Icelandair Group hf.

Condensed Consolidated Interim Financial Statements 1 January - 30 September 2008

ISK

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

Contents

Endorsement and Statement of the Board of Directors and the CEO

The condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 September 2008 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for Interim Financial Statements (IAS 34). The interim financial statements comprise the consolidated interim financial statements of Icelandair Group hf. and its subsidiaries, which were fifteen at the end of September 2008. Travel Service, owned 80% by Icelandair Group hf. at the end of the period, is consolidated since the beginning of second quarter.

According to the income statement net profit for the period from 1 January to 30 September 2008 amounted to ISK 3.102 million. According to the balance sheet, equity at the end of the period amounted to ISK 33.578 million, including share capital in the amount of ISK 974 million.

Statement by the Board of Directors and the CEO

To the best of our knowledge it is our opinion that the condensed consolidated interim financial statements give a true and fair view of the consolidated financial performance of the Company for the nine-month period ended 30 September 2008, its assets, liabilities and consolidated financial position as at 30 September 2008 and its consolidated cash flows for the period then ended.

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

The Board of Directors and the CEO have today discussed the condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 September 2008 and confirm them by means of their signatures.

Reykjavík, 11. November 2008.

Board of Directors:

Gunnlaugur M. Sigmundsson, Chairman of the Board of Directors
Ómar Benediktsson
Ásgeir Baldurs
Einar Sveinsson
Finnur Reyr Stefánsson
Jón Benediktsson
Marta Eiríksdóttir
Sigurður Atli Jónsson

CEO:

Björgólfur Jóhannsson

Independent Auditor's Review Report

To the Board of Directors of Icelandair Group hf.

Introduction

We have reviewed the accompanying condensed consolidated interim financial statements of Icelandair Group hf., which comprise the consolidated interim balance sheet as at 30 September 2008 and the consolidated interim income statement, statement of changes in equity and cash flow statement for the nine-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standards as adopted by the EU. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Qualified Conclusion

We draw the attention to Note 6 to the consolidated interim financial statement which states that impairment calculations were not performed at the end of the period. The performance of two companies within the Group was weaker to some extent in comparison with projections. Goodwill relating to these two companies amounts to ISK 2.625 million. Detailed impairment calculations relating to these two companies should therefore have been performed in the 3rd quarter as changes in circumstances indicate that goodwill might be impaired and therefore might lead to impairment loss.

Qualified Conclusion

Based on our review, with the exception of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the accompanying consolidated interim financial information does not give a true and fair view of the financial position of the entity as at 30 September 2008, and of its financial performance and its cash flows for the nine-month period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 11. November 2008.

KPMG hf.

Jón S. Helgason
Guðný H. Guðmundsdóttir

Consolidated Interim Income Statement
for the period from 1 January to 30 September 2008

	Notes	Q3 2008 1.7.-30.9.	Q3 2007 1.7.-30.9.	Q1-Q3 2008 1.1.-30.9.	Q1-Q3 2007 1.1.-30.9.
Operating income:					
Transport revenue		17.409	11.994	36.390	27.995
Aircraft and aircrew lease		19.441	4.615	37.526	10.978
Other operating revenue		4.615	3.429	10.513	9.161
		41.465	20.038	84.429	48.134
Operating expenses:					
Salaries and other personnel expenses		6.455	4.672	17.689	14.603
Aircraft fuel		9.977	3.039	19.137	7.299
Aircraft and aircrew lease		3.788	2.297	10.023	5.398
Aircraft servicing, handling and communication		6.405	1.366	11.153	3.307
Aircraft maintenance expenses		3.528	1.384	7.347	3.490
Other operating expenses		5.129	3.559	11.899	9.075
		35.282	16.317	77.248	43.172
Operating profit before depreciation and amortisation (EBITDA)		6.183	3.721	7.181	4.962
Depreciation and amortisation		(1.075)	(878)	(2.835)	(2.316)
Operating profit before net finance costs (EBIT)		5.108	2.843	4.346	2.646
Finance income		795	127	1.726	249
Finance expense		(844)	(499)	(2.515)	(1.822)
Net finance costs	3	(49)	(372)	(789)	(1.573)
Share of profit of associates		45	48	121	175
Profit before income tax		5.104	2.519	3.678	1.248
Income tax	4	(719)	(458)	(576)	(211)
Profit for the period		4.385	2.061	3.102	1.037
Attributable to:					
Equity holders of the Company		3.940	2.055	2.537	1.027
Minority Interest		445	6	565	10
Profit for the period		4.385	2.061	3.102	1.037
Profit per share:					
Basic earnings per share (ISK)		4,48	2,08	3,17	1,05
Diluted earnings per share (ISK)		4,48	2,08	3,17	1,05

