Icelandair Group hf.

Consolidated Financial Statements for the year 2012

USD

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 2012

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.

The Company's functional currency in previous years has been Icelandic Króna (ISK). The transition of the functional currency from ISK to USD was made as of 1 January 2012. Due to increased international operations the significance of the USD in the Group's operation has increased and is currently recognized as it's functional currency. Comparative figures for the previous year have been translated to USD using the conversion rate at year-end 2011 which was ISK 122.60.

In December 2012 Icelandair Group accepted Boeing's proposal, subject to finalizing a mutual agreement, for the purchase of twelve 737 MAX8 and 737 MAX9 aircraft with purchase rights for additional 12 aircraft. The first delivery to Icelandair is scheduled in the first half of 2018. The commitment for all 12 aircraft is valued at USD 1.2 billion at Boeing list prices in 2011 USD. Through negotiations with Boeing, the Company received acceptable discounts which due to confidentiality agreements cannot be disclosed. The Company intends to fund the acquisition partly by internal resources of the Company and partly by loans from commercial banks.

According to the consolidated statement of comprehensive income, profit for the year 2012 amounted to USD 44.3 million. Total comprehensive income for the year amounted to USD 38.9 million. According to the consolidated statement of financial postition, equity at the end of the year amounted to USD 295.9 million, including share capital in the amount of USD 40.6 million. Reference is made to the notes to the consolidated financial statements regarding information on changes in equity.

The Board of Directors proposes a dividend payment to shareholdersor in the year 2013 of ISK 1.500 million, equal to USD 11.7 million, which represents 30% of total comprehensive income for the year 2012.

Share capital and Articles of Association

The share capital amounted to ISK 5.0 billion at the end of the year, of 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 (Nasdaq OMX Iceland). The Company can purchase up to 10% of the nominal value of the shares of the Company according to the Icelandic Company's Act.

The Company's Board of Directors comprises five members and one alternative members elected at 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 2012 was 1,458, an increase of 189 from the beginning of the year. Three shareholders held more than 10% of outstanding shares each at year end 2012, Lífeyrissjóður verslunarmanna with 14.4% share, Lífeyrissjóður starfsmanna ríkisins with 12.6% share and Framtakssjóður Íslands slhf. with 12.1% share.

Information on matters related to share capital is disclosed in note 27.

Corporate Governance

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

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

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.

Statement by the Board of Directors and the CEO

The consolidated financial statements for the year ended 31 December 2012 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 year 2012, its assets, liabilities and consolidated financial position as at 31 December 2012 and its consolidated cash flows for the year 2012.

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 consolidated financial statements of Icelandair Group hf. for the year 2012 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, 7 February 2013.

Board of Directors:

Sigurður Helgason, Chairman of the Board
Ásthildur M. Otharsdóttir
Herdís Dröfn Fjeldsted
Katrín Olga Jóhannesdóttir
Úlfar Steindórsson

CEO:

Björgólfur Jóhannnson

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 2012, 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.

Auditors' 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 2012, 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, 7 February 2013.

KPMG ehf.

Alexander G. Eðvardsson
Guðný Helga Guðmundsdóttir

Consolidated Statement of Comprehensive Income for the year 2012

	Notes	2012	2011 Translated*
Continuing operation			
Operating income			
Transport revenue	9	604.499	507.463
Aircraft and aircrew lease		120.815	136.615
Other operating revenue	9	173.552	146.575
		898.866	790.653
Operating expenses			
Salaries and other personnel expenses	10	203.815	186.044
Aircraft fuel		219.877	179.560
Aircraft and aircrew lease		75.795	83.931
Aircraft handling, landing and communication		65.651	58.083
Aircraft maintenance expenses		52.993	58.515
Other operating expenses	10	171.089	139.585
		789.220	705.718
Operating profit before depreciation and amortisation (EBITDA)		109.646	84.935
Depreciation and amortisation	11	(58.859)	(46.313)
Operating profit (EBIT)		50.787	38.622
Finance income		17.578	7.201
Finance costs		(10.551)	(17.188)
Net finance income (costs)	12	7.027	(9.987)
Share of loss of associates, net of tax	19	(366)	(90)
Profit before tax		57.448	28.545
Income tax	22	(13.173)	4.763
Profit from continuing operations		44.275	33.308
Discontinued operation			
Profit from discontinued operation, net of tax	7	0	3.002
Profit for the year		44.275	36.310
Other comprehensive loss			
Currency translation differences		(2.285)	3.842
Currency translation differences reclassified to profit or loss		0	(9.780)
Net (loss) profit on hedge of investment, net of tax		(46)	1.158
Net investment hedge reclassified to profit or loss		(1.417)	0
Effective portion of changes in fair value of cash flow hedge, net of tax		(1.673)	563
Other comprehensive loss for the year		(5.421)	(4.217)
Total comprehensive income for the year		38.854	32.093

* See note 2c

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2012 6 Amounts are in USD thousand

Consolidated Statement of Comprehensive Income for the year 2012, contd.:

