foreign currency translation differences reclassified to profit or loss		(1,199)	(2,120)
Net profit on hedge of net investment in foreign operation, net of tax		142	49
Effective portion of changes in fair value of cash flow hedge, net of tax		69	274
Other comprehensive loss for the year		(518)	(2,412)
Total comprehensive income for the year		3,934	2,144

The notes on pages 11 to 49 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2011 6 Amounts are in ISK millions

Consolidated Statement of Comprehensive Income for the year 2011, contd.:

	Notes	2011	2010
Profit attributable to:			
Owners of the Company		4,451	4,564
Non-controlling interests		1	(8)
Profit for the year		4,452	4,556
Total Comprehensive income attributable to:			
Owners of the Company		3,933	2,152
Non-controlling interests		1	(8)
Total comprehensive income for the year		3,934	2,144
Earnings per share:			
Basic earnings per share (ISK)	29	0.89	3.07
Diluted earnings per share (ISK)	29	0.89	3.07
Earnings per share from continuing operations:			
Basic earnings per share (ISK)	29	0.82	3.45
Diluted earnings per share (ISK)	29	0.82	3.45

The notes on pages 11 to 49 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2011 7 Amounts are in ISK millions

Consolidated Statement of Financial Position as at 31 December 2011

	Notes	2011	2010
Assets:			
Operating assets	14-17	33,859	27,594
Intangible assets and goodwill	18-19	21,659	21,212
Investments in associates	20	173	178
Long-term cost	21	761	918
Other long-term receivables and deposits	22	2,772	2,768
Non-current assets		59,224	52,670
Inventories	24	1,849	1,580
Trade and other receivables	25	14,518	14,180
Marketable securites	26	3,345	1,306
Cash and cash equivalents	27	9,735	11,688
Assets held for sale	8	795	2,815
Current assets		30,242	31,569
Total assets		89,466	84,239
Equity:			
Share capital		4,975	4,975
Share premium		18,967	19,013
Reserves		3,869	4,387
Retained earnings		4,451	0
Equity attributable to equity holders of the Company	28	32,262	28,375
Non-controlling interests		29	28
Total equity		32,291	28,403
Liabilities:			
Loans and borrowings	30-31	19,999	21,356
Other payables	32	3,332	4,745
Deferred tax liabilities	23	771	1,267
Non-current liabilities		24,102	27,368
Loans and borrowings	31	4,137	3,248
Trade and other payables	34	16,551	14,048
Deferred income	35	12,385	8,807
Liabilities held for sale	8	0	2,365
Current liabilities		33,073	28,468
Total liabilities		57,175	55,836
Total equity and liabilities		89,466	84,239

The notes on pages 11 to 49 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2011 8 Amounts are in ISK millions

Consolidated Statement of Changes in Equity for the year 2011

	Attributable to equity holders of the Company						
2010	**Share capital**	**Share premium**	**Other reserves**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
Balance at 1.1.2010	975	25,450	6,899	(18,755)	14,569	36	14,605
Total comprehensive income							
Profit for the year				4,564	4,564	(8)	4,556
Other comprehensive income			(2,412)		(2,412)		(2,412)
Total comprehensive income	0	0	(2,412)	4,564	2,152	(8)	2,144
Transactions with owners of the Company, recognised directly in equity							
Contributions by and distributions to owners of the Company							
Share premium transferred to accumulated deficit		(14,091)		14,091	0		0
Share capital increase	4,000	7,654			11,654		11,654
Share based payments reversed			(100)	100	0		0
Total transactions with owners of the Company	4,000	(6,437)	(100)	14,191	11,654		11,654
Balance at 31 December 2010	4,975	19,013	4,387	0	28,375	28	28,403
2011							
Balance at 1.1.2011	4,975	19,013	4,387	0	28,375	28	28,403
Total comprehensive income							
Profit for the year				4,451	4,451	1	4,452
Other comprehensive income			(518)		(518)		(518)
Total comprehensive income	0	0	(518)	4,451	3,933	1	3,934
Transactions with owners of the Company, recognised directly in equity							
Contributions by and distributions to owners of the Company							
Share capital increase		(46)			(46)		(46)
Total transactions with owners of the Company		(46)			(46)		(46)
Balance at 31 December 2011	4,975	18,967	3,869	4,451	32,262	29	32,291

Changes in other reserves are provided in note 28.

The notes on pages 11 to 49 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2011 9 Amounts are in ISK millions

Consolidated Statement of Cash Flows for the year 2011

	Notes	2011	2010
Cash flows from operating activities:			
Profit for the year		4,452	4,556
Adjustments for:			
Depreciation and amortisation	12	5,678	6,324
Other operating items	44	2,411	2,009
Working capital from operations		12,541	12,889
Net change in operating assets and liabilities	45	1,845	2,784
Net cash from operating activities		14,386	15,673
Cash flows to investing activities:			
Acquisition of operating assets	14	(8,117)	(2,190)
Proceeds from the sale of operating assets		805	3,487
Acquisition of intangible assets	18	(175)	(214)
Prepaid aircraft acquisitions, increase		0	(38)
Cash of disposed subsidiaries, change		0	(1,530)
Cash of subsidiaries held for sale, change		5	(22)
Acquisition of long-term cost		(3,574)	(2,573)
Long-term receivables		70	(1,126)
Marketable securites		(2,031)	(1,306)
Net cash used in investing activities		(13,017)	(5,512)
Cash flows to financing activities:			
Paid in share capital		2,601	5,407
Proceeds from long term borrowings		2,109	0
Repayment of long term borrowings		(8,094)	(5,063)
Proceeds from long term payables		0	252
Repayment of short term borrowings		0	(645)
Net cash used in financing activities		(3,384)	(49)
(Decrease) increase in cash and cash equivalents		(2,015)	10,112
Effect of exchange rate fluctuations on cash held		62	(333)
Cash and cash equivalents at beginning of the year		11,688	1,909
Cash and cash equivalents at 31 December	27	9,735	11,688
Investment and financing without cash flow effect:			
Issued share capital		0	6,247
Changes in borrowings		0	(11,199)
Disposals of subsidiaries		0	7,600
Other receivables		0	(2,648)
Aquisition of operating assets		(3,460)	0
Change in trade and other payables		(460)	0
Proceeds from long term borrowings		3,920	0

Information on interest paid and received are provided in note 46.

The notes on pages 11 to 49 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2011 10 Amounts are in ISK millions

Notes

1. Reporting entity

Icelandair Group hf. (the "Company") is a public limited liability company incorporated and domiciled in Iceland. The address of the Company´s registered office is at Reykjavíkurflugvöllur in Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 31 December 2011 comprise the Company and its subsidiaries, together referred to as the "Group" and individually as "Group entities" and the Group´s interests in associates. The Group is primarily involved in the airline and tourism industry. The Company is listed on the Nasdaq OMX Iceland.

2. Basis of preparation

a. Statement of compliance

The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

The consolidated financial statements were approved and authorised for issue by the Board of Directors on 9 February 2012.

b. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that derivative financial instruments are stated at their fair value. The methods used to measure fair values are discussed further in note 5.

c. Functional and presentation currency

These consolidated financial statements are prepared in Icelandic krona (ISK), which is the Company's functional currency. All financial information presented in ISK has been rounded to the nearest million, except when otherwise indicated.

d. Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRSs 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 are revised and in any future periods affected.

Information about assumtions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

Note 19 - measurement of the recoverable amounts of cash-generating units
Note 21 - long-term cost
Note 23 - utilisation of tax losses
Note 36 - provisions and valuation of financial instruments

3. Significant accounting policies

The accounting policies set out in this note have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

a. Basis of consolidation

(i) 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.

(ii) Loss of control

On the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee.

(iii) 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. Investment in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs. The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income 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 carrying amount of the interests that form part thereof, including any long-term investments is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

(iv) 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 investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

b. Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group 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. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the exchange rate at the end of the year.

3b. contd.:

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on a financial liability designated as a hedge of the net investment in a foreign operation to the extent that the hedge is effective (see (iii) below), or qualifying cash flow hedges to the extent the hedge is effective, which are recognised in other comprehensive income.

(ii) **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 krona, including goodwill and fair value adjustments arising on acquisitions, are translated to Icelandic kronas at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Icelandic kronas at exchange rates at the dates 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 within equity is transferred to profit or loss as part of the profit or loss on disposal.

Foreign currency differences are recognised in other comprehensive income, and presented in the foreign currency translation reserve (translation reserve) in equity. However, if the operation is a non-wholly owned subsidiary, then the relevant proportion of the translation difference is allocated to the non-controlling interests.

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 presented in the translation reserve in equity.

(iii) **Hedge of net investment in foreign operations**

The Group applies hedge accounting to foreign currency differences arising between the functional currency of the foreign operation and the Company's functional currency (ISK), regardless of whether the net investment is held directly or through an intermediate parent.

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in a foreign operation are recognised in other comprehensive income to the extent that the hedge is effective, and are presented in the translation reserve within equity. 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 translation reserve is transferred to profit or loss as part of the gain or loss on disposal.

c. Financial instruments

(i) **Non-derivative financial assets**

The Group initially recognises loans and receivables and deposits on the date that they are originated. All other financial assets, including assets designated at fair value through profit or loss, are recognised initially on the trade date, which is the date that the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

3c. contd.:

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Group classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss and loans and receivables.