Amounts are in ISK million

Consolidated Interim Balance Sheet
as at 30 September 2008

	Notes	30.9.2008	31.12.2007
Assets:			
Operating assets		34.341	22.832
Intangible assets	6,7	34.472	26.846
Deferred tax asset		319	0
Investments in associates		828	2.335
Prepaid aircraft acquisitions		2.857	249
Long-term receivables and deposits		4.781	1.788
Total non-current assets		77.598	54.050
Inventories		2.200	1.301
Trade and other receivables		13.415	7.284
Receivables from sale of aircrafts		0	1.753
Prepayments		862	366
Cash and cash equivalents	5	7.417	2.006
Total current assets		23.894	12.710
Total assets		101.492	66.760
Equity:			
Share capital		974	981
Share premium		25.450	25.593
Reserves		4.442	(1.296)
Retained earnings (accumulated deficit)		2.244	(293)
Total equity attributable to equity holders of the Company		33.110	24.985
Minority interest		468	48
Total equity	8	33.578	25.033
Liabilities:			
Loans and borrowings	9	21.772	14.040
Prepayments	13	1.913	0
Deferred income tax liability		0	134
Total non-current liabilities		23.685	14.174
Loans and borrowings	9,11	13.446	11.058
Trade and other payables		24.350	12.591
Deferred income		6.433	3.904
Total current liabilities		44.229	27.553
Total liabilities		67.914	41.727
Total equity and liabilities		101.492	66.760

Amounts are in ISK million

Consolidated Interim Statement of Changes in Equity
for the period from 1 January to 30 September 2008

	Attributable to equity holders of the Company								
			Reserves						
1 January to 30 September 2007	Share capital	Share premium	Share option reserve	Hedging reserve	Translation reserve	Retained earnings	Total	Minority interest	Total equity
Equity 1.1.2007	1.000	26.090	0	(159)	(425)	(544)	25.962	42	26.004
Foreign currency translation differences for foreign operations					(1.290)		(1.290)		(1.290)
Net profit on hedge of net investment in foreign operation					10		10		10
Effective portion of changes in fair value of cash flow hedges, net of tax				161			161		161
Net income and (expense) recognised directly in equity				161	(1.280)		(1.119)		(1.119)
Profit for the period						1.027	1.027	10	1.037
Total recognised income (expense)				161	(1.280)	1.027	(92)	10	(82)
Own shares, change	(15)	(393)					(408)		(408)
Stock option expense			148				148		148
Equity 30.9.2007	985	25.697	148	2	(1.705)	483	25.610	52	25.662
1 January to 30 September 2008									
Equity 1.1.2008	981	25.593	168	(24)	(1.440)	(293)	24.985	48	25.033
Foreign currency translation differences for foreign operations					6.403		6.403	68	6.471
Effective portion of changes in fair value of cash flow hedges, net of tax				(718)			(718)	(103)	(821)
Net income and (expense) recognised directly in equity				(718)	6.403		5.685	(35)	5.650
Profit for the period						2.537	2.537	565	3.102
Total recognised income (expense)				(718)	6.403	2.537	8.222	530	8.752
Minority interest arising on business combination								(110)	(110)
Own shares, change	(7)	(143)					(150)		(150)
Stock option expense			53				53		53
Equity 30.9.2008	974	25.450	221	(742)	4.963	2.244	33.110	468	33.578

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows
for the Nine Months Ended 30 September 2008

	Notes	2008 1.1.-30.9.	2007 1.1.-30.9.
Cash flows from operating activities:			
Profit for the period		3.102	1.037
Adjustments for:			
Depreciation and amortisation		2.835	2.316
Other operating items	15	2.194	(1.299)
Working capital from operations		8.131	2.054
Net change in operating assets and liabilities		1.187	1.870
Net cash from operating activities		9.318	3.924
Cash flows from investing activities:			
Acquisition of operating assets		(4.275)	(5.024)
Proceeds from the sale of operating assets		301	3.234
Acquisition of intangible assets		(111)	(349)
Long-term receivables, decrease, (increase)		1.590	(230)
Investment in subsidiary net of cash received	2	(750)	0
Net cash used in investing activities		(3.245)	(2.369)
Cash flows from financing activities:			
Acquisition of own shares		(149)	(409)
Proceeds from borrowings		4.064	8.440
Repayment of long term borrowings		(9.838)	(7.544)
Short term borrowings, changes		2.450	(950)
Prepayments		1.367	0
Net cash used in financing activities		(2.106)	(463)
Increase in cash and cash equivalents		3.967	1.092
Effect of exchange rate fluctuations on cash held		1.444	(106)
Cash and cash equivalents at 1 January		2.006	2.776
Cash and cash equivalents at 30 September		7.417	3.762
Investment and financing without cash flow effect:			
Receivables from sale of operating assets		0	1.538
Operating assets held for sale		0	1.121