	Notes	2012	2011 Translated*
Profit attributable to:			
Owners of the Company		44.228	36.310
Non-controlling interests		47	9
Profit for the year		44.275	36.319
Total Comprehensive income attributable to:			
Owners of the Company		38.834	32.084
Non-controlling interests		20	9
Total comprehensive income for the year		38.854	32.093
Earnings per share:			
Basic earnings per share expressed in USD cent per share	28	0,89	0,73
Diluted earnings per share expressed in USD cent per share	28	0,89	0,73
Earnings per share from continuing operations:			
Basic earnings per share expressed in USD cent per share	28	0,89	0,67
Diluted earnings per share expressed in USD cent per share	28	0,89	0,67

* See note 2c

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

Consolidated Financial Statements of Icelandair Group hf. 2012 7 Amounts are in USD thousand

Consolidated Statement of Financial Position as at 31 December 2012

	Notes	2012	2011 Translated*
Assets:			
Operating assets	13-16	282.997	276.175
Intangible assets and goodwill	17-18	176.715	176.664
Investments in associates	19	1.327	1.411
Long-term cost	20	3.648	6.207
Non-current receivables and deposits	21	9.223	22.610
Non-current assets		473.910	483.067
Inventories	23	17.417	15.081
Trade and other receivables	24	135.085	118.417
Marketable securites	25	15.734	27.284
Cash and cash equivalents	26	117.060	79.405
Assets classified as held for sale	8	3.689	6.485
Current assets		288.985	246.672
Total assets		762.895	729.739
Equity:			
Share capital		40.576	40.576
Share premium		154.705	154.705
Reserves		26.164	31.557
Retained earnings		74.230	36.310
Equity attributable to equity holders of the Company	27	295.675	263.148
Non-controlling interests		257	237
Total equity		295.932	263.385
Liabilities:			
Loans and borrowings	29-30	119.358	163.124
Payables	31	22.060	27.178
Deferred tax liabilities	22	19.671	6.289
Non-current liabilities		161.089	196.591
Loans and borrowings	30	31.548	33.744
Trade and other payables	32	152.237	135.000
Deferred income	33	122.089	101.019
Current liabilities		305.874	269.763
Total liabilities		466.963	466.354
Total equity and liabilities		762.895	729.739

* See note 2c

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

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Consolidated Statement of Changes in Equity for the year 2012

	Attributable to equity holders of the Company						
2011 Translated*	**Share capital**	**Share premium**	**Reserves**	**Retained earnings**	**Total**	**Non-con-trolling interest**	**Total equity**
Balance at 1.1.2011	40.576	155.085	35.783		231.444	228	231.672
Total comprehensive income			(4.226)	36.310	32.084	9	32.093
Cost of share capital increase		(380)			(380)		(380)
Balance at 31 December 2011	40.576	154.705	31.557	36.310	263.148	237	263.385
2012							
Balance at 1.1.2012	40.576	154.705	31.557	36.310	263.148	237	263.385
Total comprehensive income			(5.393)	44.228	38.834	20	38.854
Dividend (0.16 USD per share)				(6.308)	(6.308)		(6.308)
Balance at 31 December 2012	40.576	154.705	26.164	74.230	295.675	257	295.932

Information on changes in other reserves are provided in note 27.

* See note 2c

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

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Consolidated Statement of Cash Flows for the year 2012

	Notes	2012	2011 Translated*
Cash flows from operating activities:			
Profit for the year		44.275	36.310
Adjustments for:			
Depreciation and amortisation	11	58.859	46.313
Other operating items	42	38.356	19.669
Working capital from operations		141.490	102.292
Net change in operating assets and liabilities	43	25.253	15.049
Net cash from operating activities		166.743	117.341
Cash flows to investing activities:			
Acquisition of operating assets	13	(62.529)	(66.207)
Proceeds from the sale of operating assets		6.822	6.566
Acquisition of intangible assets	17	(2.497)	(1.427)
Cash of subsidiaries held for sale, change		0	41
Acquisition of long-term cost		(26.848)	(29.152)
Long-term receivables, change		(2.605)	570
Marketable securites, change		11.181	(16.566)
Net cash used in investing activities		(76.476)	(106.175)
Cash flows to financing activities:			
Paid in share capital		0	21.215
Dividend paid	27	(6.308)	0
Proceeds from long term borrowings		0	17.202
Repayment of long term borrowings		(45.145)	(66.019)
Net cash used in financing activities		(51.453)	(27.602)
Increase (decrease) in cash and cash equivalents		38.814	(16.436)
Effect of exchange rate fluctuations on cash held		(1.159)	507
Cash and cash equivalents at beginning of the year		79.405	95.334
Cash and cash equivalents at 31 December	26	117.060	79.405
Investment and financing without cash flow effect:			
Sale of operating assets		875	0
Repayment of long term debt		(875)	0
Aquisition of operating assets		(4.000)	(28.222)
Long term receivables		4.000	0
Change in trade and other payables		0	(3.752)
Proceeds from long term borrowings		0	31.974

Information on interest paid and received are provided in note 44.

* See note 2c

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

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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 2012 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 7 February 2013.