Financial assets at fair value through profit or loss
A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such on initial recognition. Financial assets are designated as at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Attributable transaction costs are recognised in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and changes therein which takes into account any dividend income, are recognised in profit or loss.

Loans and receivables
Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables comprise cash and cash equivalent and trade and other receivables.

Cash and cash equivalents
Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

(ii) **Non-derivative financial liabilities**
The Group initially recognises debt securities issued on the date that they are originated. All other financial liabilities including liabilities designated at fair value through profit or loss are recognised initially on the trade date, which is the date that the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

The Group classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method. Other financial liabilities comprise loans and borrowings and trade and other payables.

3c. contd.:

(iii) **Share capital**

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.

Repurchase and reissue of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, 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 presented in share premium.

(iv) **Derivative financial instruments, including hedge accounting**

The Group holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures (see note 45). 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 derivative as a hedging instrument, the Group formally documents the relationship between the hedging instrument and hedged item, including the risk management objectives and strategy in undertaking the hedge transaction and the hedged risk, together with the methods that will be used to assess the effectiveness of the hedging relationship. The Group 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 ultimately could affect reported profit or loss.

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. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss.

When the hedged item is a non-financial asset, the amount accumulated in equity is included in the carrying amount of the asset when the asset is recognised. In other cases the amount accumulated in equity is reclassified to profit or loss in the same period that the hedged item affects profit or loss. If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, or the designation is revoked, then hedge accounting is discontinued prospectively. If the forecast transaction is no longer expected to occur, then the balance in equity is reclassified in profit or loss.

Other non-trading derivatives

When a derivative financial instrument is not designated in a hedge relationship that qualifies for hedge accounting, all changes in its fair value are recognised immediately in profit or loss.

3. contd.:

d. Operating assets

(i) 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 their intended use.

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

Any gain and loss on disposal of an item of operating assets (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in profit or loss.

(ii) Aircraft and flight equipment

Aircraft and flight equipment, e.g. aircraft engines and aircraft spare parts, are measured at cost less accumulated depreciation and accumulated impairment losses. When an aircraft is acquired the purchase price is divided between the aircraft itself and engines. Aircraft is depreciated over the estimated useful life of the relevant aircraft until a residual value is met. Engines are depreciated according to actual usage based on cycles flown. 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.

(iii) Subsequent costs

Subsequent expenditure is capitalised only when it is probable that the future economic benefits associated with the expenditure will flow to the Group. Ongoing repairs and maintenance is expensed as incurred.

(iv) Depreciation

Depreciation is based on the cost of an asset less its residual value. Significant components of individual assets are assessed and if a component has a useful life that is different from the remainder of that asset, that component is depreciated separately.

Items of operating assets are depreciated on a straight-line basis in profit or loss over the estimated useful lives of each component unless other systematic method is considered appropriate. Leased assets are depreciated over the shorter of the lease term or their useful lives. The estimated useful lives for the current and comparative periods are as follows:

	Useful life
Aircraft and flight equipment	4-20 years
Engines	Cycles flown
Buildings	17-50 years
Other property and equipment	3-20 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

3. contd.:

e. Intangible assets

(i) **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 measured at cost less 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 airport slots with indefinite useful lives are stated at cost less accumulated impairment losses.

(ii) **Other intangible assets**

Other intangible assets acquired by the Group and 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 years 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 reporting date and adjusted if appropriate.

(iii) **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, including expenditure on internally generated goodwill and brands, is recognised in profit or loss as incurred.

f. Leased assets

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

g. 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 and 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.

h. Impairment

(i) **Non-derivative 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 there is objective evidence of impairment as a result of one or more events has occurred after the initial recognition of the asset, and that loss events had an impact on the estimated future cash flows of that asset that can be estimated reliably.

3h. contd.:

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. When an event occurring after the impairment recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) **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. Goodwill and indefinite-lived intangibles assets are tested annually for impairment. An impairment loss is recognised if the carrying amount of an asset or cash-generating unit (CGU) exceeds its recoverable amount.

The recoverable amount of an asset or CGU 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 pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respet of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs), and then to reduce the carrying amounts of the other assets in the CGU (group of CGUs) on a pro rata basis.

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.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

An impairment loss in respect of goodwill is not reversed. For other assets, 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.

3. contd.:

i. 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 or distribution, the assets, or components of a disposal group, are remeasured 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 costs to sell. Any impairment loss on a disposal group is first 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 and losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss. Once classified as held for sale, intangible assets and operating assets are no longer amortised or depreciated.

Intangible assets and operating assets once classified as held for sale or distribution are not amortised or depreciated. In addition, equity accounting of equity-accounted investees ceases once classified as held for sale or distribution.

j. Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably 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.

Overhaul commitments relating to aircraft 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.

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

k. Deferred income

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

Icelandair's 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 recognized as revenue when they are utilized or when they expire.

3. contd.:

l. Operating income

(i) 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. Non-refundable documents are recognized as revenue two months after expected transport if not used. 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.

(ii) Aircraft and aircrew lease

Revenue from aircraft and aircrew lease is recognised in profit or loss when the service has been provided.

(iii) Other operating revenue

Revenue includes revenue from tourism, sales at airports and hotels, maintenance service sold and other revenue. 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.

m. Lease payments

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.

n. Finance income and finance costs

Finance income comprises interest income on funds invested, dividend income, foreign currency gains, and gains on hedging instruments that are recognised 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 costs comprise interest expense on borrowings, unwinding of the discount on provisions, foreign currency losses, impairment losses recognised on financial assets, and losses on hedging instruments that are recognised in profit or loss. Borrowing costs that are not directly attributable to the acquisition of a qualifying asset are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or net loss position.

3. contd.:

o. Income tax

Income tax on the profit or loss for the year comprises only deferred tax despite profit due to usage of carry forward tax losses. 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.

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, and 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.

p. 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 on 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 year.

q. 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.

r. Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenue and incur expenses, including revenue 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 is the aircraft fleet, the majority of which is 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, reported to the CEO 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 operating assets and intangible assets other than goodwill.

4. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group.

5. 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.

(i) 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 aircraft 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.

(ii) 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.

(iii) Trade and other receivables

The fair value of trade and other 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.

(iv) Derivatives

The fair value of forward exchange contracts is based on their quoted price, if available. If a quoted 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.

(v) 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.

(vi) 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.

6. Operating segments

Segment information is presented in the 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.

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. A 30% share in Travel Service is defined as non-core operation and classified as held for sale. Investment in SmartLynx, previously classified as held for sale was sold in December 2011.

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

Segment results include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Route network

Six companies are categorised as being part of the Route Network: 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: Iceland Travel and Icelandair Hotels.

Information on reportable segments

	Route network		Tourism services		Total	
	2011	2010	2011	2010	2011	2010
External revenue	87,270	81,235	9,265	6,691	96,535	87,926
Inter-segment revenue	19,545	18,652	160	135	19,705	18,787
Segment EBITDAR*	16,703	20,763	932	835	17,635	21,598
Segment EBITDA	10,164	12,793	133	129	10,297	12,922
Finance income	300	783	16	228	316	1,011
Finance costs	(1,375)	(2,173)	(109)	(99)	(1,484)	(2,272)
Depreciation and amortisation	(5,341)	(6,111)	(196)	(206)	(5,537)	(6,317)
Share of profit of equity accounted investees	1	(391)	(9)	0	(8)	(391)
Reportable segment profit (loss) before income tax	3,749	4,901	(165)	52	3,584	4,953
Reportable segment assets	70,530	62,105	2,846	2,130	73,376	64,235
Investment in associates	68	72	50	56	118	128
Capital expenditure	13,501	4,721	638	99	14,139	4,820
Reportable segment liabilities	54,331	47,981	2,411	1,557	56,742	49,538

*EBITDAR means EBITDA before operating lease expenses.

Consolidated Financial Statements of Icelandair Group hf. 2011 23 Amounts are in ISK millions

6. contd.:

Reconciliations of reportable segment revenues, profit or loss, assets and liabilities, and other material items

	2011	2010
Revenue		
Total revenue for reportable segments	116,240	106,713
Other revenue	399	89
Elimination of inter-segment revenue	(19,705)	(18,787)
Consolidated revenue	96,934	88,015
Profit or loss		
Total profit of reportable segments	3,584	4,953
Unallocated amounts:		
Gain on disposals in relation to financial restructuring	0	4,245
Corporate expenses	(84)	(2,622)
Consolidated profit from continuing operations before tax	3,500	6,576
Assets		
Total assets for reportable segments	73,376	64,235
Other assets	15,972	19,876
Investments in associates	118	128
Consolidated total assets	89,466	84,239
Liabilities		
Total liabilities for reportable segments	56,742	49,538
Other liabilities	433	6,298
Consolidated total liabilities	57,175	55,836

Other material items 2011	Reportable segment totals	Adjustments	Consolidated totals
Segment EBITDAR	17,635	116	17,751
Segment EBITDA	10,297	116	10,413
Finance income	316	567	883
Finance costs	(1,484)	(623)	(2,107)
Depreciation and amortisation	(5,537)	(141)	(5,678)
Share of loss of associates	(8)	(3)	(11)
Capital expenditure	14,139	1,187	15,326
Other material items 2010			
Segment EBITDAR	21,598	(344)	21,254
Segment EBITDA	12,922	(344)	12,578
Finance income	972	(717)	255
Finance costs	(2,624)	(1,163)	(3,787)
Depreciation and amortisation	(6,317)	(7)	(6,324)
Share of loss of associates	(391)	0	(391)
Capital expenditure	4,830	185	5,015