Amounts are in ISK million

Notes

Significant accounting policies

a. ***Reporting entity***

Icelandair Group hf. (the "Company") is a limited liability company incorporated and domiciled in Iceland. The address of the Company´s registered office is at Reykjavíkurflugvöllur in Reykjavík, Iceland. The consolidated interim financial statements of the Company as at and for the nine-month period ended 30 September 2008 comprise the Company and its subsidiaries (together referred to as the “Group”) and the Group´s interests in associates. The Group´s operations are in the airline transportation and tourism industry.

b. ***Statement of compliance***

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting* . They do not include all of the information required for a complete set of consolidated annual financial statements, and should be read in conjunction with the consolidated financial statements of the Company as at and for the year ended 31 December 2007.

The condensed consolidated interim financial statements were approved by the board of directors on 11. November 2008.

c. ***Significant accounting policies***

The accounting policies and methods of computation applied by the Company in these condensed interim consolidated financial statements are the same as those applied by the Company in its consolidated financial statements as at and for the year ended 31 December 2007. The consolidated financial statements for the year ended 31 December 2007 are available at the Company's office and website, www.icelandairgroup.is and at The Icelandic Stock Exchange website, www.omxgroup.com.

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

d. ***Use of estimates and judgements***

The preparation of interim 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.

Segment reporting

1. Business segments

1 January to 30 September 2008

	Scheduled airline & tourism operations	Global capacity and aircraft trading	Shared services	Eliminations	Consolidated
External revenue	44.687	39.517	225		84.429
Inter-segment revenue	11.527	766	617	(12.910)	
Segment revenue	56.214	40.283	842	(12.910)	84.429
Segment EBITDAR	6.434	9.008	(653)		14.789
Segment EBITDA	3.251	4.533	(603)		7.181
Segment results	1.109	3.861	(624)		4.346
Net finance costs	(186)	425	(1.028)		(789)
Share of profit of associates	1	120	0		121
Income tax	(22)	(817)	263		(576)
Profit (loss) for the period	902	3.589	(1.389)		3.102
Segment assets	51.605	28.770	64.178	(43.889)	100.664
Investments in associates	116	709	3		828
Total assets	51.721	29.479	64.181	(43.889)	101.492
Segment liabilities	45.500	22.133	29.634	(29.353)	67.914
Capital expenditure	2.475	1.895	16		4.386
Depreciation	1.941	513	18		2.472
Amortisation of intangible assets	201	159	3		363

Amounts are in ISK million

Segment reporting

1. Business segments, contd.:

1 January to 30 September 2007

	Scheduled airline & tourism operations	Global capacity and aircraft trading	Shared services	Eliminations	Consolidated
External revenue	37.176	10.877	81		48.134
Inter-segment revenue	9.744	20	458	(10.222)	
Segment revenue	46.920	10.897	539	(10.222)	48.134
Segment EBITDAR	6.634	2.643	(337)		8.940
Segment EBITDA	3.870	1.429	(337)		4.962
Segment results	2.061	934	(349)		2.646
Net finance costs	(361)	(250)	(962)		(1.573)
Share of profit of associates	0	175	0		175
Income tax	(307)	(237)	333		(211)
Profit (loss) for the period	1.393	622	(978)		1.037
Segment assets	35.563	12.261	45.780	(25.677)	67.927
Investments in associates	20	1.913	0		1.933
Total assets	35.583	14.174	45.780	(25.677)	69.860
Segment liabilities	28.425	11.691	19.364	(15.282)	44.198
Capital expenditure	3.548	1.792	33		5.373
Depreciation	1.595	255	8		1.858
Amortisation of intangible assets	212	241	5		458