Consolidated Financial Statements of Icelandair Group hf. 2011 24 Amounts are in ISK millions

7. Discontinued operation

On December 30th 2011 SmartLynx, previously classified as discontinued operations, was sold. SmartLynx's results for the year 2011 as discontinued operation are specified as follows:

Results of discontinued operation	**2011**	**2010**
Revenue	7,925	8,495
Expenses	(8,268)	(9,767)
Results from operating activities	(343)	(1,272)
Net finance costs	(44)	(196)
Income tax	(1)	0
Results from operating activities, net of income tax	(388)	(1,468)
Reversal of translation reserve	1,155	0
Guarantees of discontinued operation reversed	(399)	906
Profit (loss) for the year	368	(562)
Basic profit (loss) per share	0.07	(0.38)
Diluted profit (loss) per share	0.07	(0.38)

Cash flows from discontinued operation		
Net cash used in operating activities	(265)	(789)
Net cash used in investing activities	(393)	(335)
Net cash from financing activities	658	1,146
Net cash from discontinued operation	0	22

8. Assets and liabilities classified as held for sale

At year end 2011 assets held for sale consist of 30% share in Travel Service and one Dash 8 aircraft from Air Iceland.

Travel Service sale process started in 2011 and is expected to be finalized in the first half of 2012. The Group will receive the first ISK 0.5 million of the potential sale price, the creditors that participated in the financial restructuring of the balance sheet in 2010 will receive proceeds between ISK 0.5 billion ISK and ISK 1.6 billion ISK and the Group proceeds above ISK 1.6 billion.

In December 2011 an agreement on the sale of one Dash 8 aircraft was signed. The aircraft will be delivered in April 2012. Since the conditions for the sale have not been met in 2011, as the delivery of the aircraft has not taken place, the sale is not recognized in the 2011 Financial Statements. Assets held for sale are specified as follows:

Assets classified as held for sale	**2011**	**2010**
Operating assets	295	1,012
Intangible assets	0	20
Other non-current assets	0	682
Investment in other companies	500	500
Inventories	0	71
Trade and other receivables	0	436
Cash and cash equivalents	0	94
	795	2,815

Liabilities classified as held for sale		
Non-current loans and borrowings	0	1
Current loans and borrowings	0	517
Trade and other payables	0	1,700
Deferred income	0	147
	0	2,365

Consolidated Financial Statements of Icelandair Group hf. 2011 25 Amounts are in ISK millions

9. Operating income

Transport revenue is specified as follows:

	2011	2010
Passengers	57,716	48,634
Cargo and mail	4,499	5,310
Total transport revenue	62,215	53,944

Other operating revenue is specified as follows:

	2011	2010
Sale at airports and hotels	5,894	4,736
Revenue from tourism	5,712	3,996
Aircraft and cargo handling services	3,242	2,850
Revenue from maintenance and aircraft handling	1,021	1,092
Gain on sale of operating assets	316	0
Other operating revenue	1,785	1,425
Total other operating revenue	17,970	14,099

10. Operating expenses

Salaries and other personnel expenses are specified as follows:

	2011	2010
Salaries	14,726	13,118
Contribution to pension funds	2,011	1,811
Other salary-related expenses	1,949	1,722
Other personnel expenses	4,123	3,764
Total salaries and other personnel expenses	22,809	20,415
Average number of full year equivalents	2,350	2,197

Other operating expenses are specified as follows:

	2011	2010
Operating cost of real estates and fixtures	1,957	1,780
Communication expenses	1,333	1,387
Advertising expenses	2,004	1,713
Booking fee and commission expenses	3,128	2,756
Cost of goods sold	1,899	1,401
Customer services	1,360	1,177
Tourism expenses	2,999	1,890
Other operating expenses	2,433	3,547
Total other operating expenses	17,113	15,651

11. Auditors' fees

Fees to the Group's auditors is specified as follows:

	2011	2010
Audit of financial statements	35	35
Review of interim accounts	4	10
Other services	9	15
Total auditors' fees	48	60

The above mentioned figures include fees to the auditors of all companies within the Group. Fees to auditors, other than the auditors of the Parent Company amounted to ISK 3 million during the year 2011 (2010: ISK 10 million).

Consolidated Financial Statements of Icelandair Group hf. 2011 26 Amounts are in ISK millions

12. Depreciation and amortisation

The depreciation and amortisation charge in profit or loss is specified as follows:

	2011	2010
Depreciation of operating assets, see note 14	5,470	5,188
Amortisation of intangible assets, see note 18	208	418
Impairment, see note 18	0	718
Depreciation, amortisation and impairment losses recognised in profit or loss	5,678	6,324

13. Finance income and finance costs

Finance income and finance costs are specified as follows:

	2011	2010
Interest income on bank deposits	154	102
Other interest income	729	153
Finance income total	883	255
Interest expense on loans and borrowings	1,355	3,239
Other interest expenses	73	134
Net foreign exchange loss	679	414
Finance costs total	2,107	3,787
Net finance costs	(1,224)	(3,532)

14. Operating assets

Operating assets are specified as follows:

Cost	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Balance at 1 January 2010	31,543	2,667	2,702	36,912
Additions through business combinations	6,861	0	0	6,861
Additions during the year	1,757	222	211	2,190
Sales and disposals during the year	(4,592)	(53)	(595)	(5,240)
Effect of movements in exchange rates	(2,196)	0	(15)	(2,211)
Balance at 31 December 2010	33,373	2,836	2,303	38,512
Additions during the year	10,690	65	822	11,577
Sales and disposals during the year	(2,774)	0	(31)	(2,805)
Effect of movements in exchange rates	1,497	0	1	1,498
Assets classified as held for sale	(469)	0	0	(469)
Balance at 31 December 2011	42,317	2,901	3,095	48,313
Depreciation and impairment losses				
Balance at 1 January 2010	8,306	462	1,130	9,898
Depreciation for the year	4,649	148	391	5,188
Sales and disposals during the year	(3,010)	(43)	(571)	(3,624)
Effect of movements in exchange rates	(533)	0	(11)	(544)
Balance at 31 December 2010	9,412	567	939	10,918
Depreciation for the year	4,899	163	408	5,470
Sales and disposals during the year	(2,241)	0	(26)	(2,267)
Effect of movements in exchange rates	520	0	2	522
Assets classified as held for sale	(189)	0	0	(189)
Balance at 31 December 2011	12,401	730	1,323	14,454

Consolidated Financial Statements of Icelandair Group hf. 2011 27 Amounts are in ISK millions

14. contd.:

Carrying amounts	Aircraft and flight equipment	Buildings	Other property and equipment	Total
At 1 January 2010	23,237	2,205	1,572	27,014
At 31 December 2010	23,961	2,269	1,364	27,594
At 31 December 2011	29,916	2,171	1,772	33,859
Depreciation ratios	5-25%	2-6%	5-33%	

During the year the Group purchased four Boeing 757 aircraft of which three had been leased by the Group for a number of years. The Group also purchased two Dash 8 aircraft and an agreement was signed for significant improvement of the aircraft which involved replacing three engines. Of these improvements ISK 0,5 billion is still outstanding at year end 2011. The Dash 8 aircraft will be delivered for operation in February and April 2012.

15. Mortgages and commitments

The Group's operating assets including rotable and consumable spare parts are mortgaged to secure debt. The remaining balance of the debt amounted to ISK 22,386 million at the end of the year 2011 (2010: ISK 22,834 million).

16. Insurance value of aircraft and flight equipment

The insurance value and book value of aircraft and related equipment of the Company at year-end are specified as follows:

	Insurance value		Carrying amount	
	2011	2010	2011	2010
Boeing - 12 / 8 aircraft	45,239	35,871	23,985	19,195
Other aircraft	7,601	6,805	2,211	1,164
Flight equipment	7,656	5,913	3,720	3,602
Total aircraft and flight equipment	60,496	48,589	29,916	23,961

17. Insurance value of buildings and other operating assets

The principal buildings owned by the Group at 31 December 2011 are the following:

	Official assessment value		Insurance value		Carrying amount	
	2011	2010	2011	2010	2011	2010
Maintenance hangar, Keflavík	1,683	1,657	3,494	3,141	723	773
Freight building, Keflavík	392	388	846	736	321	334
Office building, Reykjavík	724	711	1,298	1,177	273	264
Service building, Keflavík	400	412	794	670	179	200
Other buildings in Reykjavik	550	570	1,123	1,025	266	285
Other buildings	386	370	1,127	1,008	409	413
Buildings total	4,135	4,108	8,682	7,757	2,171	2,269

Official valuation of the Group's leased land for buildings at 31 December 2011 amounted to ISK 818 million (2010: ISK 806 million) and is not included in the statement of financial position.

The insurance value of the Group's other operating assets and equipment amounted to ISK 5,548 million at year end 2011 (2010: ISK 4,743 million). The carrying amount at the same time was ISK 1,915 million (2010: ISK 1,364 million).