Amounts are in ISK million

Business Combination

2. On 18 September 2007 the Company signed a purchase agreement for the acquisition of the Czech airline Travel Service, the largest private airline in the Czech Republic. Travel Service operates charter flights to and from Prague and Budapest and also owns and operates the low cost airline Smart Wings. According to the agreement Icelandair Group hf. purchases the shares in two stages, 50% of the shares in 2007 and 50% during 2008. The 50% share in Travel Service acquired in 2007 was acquired through the holding company, Lerox CZ s.r.o. which is 100% owned by Icelandair Group hf. The 50% share of Travel Service was accounted for using the equity method within Lerox CZ s.r.o. from the acquisition date of Lerox CZ s.r.o. as of 1 November 2007 until 1 April 2008, the acquisition date, when Icelandair Group hf. obtained control of Travel Service due to resolution of constraints in the share purchase agreement.

   During the 2nd Quarter, Icelandair Group hf. acquired the second 50% part of the shares in Travel Service directly and at the same time transferred the ownership of the 50% from Lerox to Icelandair Group hf. According to the purchase agreement the sellers had option to buy back 20% of the shares at the completion date in 2008. The sellers exercised this option so Icelandair Group hf. owns 80% of Travel Service at the end of the period. The Sellers have put option on 20% which can be exercised at any time before 31 December 2009.

   The acquisition had the following effect on the Group´s assets and liabilities on acquisition date:

	Travel Service
Non-current assets	2.051
Current assets	2.548
Non-current liabilities	(1.632)
Current liabilities	(3.237)
Net assets	(270)
Goodwill on acquisition	2.383
Total purchase price, satisfied in cash	2.113
Paid in 2007	(960)
Cash and cash equivalents acquired	(403)
Net cash outflow	750

   The purchase price includes 104 million ISK direct cost related to the transaction.

   Necessary information to work on the purchase price allocation were not obtained before the reporting date so it is only provisional. The allocation will be finalized before year end 2008.

   Consolidated revenues increased by 24.096 million ISK and profit increased by 2.847 million ISK by consolidating Travel Service from 1 April 2008.

Amounts are in ISK million

Finance income and finance expense

3. Finance income and finance expense are specified as follows:

	2008 1.1.-30.9.	2007 1.1.-30.9.
Interest income on bank deposits	140	119
Other interest income	171	104
Gain from sale of derivatives	306	0
Net foreign exchange gain	1.109	26
Finance income total	1.726	249
Interest expense on loans and borrowings	2.394	1.720
Other interest expenses	121	102
Finance expense total	2.515	1.822
Net finance expense	(789)	(1.573)

Income tax

4. The effective tax rate for the period 1 January to 30 September 2008 was 16% (1 January to 30 September 2007: 17%) The change is mainly attributable to non-deductible expenses, effect of tax rates in foreign jurisdictions and the change in the Company's domestic tax rate.

In May 2008 the Icelandic Parliament approved a decrease in the income tax rate from 18% to 15% as of 1 January 2008 and the change will become effective in the tax assessment of the year 2009. Due to this the deferred tax liability at year-end 2007 has decreased by ISK 22,4 million. The decrease is recognised as a part of income tax in the income statement.

Cash and cash equivalents

5. Included in cash and cash equivalents in the balance sheet are demand deposits in the amount of ISK 513 million and investments in money market funds and money market loans in the amount of ISK 1.332 million whose withdrawal or repayment has become temporarily restricted after 30 September 2008. These amounts have not been reclassified out of cash and cash equivalents in the balance sheet because the restrictions did not exist at 30 September 2008 and they were readily convertible to known amounts of cash at that date.

Goodwill

6. The performance of two companies within the Group was weaker to some extent in comparison with projections. Goodwill relating to these two companies amounts to ISK 2.625 million. In the beginning of 4th quarter the business environment changed due to financial crisis in the Icelandic market. Great uncertainty is how much these crisis will affect the Group’s businesses and therefore the possible impairment of goodwill allocated to different segments. Detailed impairment calculations were not performed at the end of the period, the annual calculation will be performed in the 4th quarter along with the Group’s budgeting process.

Amounts are in ISK million

Intangible assets

7. When Latcharter was acquired in the year 2006, part of the purchase price was allocated to the company's trademark Latcharter, defined with indefinite useful life. At the end of 3rd quarter the company introduced a new trade mark, SmartLinx, that will be taking over the old trade mark which from that time will have finite useful life. The estimated useful life of the old trade mark is considered to be three to five years. The carrying value amounting to ISK 402 million, will be amortised over that period from the beginning of 4th quarter.