Consolidated Financial Statements of Icelandair Group hf. 2011 28 Amounts are in ISK millions

18. Intangible assets and goodwill

Intangible assets and goodwill are specified as follows:

Cost	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
Balance at 1 January 2010	23,038	4,805	639	1,138	29,620
Additions during the year	0	0	0	214	214
Sales and disposals during the year	(4,395)	(315)	(19)	(190)	(4,919)
Effect of movements in exchange rates	(692)	(149)	(12)	(12)	(865)
Balance at 31 December 2010	17,951	4,341	608	1,150	24,050
Additions during the year	0	0	0	175	175
Sales and disposals during the year	0	0	0	(106)	(106)
Effect of movements in exchange rates	377	69	33	1	480
Balance at 31 December 2011	18,328	4,410	641	1,220	24,599
Amortisation and impairment losses					
Balance at 1 January 2010	4,726	319	380	597	6,022
Amortisation for the year	17	0	119	282	418
Amortisation for the year of discontinued operation	0	0	0	10	10
Impairment loss	322	370	26	0	718
Sales and disposals during the year	(3,664)	(370)	(127)	(189)	(4,350)
Effect of movements in exchange rates	0	0	29	(9)	20
Balance at 31 December 2010	1,401	319	427	691	2,838
Amortisation for the year	0	0	41	167	208
Sales and disposals during the year	0	0	0	(106)	(106)
Balance at 31 December 2011	1,401	319	468	752	2,940
Carrying amounts					
At 1 January 2010	18,312	4,486	259	541	23,598
At 31 December 2010	16,550	4,022	181	459	21,212
At 31 December 2011	16,927	4,091	173	468	21,659

Consolidated Financial Statements of Icelandair Group hf. 2011 29 Amounts are in ISK millions

19. Impairment test

Goodwill and other intangible assets that have indefinite live are tested for impairment at each reporting date. These assets were recognised at fair value on acquistion dates. Goodwill and other intangible assets with indefinite live are specified as follows:

	2011	2010
Goodwill	16,927	16,550
Trademarks and airport slots	4,091	4,022
Total	21,018	20,572

For the purpose of impairment testing on goodwill, goodwill is allocated to the subsidiaries which represent the lowest level within the Group at which the goodwill is monitored for internal management purposes. The aggregate carrying amount of goodwill allocated to each cash generated unit (CGU) are as follows:

	2011	2010	2011	2010
	Goodwill		Trademarks and slots	
Route network	16,627	16,250	4,091	4,022
Tourism services	300	300	0	0
Total goodwill	16,927	16,550	4,091	4,022

The recoverable amounts of cash-generating units was based on their value in use and was determined by discounting the future cash flows generated from the continuing use of the CGU. Cash flows were projected based on actual operating results and a 5-year business plan. Cash flows were extrapolated for determining the residual value using a constant nominal growth rate which was consistent with the long-term average growth rate for the industry. Management believes that this forecast period was justified due to the long-term nature of the business.

The values assigned to the key assumptions represent management's assessment of future trends in the airline, transportation and the tourism industry and are based on both external sources and internal sources (historical data). Value in use was based on the following key assumptions:

	2011	2010	2011	2010
	Route network		Tourism services	
Long term growth rate	3-4%	3-4%	4.0%	4.0%
Revenue growth:				
Weighted average 2011 / 2010	12.5%	3.0%	26.2%	1.6%
2012 - 2016 / 2011 - 2015	5.3%	5.6%	8.0%	15.0%
Budgeted EBITDA growth	3.4%	8.9%	16.8%	15.1%
WACC	7,5 - 13,4%	8,3 - 12,4%	10.4%	8,9 - 10,9%
Debt leverage	29 - 72%	27 - 73%	21.2%	54.7%
Interest rate	5,4 - 7,3%	6,0 - 7,0%	5.2%	3,3 - 5,3%

Changes in key assumptions would have the following impact on the carrying amount of goodwill:

	2011	2010
WACC +1%	(276)	0
EBITDA - 5%	0	0

No impairment loss is recognised in the Financial Statements.

Consolidated Financial Statements of Icelandair Group hf. 2011 30 Amounts are in ISK millions

20. Investments in associates

Summary of aggregate financial information for significant associates, not adjusted for the percentage ownership held by the Group:

	Ownership 2011	2010
Ábyrg spilamennska ehf.	50%	50%
EBK ehf.	25%	25%
Gufa ehf.	28%	28%
Icelease ehf.	33%	33%
Tjarnir ehf.	22%	22%
Assets	854	388
Liabilities	504	150
Revenues	167	66
Expenses	205	61
Net (loss) profit	(38)	5
Share of loss of associates	(11)	(391)

21. Long-term cost

Long-term cost corresponds to amounts paid for engine overhauls and heavy maintenance of leased aircraft which is expensed over the lease period of the aircraft. Long-term cost is specified as follows:

	2011	2010
Long-term cost	1,398	1,498
Expensed in 2012 / 2011, classified as maintenance prepayments	(637)	(580)
Total long-term cost	761	918

Long-term cost will be expensed as follows:

	2011	2010
Expensed in 2011	-	580
Expensed in 2012	637	442
Expensed in 2013	322	271
Expensed in 2014	244	147
Expensed in 2015	108	46
Expensed in 2016	62	4
Subsequent	25	8
Total long-term cost, including current maturities	1,398	1,498

22. Long-term receivables and deposits

Long-term receivables consist of notes, deposits for aircraft and engine lease and various other travel related security fees.

Long-term receivables and deposits are specified as follows:	2011	2010
Loans, effective interest rate 6.24% / 7.20%	33	70
Interest bearing receivable, interest rate 5%	994	1,344
Deposits	2,011	1,581
	3,038	2,995
Current maturities of long-term receivables	(266)	(227)
Long-term receivables and deposits total	2,772	2,768

Consolidated Financial Statements of Icelandair Group hf. 2011 31 Amounts are in ISK millions

22. contd.:

Long-term receivables contractual repayments are specified as follows:	2011	2010
Repayments in 2011	-	227
Repayments in 2012	266	159
Repayments in 2013	1,626	1,819
Repayments in 2014	786	540
Repayments in 2015	136	8
Repayments in 2016	15	11
Subsequent	209	231
Total loans, including current maturities	3,038	2,995

Long-term receivables and deposits denominated in currencies other than the functional currency comprise ISK 3,020 million (2010: ISK 2,973 million).

23. Taxes

Tax recognised in profit or loss

	2011	2010
Deferred tax expense		
Origination and reversal of temporary differences	(584)	1,331
Increase in tax rate	0	127
Total tax expense recognised in profit or loss	(584)	1,458

Tax recognised directly in equity

	2011	2010
Operating assets	44	(249)
Total tax recognised directly in equity	44	(249)

Tax recognised in other comprehensive income

	2011	2010
Net profit on hedge of net investment in foreign operations	(38)	77
Effective portion of changes in fair value of cash flow hedge	(20)	40
Total tax recognised in other comprehensive income	(58)	117
Total tax recognised in equity	(14)	(132)

Reconciliation of effective tax rate

		2011		2010
Profit before tax and discontinued operation		3,500		6,576
Income tax according to current tax rate	20.0%	700	18.0%	1,184
Change in tax rate from 18% to 20%	0.0%	0	1.9%	127
Tax exempt revenue	(29.9%)	(1,047)	(4.0%)	(264)
Non-deductible expenses	1.1%	38	9.1%	596
Other items	(7.9%)	(275)	(2.8%)	(185)
Effective tax rate	(16.7%)	(584)	22.2%	1,458

Consolidated Financial Statements of Icelandair Group hf. 2011 32 Amounts are in ISK millions

23. contd.:

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are specified as follows:	2011	2010
Deferred tax assets and liabilities 1.1.	(1,267)	140
Exchange rate difference	(74)	(48)
Income tax recognised in profit or loss	584	(1,458)
Income tax recognised in equity	(14)	132
Assets held for sale	0	(33)
Deferred tax liabilities 31.12.	(771)	(1,267)

Deferred tax assets and liabilities is attributable to the following:

	Assets		Liabilities		Net	
	2011	2010	2011	2010	2011	2010
Operating assets	0	0	(2,630)	(2,091)	(2,630)	(2,091)
Intangible assets	0	0	(86)	(11)	(86)	(11)
Derivatives	0	0	(35)	(7)	(35)	(7)
Deferred gains	0	0	0	(555)	0	(555)
Trade receivables	77	173	0	0	77	173
	77	173	(2,751)	(2,664)	(2,674)	(2,491)
Tax loss carry-forwards	1,765	1,314	0	0	1,765	1,314
Other items	138	0	0	(90)	138	(90)
Deferred income tax	1,980	1,487	(2,751)	(2,754)	(771)	(1,267)

Movement in deferred tax balance during the year

	1 January 2011	Recognised in income statement	Exchange rate difference	Additions through business combination	Recognised in equity	31 December 2011
Operating assets	(2,091)	(443)	(140)	0	44	(2,630)
Intangible assets	(11)	(75)	0	0	0	(86)
Derivatives	(7)	7	0	0	(35)	(35)
Deferred gains	(555)	555	0	0	0	0
Trade receivables	173	(80)	(16)	0	0	77
Tax loss carry-forwards	1,314	412	39	0	0	1,765
Other items	(90)	208	43	0	(23)	138
	(1,267)	584	(74)	0	(14)	(771)