Equity

8. The Company's share capital amounts to ISK 1,000 million as decided in its Articles of Association. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share of one ISK.

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.

Share option reserve

The reserve includes the accrued part of the fair value of share options. This reserve is reversed if share options are forfeited and is transferred to share premium if share options are exercised.

Hedging reserve

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.

Translation reserve

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 subsidiary.

Loans and borrowings

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

	30.9.2008	31.12.2007
Non-current loans and borrowings are specified as follows:		
Secured bank loans	23.922	14.851
Convertible notes	1.910	1.889
	25.832	16.740
Current maturities	(4.060)	(2.700)
Total non-current loans and borrowings	21.772	14.040

Amounts are in ISK million

Loans and borrowings

9. Contd.:

Current loans and borrowings are specified as follows:

	30.9.2008	31.12.2007
Current maturities of non-current liabilities	4.060	2.700
Short-term loans from credit institutions	9.386	8.358
Total current loans and borrowings	13.446	11.058
Total loans and borrowings	35.218	25.098

Refinance of short term borrowings are worked upon with the Group's commercial bank.

10. Secured bank loans are specified as follows:

	Average interest rates	Total remaining balance 30.9.2008	Average interest rates	Total remaining balance 31.12.2007
Debt in USD	5,3%	19.609	5,6%	12.230
Debt in EUR	6,5%	2.290	6,9%	1.629
Debt in GBP	-	0	7,9%	19
Debt in JPY	-	0	2,2%	16
		21.899		13.894
Debt in ISK indexed	9,5%	2.023	6,5%	957
Total secured bank loans		23.922		14.851

11. Contractual repayments of non-current borrowings are specified as follows:

	30.9.2008
Repayments in 1.10.2008 - 30.9.2009	4.060
Repayments in 1.10.2009 - 30.9.2010	4.505
Repayments in 1.10.2010 - 30.9.2011	7.596
Repayments in 1.10.2011 - 30.9.2012	1.731
Repayments in 1.10.2012 - 30.9.2013	2.506
Subsequent repayments	5.434
Total non-current borrowings	25.832

Amounts are in ISK million

Convertible notes

12. Convertible notes are specified as follows:

Proceeds from issue of convertible notes - nominal amount	2.000	2.000
Transaction cost	(23)	(39)
Net proceeds	1.977	1.961
Amount classified as equity	(89)	(110)
Expensed transaction cost	22	38
Carrying amount of liability	1.910	1.889

Convertible notes were issued in October 2006. The nominal amount in ISK will be paid in a single amount in 2011. They are convertible at the option of the holder into ordinary shares over the 5 year period at the price ISK 29.7 per share, 20% each year. The effective interest was 17.5% at year-end.

Prepayments

13. Prepayments at the end of the period consist of deposits from 3rd party in relation to future aircraft transactions.

Group entities

14. The Company holds fifteen subsidiaries, which are all included in the consolidated interim financial statements. They are:

	Share
Scheduled airline and tourism operations:	
Air Iceland ehf.	100%
Iceland Travel ehf.	100%
Icelandair ehf.	100%
Icelandair Cargo ehf.	100%
Icelandair Ground Services ehf. (IGS)	100%
Icelandair Hotels ehf.	100%
Global capacity solutions and aircraft trading:	
Bluebird Cargo ehf.	100%
IceLease ehf.	100%
IG Invest ehf.	100%
Loftleiðir - Icelandic ehf.	100%
Smart Linx, Latvia	100%
Lerox CZ s.r.o., dormant	100%
Travel Service, Czech Republic	80%
Shared services:	
IceCap Ltd., Guernsey	100%
Icelandair Shared Services ehf.	100%

The subsidiaries own 18 subsidiaries that are all included in the consolidated interim financial statements.

Amounts are in ISK million

Statement of cash flows

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

	2008 1.1.-30.9.	2007 1.1.-30.9.
Gain on the sale of assets	(112)	(1.193)
Exchange rate difference and indexation of liabilities and assets	2.041	(959)
Share of profit of associates	(121)	(175)
Income tax	(160)	211
Stock option	53	148
Other items	493	669
Total other operating items in the statement of cash flows	2.194	(1.299)

Ratios

16. The Group's primary ratios are specified as follows:

	30.9.2008	31.12.2007
Working capital ratio - current assets/current liabilities	0,54	0,46
Equity ratio - equity/total assets	0,33	0,37
Intrinsic value of share capital - equity/share capital	34,47	25,52

Amounts are in ISK million