Operating assets	(1,801)	(809)	0	270	249	(2,091)
Intangible assets	(195)	184	0	0	0	(11)
Derivatives	67	0	3	0	(77)	(7)
Deferred gains	0	(555)	0	0	0	(555)
Trade receivables	6	168	0	(1)	0	173
Tax loss carry-forwards	2,096	(503)	(46)	(233)	0	1,314
Other items	(33)	57	(5)	(69)	(40)	(90)
	140	(1,458)	(48)	(33)	132	(1,267)

Consolidated Financial Statements of Icelandair Group hf. 2011 33 Amounts are in ISK millions

24. Inventories

Inventories are specified as follows:

	2011	2010
Spare parts	1,346	1,196
Other inventories	503	384
Inventories total	1,849	1,580

25. Trade and other receivables

Trade and other receivables are specified as follows:

	2011	2010
Trade receivables	8,616	5,525
Maintenance prepayments	633	580
Other prepayments	300	370
Restricted cash	333	2,879
Share capital subscription	0	2,648
Current maturities of long term-receivables	266	227
Other receivables	4,370	1,951
Trade and other receivables total	14,518	14,180

At 31 December 2011 trade receivables are shown net of an allowance for doubtful debts of ISK 1.043 million (2010: ISK 1,074 million).

Prepaid expenses which relate to subsequent periods amounted to ISK 300 million (2010: ISK 370 million) at year end. The prepayments consist mainly of insurance expenses and prepaid rental expenses.

Receivables denominated in currencies other than the functional currency comprise ISK 3.950 million (2010: ISK 2,911 million) of trade receivables.

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in note 36.

26. Marketable securities

Marketable securities at year end consist of securities listed on the OMX Nordic and are accounted for at fair value at year end.

27. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2011	2010
Marketable securities	1,946	2,002
Bank deposits	7,753	9,645
Cash on hand	36	41
Cash and cash equivalents total	9,735	11,688

Consolidated Financial Statements of Icelandair Group hf. 2011 34 Amounts are in ISK millions

28. Equity

(i) Share capital

The Company's share capital amounts to ISK 5,000 million according to its Articles of Association. Shareholders are entitled to receive dividends as declared from time to time and are entitled to one vote per share of one ISK.

The Company held treasury shares in the amount of ISK 25 million at the year end 2011 (2010: ISK 25 million).

(ii) Share capital and share premium

Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Company. According to Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve which can not be paid out as dividend to shareholders.

Expenses directly attributable to the share capital increase in 2011 amounted to ISK 46 million and are deducted from share premium.

(iii) Other reserves

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations, as well as from the translation of liabilities that hedge net investment in a foreign operation.

Other reserves are specified as follows:

	Share option reserve	Hedging reserve	Translation reserve	Total reserves
Balance 1 January 2010	100	(302)	7,101	6,899
Foreign currency translation differences of foreign operations			(615)	(615)
Foreign currency translation differences reclassified to profit or loss			(2,120)	(2,120)
Net profit on hedge of net investment in foreign operation, net of tax			49	49
Effective portion of changes in far value of cash flow hedges, net of tax		274		274
Share option reserve reversed	(100)		0	(100)
Balance at 31 December 2010	0	(28)	4,415	4,387
Balance at 1 January 2011	0	(28)	4,415	4,387
Foreign currency translation differences of foreign operations			470	470
Foreign currency translation differences reclassified to profit or loss			(1,199)	(1,199)
Net profit on hedge of net investment in foreign operation, net of tax			142	142
Effective portion of changes in far value of cash flow hedges, net of tax		69		69
Balance at 31 December 2011	0	41	3,828	3,869

Consolidated Financial Statements of Icelandair Group hf. 2011 35 Amounts are in ISK millions

28. contd.:

(iv) **Dividends**

The Board of Directors has agreed to the following dividend policy: "The goal is to pay 20-40% of annual net profit as dividend. Final decision on dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions."

No dividend was paid during the years 2011 and 2010. The Board of Directors proposes that ISK 800 million will be paid to shareholders in the year 2012 as dividend.

29. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Parent by the weighted average number of outstanding shares during the year and shows the earnings for share. The calculation of diluted earnings per share takes into consideration the issued convertible notes when calculating the share capital.

	2011	2010
Basic earnings per share:		
Profit for the year attributable to equity holders of the Parent	4,451	4,564
Average share capital	4,975	1,485
Profit per share of ISK 1	0.89	3.07
Profit attributable to ordinary equity holders of the parent company:		
Profit for the year attributable to equity holders of the Parent	4,451	4,564
Discontinued operations	(368)	562
Total	4,083	5,126
Weighted average number of shares		
in million shares		
Issued shares at beginning of year	4,975	975
Effect of new shares sold in November 2010	0	485
Effect of new shares sold in December 2010	0	26
Weighted average number of shares at for the year	4,975	1,486
Earnings per share:		
Earnings per share (ISK)	0.89	3.07
Diluted earnings per share (ISK)	0.89	3.07
Earnings per share from continuing operations:		
Basic earnings per share (ISK)	0.82	3.45
Diluted earnings per share (ISK)	0.82	3.45

30. 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. For more information about the Group´s exposure to interest rate, foreign currency and liquidity risk, see note 45.

Non-current loans and borrowings are specified as follows:	2011	2010
Secured bank loans	22,386	22,834
Unsecured loans	1,750	1,770
	24,136	24,604
Current maturities	(4,137)	(3,248)
Total non-current loans and borrowings	19,999	21,356

Current loans and borrowings are specified as follows:

	2011	2010
Current maturities of non-current liabilities	4,137	3,248
Total current loans and borrowings	4,137	3,248
Total loans and borrowings	24,136	24,604

31. Terms and debt repayment schedule

	Currency	Nominal interest rates year end 2011	Year of maturity	Total remaining balance 2011	2010
Secured bank loan	USD	4.2%	2013-2018	16,992	15,638
Secured bank loan	EUR	5.8%	2017	2,293	3,699
Secured bank loan	ISK	6.5%	2013-2017	2,979	3,227
Secured bank loan, indexed	ISK	6.3%	2012-2028	122	270
Unsecured bond issue, indexed	ISK	5.7%	2012-2023	1,750	1,770
Total interest-bearing liabilities				24,136	24,604

Repayments of loans and borrowings are specified as follows:

	2011	2010
Repayments in 2011	-	3,248
Repayments in 2012	4,137	3,099
Repayments in 2013	5,175	7,820
Repayments in 2014	5,547	4,242
Repayments in 2015	1,939	1,033
Repayments in 2016	1,949	1,061
Subsequent repayments	5,389	4,101
Total loans and borrowings	24,136	24,604

32. Long-term payables

Long-term payables corresponds to accrued cost of overhauling engines of leased aircraft and security deposits from lease contracts. Long term obligation at year end 2011 amounts to ISK 3.332 million (2010: ISK 4,745 million) and short term obligation, which is included in other payables amounts to 2.910 million (2010: ISK 1,249 million).

Consolidated Financial Statements of Icelandair Group hf. 2011 37 Amounts are in ISK millions

33. Share-based payments

The number and weighted average exercise price of share options is as follows in thousands:

	Weighted average exercise price 2011	Number of options 2011	Weighted average exercise price 2010	Number of options 2010
Outstanding at 1 January	-	-	27.5	14,126
Forfeited during the year	-	-	27.5	(14,126)
Outstanding at 31 December	-	0	27.5	0
Exercisable at 31 December		0		0

There were no outstanding options at year end 2011. All outstanding options at year end 2009 were forfeited in January 2010.

34. Trade and other payables

Trade and other payables are specified as follows:	2011	2010
Trade payables	4,228	3,298
Derivatives used for hedging	50	53
Other payables	12,273	10,697
Total trade and other payables	16,551	14,048

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 36.

35. Deferred income

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

Deferred income are specified as follows:	2011	2010
Sold unused tickets	9,046	6,133
Frequent flyer points	1,622	1,567
Other prepayments	1,717	1,107
Total deferred income	12,385	8,807

36. Financial risk management

Overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies, and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established the Risk Management Commitee, which is responsible for developing and monitoring the Group's risk management policies. The committee reports regularly to the Board of Directors on its activities.

36. contd.:

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 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.

Credit risk

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

Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was as follows:

		Carrying amount	
	Note	**2011**	**2010**
Long-term receivables and deposits	27	2,772	2,768
Trade and other receivables	29	14,518	14,180
Marketable securities	30	3,345	1,306
Cash and cash equivalents	31	9,735	11,688
		30,370	29,942

Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

Credit risk is linked to trade receivables, investment of liquid assets and agreements with financial institutions related to financial operations, e.g. hedging. The relative spread of trade receivables across counterparties is also crucial for credit risk exposure. 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. 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.

Guarantees

The Group's policy is to provide financial guarantees only to wholly-owned subsidiaries. However at year end 2011 the Group is still guaranteeing from divested companies (see note 40), the PDP payments of one 787 Boeing Dreamliner order but the economical proceeds from these orders have been sold to the creditors in relation to the financial restructuring in the year 2010.

The Group will remain a guarantor in terms of the lease of two Airbus 320 aircraft until April 2012 and two Boeing 767 until the end of the year 2012. These aircraft are operated under SmartLynx's air operator's certificate.

Consolidated Financial Statements of Icelandair Group hf. 2011 39 Amounts are in ISK millions

36. contd.:

Impairment losses
The aging of trade receivables at the reporting date was as follows:

	Gross 2011	Impairment 2011	Gross 2010	Impairment 2010
Not past due	5,553	(45)	4,089	(45)
Past due 0-30 days	1,215	(22)	1,199	(293)
Past due 31-120 days	1,444	(360)	837	(394)
Past due 121-365 days	1,131	(334)	184	(107)
More than one year	316	(282)	290	(235)
Total	9,659	(1,043)	6,599	(1,074)

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

	2011	2010
Balance at 1 January	1,074	448
Impairment loss recognized (reversed)	(31)	626
Balance at 31 December	1,043	1,074

Based on historical default rates, the management believes that minimal impairment allowance is necessary in respect of trade receivables not past due or past due by 30 days; a significant part of the balance relates to customers that have a good track record with the Group.

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.

Liquidity risk
Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity 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 policy is to divide liquid assets into three classes depending on duration and match them against the Group's liquidity preferences laid out by the management on annual basis. Classes one and two include the estimated minimum of accessible funds for operational liquidity, but differ in terms of asset duration. 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.

Consolidated Financial Statements of Icelandair Group hf. 2011 40 Amounts are in ISK millions

36. contd.:

The following are the contractual maturities of financial liabilities, including estimated interest payments and payments of off-balance sheet items.

31 December 2011	Carrying amount	Contractual cash flows	Within 12 months	1-2 years	2-5 years	More than 5 years
Financial liabilities						
Unsecured bank loans	1,750	(2,470)	(210)	(205)	(616)	(1,439)
Secured bank loans	22,386	(26,357)	(5,145)	(6,002)	(10,541)	(4,669)
Payables & prepayments	19,883	(19,883)	(16,551)	(1,804)	(1,528)	0
	44,019	(48,710)	(21,906)	(8,011)	(12,685)	(6,108)
Off balance sheet liabilities						
Operating lease payments	0	(28,826)	(6,955)	(4,266)	(6,511)	(11,094)
Exposure to liquidity risk	44,019	(77,536)	(28,861)	(12,277)	(19,196)	(17,202)
31 December 2010						
Financial liabilities						
Unsecured bond issue	1,770	(2,600)	(247)	(205)	(586)	(1,562)
Secured bank loans	22,834	(27,549)	(4,275)	(4,053)	(14,691)	(4,530)
Payables & prepayments	18,793	(18,793)	(14,048)	(2,010)	(2,109)	(626)
	43,397	(48,942)	(18,570)	(6,268)	(17,386)	(6,718)
Off balance sheet liabilities						
Operating lease payments	0	(30,005)	(7,657)	(6,556)	(7,343)	(8,449)
Exposure to liquidity risk	43,397	(78,947)	(26,227)	(12,824)	(24,729)	(15,167)

Unused loan commitments at year end 2011 amounted to ISK 500 million (2010: ISK 500 million).

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and fuel price will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group uses derivatives in order to manage market risks. All such transactions are carried out within the guidelines set by the Board of Directors. The Group seeks to apply hedge accounting in order to manage volatility in profit or loss.

Consolidated Financial Statements of Icelandair Group hf. 2011 41 Amounts are in ISK millions

36. contd.:

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 in 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, 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 6 to 9 month horizon and uses a portfolio of instruments, but most importantly forwards.

Exposure to currency risk

The Group's exposure to foreign currency risk is as follows based on notional amounts in major currencies:

2011	**USD**	**EUR**	**DKK**	**SEK**	**NOK**
Net bal. sheet exposure	591	(2,428)	314	(61)	112
Forecast revenue	42,007	26,510	4,398	4,988	5,309
Forecast purchases	(54,658)	(16,295)	(1,401)	409	(621)
Forward FX contracts	1,708	(1,544)	0	0	0
Net currency exposure	(10,352)	6,243	3,311	5,336	4,800
2010					
Net bal. sheet exposure	(283)	(3,607)	392	488	767
Forecast revenue	29,276	13,060	3,011	3,536	3,182
Forecast purchases	(39,635)	(8,775)	(1,270)	(341)	(423)
Forward FX contracts	520	(520)	0	0	0
Net currency exposure	(10,122)	158	2,133	3,683	3,526

The following significant exchange rates applied during the year:

	Average rate		**Reporting date spot rate**	
	2011	**2010**	**2011**	**2010**
USD	116.31	122.53	122.60	115.34
EUR	161.90	162.62	159.17	154.36
DKK	21.80	21.84	21.42	20.71
NOK	20.87	20.24	20.52	19.77
SEK	18.03	17.07	17.89	17.20

Consolidated Financial Statements of Icelandair Group hf. 2011 42 Amounts are in ISK millions

36. contd.:

Sensitivity analysis

A 10% strengthening of the ISK against the following currencies at 31 December 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. This analysis is performed on the same basis as for 2010.

	Equity	Profit or loss
2011		
USD	828	1,193
EUR	(499)	(525)
DKK	(265)	(265)
NOK	(427)	(427)
SEK	(384)	(384)
2010		
USD	830	1,071
EUR	(13)	(37)
DKK	(175)	(175)
NOK	(289)	(289)
SEK	(302)	(302)

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.

Interest rate risk

The largest share of outstanding long term loans, carrying 1-6 months floating interest rates are directly related to aircraft financing and denominated in USD as a consequence. The risk management policy benchmark for variable rate exposure is the level of net interest bearing debt. Swap contracts are mainly used to exchange floating rates for fixed up to 5 years ahead, which at year end 2011 amounts to USD 10 million.

At the reporting date the interest rate profile of the Group´s interest bearing financial instruments was as follows:

	Carrying amount	
	2011	**2010**
Fixed rate instruments		
Financial assets	1,778	1,424
Financial liabilities	(7,099)	(4,381)
	(5,321)	(2,957)
Variable rate instruments		
Financial assets	0	0
Financial liabilities	(17,037)	(20,223)
	(17,037)	(20,223)

Consolidated Financial Statements of Icelandair Group hf. 2011 43 Amounts are in ISK millions

36. contd.:

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.

A change of 100 basis points in interest rates would have immaterial effects on the fair value.

Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the 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.

	Equity	
	100 bp increase	**100 bp decrease**
31 December 2011		
Variable rate instruments	(52)	52
Cash flow sensitivity (net)	(52)	52
31 December 2010		
Variable rate instruments	11	(5)
Cash flow sensitivity (net)	11	(5)

Other market price risk

Fuel price risk

The Group maintains a policy of hedging fuel price exposure by a ratio reflecting forward sales of tickets and up to 60% of the fuel exposure by using swaps and options going 6 to 9 months forward on rolling basis.

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 equtiy:

	2011	**2010**	**2011**	**2010**
	Effect on equity		**Effect on profit before tax**	
Increase in fuel prices by 10%	202	30	0	0
Decrease in fuel prices by 10%	(202)	(30)	0	0

Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Board seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

Consolidated Financial Statements of Icelandair Group hf. 2011 44 Amounts are in ISK millions

37. Financial instruments and fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

	2011 Carrying amount	2011 Fair value	2010 Carrying amount	2010 Fair value
Loans and receivables	17,290	17,290	16,948	16,948
Marketable securities	3,345	3,345	1,306	1,306
Cash and cash equivalents	9,735	9,735	11,688	11,688
Unsecured bond issue	(1,750)	(1,750)	(1,770)	(1,770)
Secured bond loans	(22,386)	(22,386)	(22,834)	(22,834)
Payables and prepayments	(19,883)	(19,883)	(18,793)	(18,793)
Total	(13,649)	(13,649)	(13,455)	(13,455)

The basis for determining fair values is disclosed in note 4.

38. Off-balance sheet items

Leases as lessee

As a lessee the Group has in place operating leases for 15 aircraft at the end of December 2011. The leases are for ten 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. During the year ISK 7.338 million was recognised as an expense in profit or loss in respect of operating leases (2010: ISK 8.676 million). At the end of December 2011 the leases are payable as follows:

	Real estate	Aircraft	Other	Total 2011	Total 2010
In the year 2010	-	-	-	-	7,657
In the year 2011	1,326	5,324	305	6,955	6,556
In the year 2012	1,228	2,914	124	4,266	3,764
In the year 2013	1,210	1,405	87	2,702	1,908
In the year 2014	1,166	1,152	71	2,389	1,670
In the year 2015	1,121	232	67	1,420	1,263
Subsequent	11,028		66	11,094	7,187
Total	17,079	11,027	720	28,826	30,005

Consolidated Financial Statements of Icelandair Group hf. 2011 45 Amounts are in ISK millions

39. Leases as lessor

As a lessor the Company leases aircraft on wet, dry and other various leases, both on short and long term leases. Lease income for the year 2011 amounted to ISK 16,749 million (2010; ISK 19,972 million). Contracted leases at year end were as follows:

	2011	2010
In the year 2011	-	12,908
In the year 2012	10,282	10,911
In the year 2013	5,519	5,683
In the year 2014	2,168	3,064
In the year 2015	2,029	2,689
In the year 2016	1,022	961
Total	21,020	36,216

40. Capital commitments

IG Invest, a former subsidiary of the Company, has signed an agreement with Boeing regarding the purchase of one Boeing 787 Dreamliner aircraft to be delivered in the year 2014. Despite the disposal of IG Invest, Icelandair Group is still guarantor for these capital commitments.

As a part of the financial restructuring of the Company's balance sheet in 2010 the Company divested assets to its creditors for ISK 7.6 billion. Icelandair Group guarantees that the final sale price will be at least ISK 4.0 billion, however the maximum guarantee is ISK 0.5 billion. If the creditors will receive ISK 7.6 billion plus REIBOR+3% interest for the assets at sale, Icelandair Group will receive 50% of the upside net of REIBOR +3%.

41. Contingencies

During the first half of 2007 the Icelandic Competition Authorities imposed a fine on the subsidiary Icelandair ehf. due to an alleged breach of the Icelandic Competition law. The penalty amounts to ISK 130 million following a ruling by the Competition Appeals Committee. Icelandair ehf. took this case to the District Court of Reykjavik which ruled in February 2010 to dismiss the penalty. The court ruling was appealed to the Supreme Court of Iceland which ruled in January 2011 that due to formalities the District Court should reopen the case. The District Court confirmed its ruling in 2011 and a final decision by the Supreme Court is expected in Feburary 2012. The Group considers that the final ruling will be in favour of the Group.

Consolidated Financial Statements of Icelandair Group hf. 2011 46 Amounts are in ISK millions

42. Related parties

Identity of related parties

The Group has a related party relationship with its shareholders with significant influence, subsidiaries, associates, and with its directors and executive officers.

Transactions with management and key personnel

Salaries and benefits of management paid for their work for Group companies during the year 2011, share option agreements and shares in the Company are specified as follows:

	Salaries and benefits		Shares held at year-end 2011	Share held by related parties
Board of Directors:				
Sigurður Helgason, chairman of the board	3.8	*	4.5	
Finnbogi Jónsson	1.9	**		
Herdís Dröfn Fjeldsted	2.1	**		
Katrín Olga Jóhannesdóttir	2.3		0.4	
Úlfar Steindórsson	2.1			
Anna Guðný Aradóttir, alternative board member	0.2			
Auður Björk Guðmundsdóttir, alternative board member	0.2			
Magnús Magnússon, alternative board member	0.3	*		
Vilborg Lofts, former alternative board member	0.1			
Key employees:				
Björgólfur Jóhannsson CEO of Icelandair Group hf.	41.7		1.0	
Bogi Nils Bogason, CFO of Icelandair Group hf.	33.3		1.0	
Birkir Hólm Guðnason, CEO of Icelandair ehf.	34.1			
Guðni Hreinsson, MD of Loftleidir - Icelandic ehf.	22.2			
Six MD of group companies	123.4		6.1	

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

*Two board members have dismissed their rights to salaries so instead the board agreed to pay the same amount to Icelandair's Special Children's Travel Fund.

**The salaries of two board members are paid to Framtakssjódur Íslands slhf.

Transaction with associates

During the year 2011 the Group purchased services from associates for ISK 28 million (2010: ISK 0 million). The Group's revenues were ISK 8 million from associates (2010: ISK 6 million). The Group has not granted any loans to its associates. Transactions with associates are priced on an arm's length basis.

Transaction with shareholders

Shareholders with significant influence at year end 2011 is Framtakssjóður Íslands slhf. Transactions with Framtakssjóður Íslands slhf. and its four identified associated companies consist of purchase and sale of services in the ordinary course of business on an arm's length basis. Total purchases in 2011 from these entities amounted to ISK 286 million (2010: N/A). Total sales amounted to ISK 57 million (2010: N/A).

Consolidated Financial Statements of Icelandair Group hf. 2011 47 Amounts are in ISK millions

43. Group entities

The Company holds ten subsidiaries at year end 2011. SmartLynx, Latvia was sold at year end 2011 and is included in discontinued operations. 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 4.7 billion and EBITDA of ISK 1.1 billion. Addition during the 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 financial statements are specified as follows:

	Ownership interest 2011
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, sold at year end 2011	100%

The subsidiaries further own 17 subsidiaries that are also included in the consolidated financial statements.

At year end the shares in the subsidiaries in Route Network and Tourism services are pledged as mortgage against the Group's borrowings.

44. Statement of cash flows

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

	2011	**2010**
Expensed long term cost	3,903	4,618
Exchange rate difference and indexation of liabilities and assets	(34)	193
Gain on disposals in relation to financial restructuring	0	(4,246)
Gain from assets held for sale	(755)	(906)
(Gain) loss on the sale of operating assets	(316)	162
Share of profit of associates	11	391
Income tax	(584)	1,458
Other items	186	339
Total other operating items in the statement of cash flows	2,411	2,009

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

	2011	2010
Inventories, increase	(269)	(187)
Trade and other receivables, (increase) decrease	(684)	1,998
Trade and other payables, decrease	(780)	(656)
Deferred income, increase	3,578	1,629
Net change in operating assets and liabilities in the statement of cash flows	1,845	2,784

Consolidated Financial Statements of Icelandair Group hf. 2011 48 Amounts are in ISK millions

46. Additional cash flow information:

	2011	2010
Interest paid	1,490	1,703
Interest received	692	219

47. Ratios

The Group's primary ratios at year end are specified as follows:

Current ratio	0.91	1.11
Equity ratio	0.36	0.34
Intrinsic value of share capital	6.49	5.71

Consolidated Financial Statements of Icelandair Group hf. 2011 49 Amounts are in ISK millions

Corporate Governance Statement

The framework

The guidelines on Corporate Governance issued by the Iceland Chamber of Commerce, NASDAQ OMX Iceland and the Confederation 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's Corporate Governance practices. The Company's Articles of Association are on the Company's website and the guidelines and the rules for Issuers are on the website of NASDAQ OMX Iceland.

The Company complies in all main respect to the rules mentioned above. The Company however does not have a Nomination Committee as the Board of Directors has not seen the need for it. That decision will however be reconsidered in 2012. No government organization has found the Company to be in breach with any rule or regulation.

Internal audit and risk management

The Group's 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's 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 shall oversee the annual accounts of the Company and the Group's consolidated accounts. The committee is responsible for evaluation of the independence and the eligibility of both the Company´s auditor and auditing firm. The committee shall make suggestions to the Board of Directors regarding the selection of the Company´s auditor. The Audit Committee convenes on average six times a year.

Audit Commitee:
Katrín Olga Jóhannesdóttir, chairman
Herdís Dröfn Fjeldsted
Úlfar Steindórsson

Values and code of ethics and corporate responsibility

The company's values are:
WE CARE for our customers, employees, environment and shareholders.
WE THINK CLIENTS through consistency, reliability, clear product alternatives and friendly service.
WE DRIVE RESULTS via teamwork, shared information and values, accountability and profitability.

On 25 May 2009 the Board of Directors approved a Code of Ethics that was amended on 5 January 2011. The Code of Ethics is accessible to all Company's employees through the Company's intranet, MyWork.

Compensation Committee

The purpose of the Compensation Committee is to avoid placing the Company's management in control of their own remuneration and, furthermore, to ensure that the management's remuneration is structured so as to serve the long-term interests of shareholders. The main tasks of the Compensation Committee are policy making with respect to the management's performance related bonuses, including stock options. The Committee conducts evaluations of management remuneration and monitors the management's acquisition of stock in the Company. The Compensation Committee convenes on average four times a year.

Compensation Committee
Sigurður Helgason, chairman
Finnbogi Jónsson

The Board of Directors and Executive Committee

Board of Directors

Sigurður Helgason, chairman

Sigurdur Helgason was born in 1946 and has been a Member of the Board of Directors at Finnair since 2007. He was President & CEO of Flugleidir/FL-Group/Icelandair 1985 - 2005. He was Director Cash Management 1974-1980, Senior Vice-President Finance 1980-1983, General Manager The Americas 1983-1985 for Flugleidir/Icelandair. He was Chairman of the Board of The Icelandic International Development Fund 2005-2008. He is the Chairman of the Icelandair Special Children Travel Fund since 2005. He was a member of the IATA board of Govenors 2004/2005. He graduated with a MBA degree from The University of North Carolina, Chapel Hill, USA in 1973 and a Cand. Oecon. degree from the University of Iceland in 1971. He joined the Board on 6 August 2009.

Finnbogi Jónsson, deputy chairman

Finnbogi Jónsson was born in 1950 and is the former CEO of the Icelandic Enterprise Fund. He was the CEO of the The New Business Venture Fund from 2006. Finnbogi was the CEO of SR-Mjöl from 2003-2006. Finnbogi has for the past 25 years held various managerial positions within the Icelandic fishing industry. Finnbogi has also held various board positions, mainly within the fishing industry and related businesses. Finnbogi is the Chairman of the Board of Eignarhaldsfélagið Vestia ehf. and Gogo Holding slhf. He holds a degree in engineering and business from the University of Lund in Sweden. He joined the Board on 15 September 2010.

Herdís Dröfn Fjeldsted

Herdis Drofn Fjeldsted was born in 1971 and is the Investment Manager at Framtakssjodur Islands, holds a BSc degree in business administration and a MSc degree in corporate finance from Reykjavik University 2010. She is also a certified securities broker. Herdis joined Framtakssjodur Islands after about six years in the private equity industry. Most recently, Herdis was a member of the investment team at Thule Investments. Her job there consisted of investment analysis, negotiations and active participation in individual companies owned by the fund. Herdis is Chairman of the Board of Wave Operations and Board Director of Icelandair Group. She joined the Board on 14 December 2010.

Katrín Olga Jóhannesdóttir

Katrin Olga Johannesdóttir was born in 1962 and is the former Chief Strategy Officer of Skipti hf and the current Chairman of Já upplýsingaveitur hf. Previously she was a VP for sales and marketing and VP for residential markets at Síminn. Prior to that she held a position as the managing director of Navision Iceland and was a management consultant at VSO. Katrin Olga is currently a board member of the Central Bank of Iceland, Ölgerðin hf., Reykjavik University, the Iceland Chamber of Commerce and Njála ehf. Previously she was a board member of Sirius IT and SkjáMiðlar. She holds a Cand. Oecon degree, from the University of Iceland and a MSc in Business Economics from Odense University. She joined the Board on 6 August 2009.

Úlfar Steindórsson

Úlfar Steindórsson was born in 1956 and is the CEO of Toyota in Iceland and Jú ehf. He was the CEO of Primex ehf. in Siglufjordur from 2002-2004, and the CEO of the New Business Venture Fund from 1999-2002. Úlfar is the chairman of the board of Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf., and TK bílar ehf. Úlfar is a board member of Blue Lagoon International Ltd, Bláa Lónið hf., Blue Lagoon internation ehf., Eldvörp ehf., Hótel Bláa lónið ehf., Hreyfing Eignarhaldsfélag ehf., Johan rönning hf., Kraftvélar ehf., Motormax ehf., S.Guðjónsson ehf., Skorri ehf., and UK fjárfestingar ehf. Úlfar holds a Cand.Oecon from the University of Iceland and a MBA from Virgina Commonwealth University. He joined the Board on 15 September 2010.

Executive committee

Björgólfur Jóhannsson, president and CEO

Bjorgólfur was born in 1955 and joined Icelandair Group January 15th 2008. Before joining Icelandair Group Björgólfur was the CEO of Icelandic Group from March 2006. From 1992-1996 Björgólfur was the CFO of UA in Akureyri. He became the CEO of Síldarvinnslan in 1999 and served as the Director of Innovation and Development at Samherji from 1996, having worked as a chartered accountant for two auditing firms from 1980. Björgólfur served as the Chairman of the Board of the Federation of Icelandic Fishing Vessel Owners from 2003-2008. He graduated with a degree in Business Administration from the University of Iceland in 1983 and became a chartered accountant in 1985.

Bogi Nils Bogason, CFO
Magnea Thórey Hjálmarsdóttir, Managing Director of Icelandair Hotels
Birkir Hólm Guðnason, CEO of Icelandair

Board of Directors

The Company's Board of Directors exercises the supreme authority in the Company's affairs between shareholders' meetings, and it is entrusted with the task of ensuring that the organisation and activities of the Company's operation are at all times in correct and proper order.

The Board of Directors is instructed in the Company's Articles of Association to appoint a President and CEO for the Company and decide the terms of his or her employment. The Board of Directors and President and CEO are responsible for the management of the Company.

The Company's Board of Directors must at all times ensure that there is adequate supervision of the Company's accounts and the disposal of its assets and shall adopt working procedures in compliance with the Companies Act. Only the Board of Directors may assign powers of procuration on behalf of the Company. The signatures of the majority of the members of the Board are required to bind the Company. The President and CEO has charge of the day-to-day operation of the Company and is required in his work to observe the policy and instructions set out by the Company's Board of Directors. Day-to-day operation does not include measures which are unusual or extraordinary. Such measures can only be taken by the President and CEO with the specific authorization of the Board of Directors, unless it is impossible to await the decision of the Board without seriously disadvantaging the operation of the Company. In such instances, the President and CEO is required to consult with the Chairman of the Board, if possible, after which the Board of Directors must immediately be notified of the measures. The President and CEO shall ensure that the accounts and finances of the Company conform to the law and accepted practices and that all assets belonging to the Company are securely safeguarded. The President and CEO is required to provide 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.

The Company's Board of Directors consists of five members and three alternate members, elected at the annual general meeting for a term of one year. Those who intend to stand for election to the Board of Directors must inform the Board in writing of their intention at least five days before the annual general meeting, or extraordinary shareholders' meeting at which elections are scheduled. Only those who have informed the Board of their candidacy are eligible.

The Board of Directors elects a Chairman and Deputy Chairman from among its members, and otherwise allocates its obligations among its members as needed. The Chairman calls Board meetings. A meeting must also be held if requested by a member of the Board of Directors or the President and CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an 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 President and CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in discussions and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings and must be signed by participants in the meeting. A Board member who disagrees with a decision made by the Board of Directors is entitled to have his or her dissenting opinion entered in the book of minutes. The same applies to the President and CEO. The Chairman is responsible for the Board's relations with the shareholders and he shall inform the Board on the views of the shareholders.

On 12 September 2007 the Board of Directors approved Rules on Working Procedures for the Board of Directors that was emended on 15 November 2010. The Rules on Working Procedures are accessible to the Board of Directors and the management through the Board's intranet, Coredata. In accordance with article 14 of the Rules on Working Procedures the Board of Directors must annually evaluate its work, size, composition and practices, and must also evaluate the performance of the CEO and others responsible for the day-to-day management of the Company and its development. The annual performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails e.g. evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration the work components which the Board believes may be improved.

The Board of Directors elects the members of the two sub-committees; the Compensation Committee and the Audit Committee. The sub-committees adhere to the Rules on Working Procedures. The Board of Directors convenes on average twelve times a year. The Board of Directors however convened eleven times in the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company. Sigurdur Helgason, Katrin Olga Johannesdottir and Ulfar Steindorsson were independent from the Company's major shareholders in 2011.

Quarterly statements (unaudited)

Unaudited summary of the Group's operating results by quarters:

	Q1	Q2	Q3	Q4	Total
Year 2011					
Operating income	16,017	25,029	35,868	20,020	96,934
Operating expenses without depreciation	(16,215)	(22,942)	(27,215)	(20,149)	(86,521)
Operating (loss) profit bef. depr. (EBITDA)	(198)	2,087	8,653	(129)	10,413
Depreciation	(1,237)	(1,464)	(1,569)	(1,408)	(5,678)
Operating (loss) profit (EBIT)	(1,435)	623	7,084	(1,537)	4,735
Net finance (expense) income	(424)	(180)	(454)	(166)	(1,224)
Share of profit (loss) of associates	1	9	4	(25)	(11)
Profit (loss) before income tax	(1,858)	452	6,634	(1,728)	3,500
Income tax	737	(43)	(1,270)	1,160	584
(Loss) profit from continuing operations	(1,121)	409	5,364	(568)	4,084
Profit from discontinued operation	0	0	0	368	368
(Loss) profit	(1,121)	409	5,364	(200)	4,452
Other comprehensive income (loss)	221	(326)	373	(786)	(518)
Total comprehensive income (loss)	(900)	83	5,737	(986)	3,934
Working capital (used in) from operations	(607)	3,090	9,345	713	12,541
Net cash from (used in) operating activities	8,582	5,259	(648)	1,193	14,386
Net cash used in investing activities	(6,440)	(1,596)	(2,073)	(2,908)	(13,017)
Net cash from (used in) financing activities	1,113	(3,430)	(2,368)	1,301	(3,384)

	Q1	Q2	Q3	Q4	Total
Year 2010					
Operating income	16,283	21,885	31,082	18,765	88,015
Operating expenses without depreciation	(16,105)	(19,736)	(21,947)	(17,649)	(75,437)
Operating profit (loss) bef. depr. (EBITDA)	178	2,149	9,135	1,116	12,578
Depreciation	(1,341)	(1,306)	(1,590)	(2,087)	(6,324)
Operating (loss) profit (EBIT)	(1,163)	843	7,545	(971)	6,254
Gain on disposals in relation to financial restructuring	0	0	0	4,245	4,245
Net finance (expense) income	(736)	(1,051)	(1,171)	(574)	(3,532)
Share of profit (loss) of associates	63	1	10	(465)	(391)
Profit (loss) before income tax	(1,836)	(207)	6,384	2,235	6,576
Income tax	351	46	(1,187)	(668)	(1,458)
(Loss) profit from continuing operations	(1,485)	(161)	5,197	1,567	5,118
Loss from discontinued operation	(400)	0	0	(162)	(562)
(Loss) profit	(1,885)	(161)	5,197	1,405	4,556
Other comprehensive income (loss)	337	232	(1,356)	(1,625)	(2,412)
Total comprehensive income (loss)	(1,548)	71	3,841	(220)	2,144
Working capital from operations	80	1,628	9,573	1,608	12,889
Net cash from operating activities	3,967	5,419	2,556	3,731	15,673
Net cash used in investing activities	(690)	(1,614)	(459)	(2,749)	(5,512)
Net cash (used in) from financing activities	(1,161)	(382)	(1,887)	3,381	(49)

Consolidated Financial Statements of Icelandair Group hf. 2011 54 Amounts are in ISK millions