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 values. The methods used to measure fair values are discussed further in note 5.

c. Functional and presentation currency

These Consolidated Financial Statements are presented in U.S dollars (USD), which is the Company's functional currency. All financial information presented in USD has been rounded to the nearest thousand, except when otherwise indicated.

The Company's functional currency in previous years has been ISK. The transition of the functional currency from ISK to USD was made as of 1 January 2012. Due to increased international operations the significance of the USD in the Group's operation has increased and is currently recognized as it's functional currency. All comparative figures for the previous year have been translated to USD using the conversion rate at year-end 2011 which was ISK 122.60, including financial information presented in the notes.

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 18 - measurement of the recoverable amounts of cash-generating units
Note 20 - long-term cost
Note 21 - utilisation of tax losses
Note 35 - 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. Currency exchange

(i) Currency transactions

Transactions in currencies other than functional currencies (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 currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The 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 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) **Subsidiaries with other functional currency**

Assets and liabilities of foreign operations and subsidiaries with functional currency in other than USD, including goodwill and fair value adjustments arising on acquisitions, are translated to USD at exchange rates at the reporting date. Income and expenses are translated to USD at exchange rates at the dates of the transactions. Currency differences arising on translation are recognised in other comprehensive income. When an operation is disposed of, in part or in full, the relevant amount in the currency translation reserve within equity is transferred to profit or loss as part of the profit or loss on disposal.

Currency differences are recognised in other comprehensive income, and presented in the translation reserve in equity. However, if the operation is not a 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 subsidiary and the Company's functional currency (USD), regardless of whether the net investment is held directly or through an intermediate parent.

Currency differences arising on the translation of a financial liability designated as a hedge of a net investment in a subsidiary 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.

Financial assets classified as held-for-trading comprise marketable securities actively managed by the Group's treasury department to address short-term liquidity needs.

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 restricted cash and cash equivalent and trade and other receivables.

Cash and cash equivalents
Cash and cash equivalents comprise cash balances and call deposits and marketable securities 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 34). 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 during which 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.

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.

Intangible assets and operating assets once classified as held for sale or distribution are not amortised or depreciated, and any equity-accounted investee is no longer equity accounted.

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 profit or loss 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, as applicable.

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 when 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 products.

Gain on sale of operating assets is recognised in profit or loss when the risks and rewards of ownership are 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 currency movements are in a net gain or net loss position.

3. contd.:

o. Income tax

Income tax on 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. 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.

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 2013, 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.

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

Seven companies are categorised as being part of the Route Network: Icelandair, Icelandair Cargo, Loftleidir, Air Iceland, Icelandair Ground Services, Feria and Fjárvakur - Icelandair Shared Services.

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	
	2012	2011	2012	2011	2012	2011
External revenue	817.121	711.827	78.315	75.571	895.436	787.398
Inter-segment revenue	148.055	159.421	4.278	1.305	152.333	160.726
Segment EBITDAR*	153.351	136.240	12.361	7.602	165.712	143.842
Segment EBITDA	105.541	82.904	4.045	1.085	109.586	83.989
Finance income	16.564	2.446	179	131	16.743	2.577
Finance costs	(7.861)	(11.215)	(951)	(890)	(8.812)	(12.105)
Depreciation and amortisation	(55.585)	(43.564)	(1.504)	(1.599)	(57.089)	(45.163)
Share of profit of equity accounted investees	1	8	(290)	(73)	(289)	(65)
Reportable segment profit (loss) before income tax	58.660	30.579	1.479	(1.346)	60.139	29.233
Reportable segment assets	615.880	575.285	21.933	23.214	637.813	598.499
Investment in associates	24	554	503	408	527	962
Capital expenditure	93.467	110.122	2.361	5.204	95.828	115.326
Reportable segment liabilities	459.263	443.157	17.948	19.665	477.211	462.822

*EBITDAR means EBITDA before operating lease expenses.

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6. contd.:

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

	2012	2011
Revenue		
Total revenue for reportable segments	1.047.769	948.124
Other revenue	3.430	3.255
Elimination of inter-segment revenue	(152.333)	(160.726)
Consolidated revenue	898.866	790.653
Profit or loss		
Total profit of reportable segments	60.139	29.233
Unallocated corporate expenses	(2.691)	(688)
Consolidated profit from continuing operations before tax	57.448	28.545
Assets		
Total assets for reportable segments	637.813	598.499
Other assets	124.555	130.278
Investments in associates	527	962
Consolidated total assets	762.895	729.739
Liabilities		
Total liabilities for reportable segments	477.211	462.822
Other liabilities	(10.248)	3.532
Consolidated total liabilities	466.963	466.354

Other material items 2012	Reportable segment totals	Adjust-ments	Consoli-dated totals
Segment EBITDAR	165.712	60	165.772
Segment EBITDA	109.586	60	109.646
Finance income	16.743	835	17.578
Finance costs	(8.812)	(1.739)	(10.551)
Depreciation and amortisation	(57.089)	(1.770)	(58.859)
Share of loss of associates	(289)	(77)	(366)
Capital expenditure	95.828	46	95.874
Other material items 2011			
Segment EBITDAR	143.842	946	144.788
Segment EBITDA	83.989	946	84.935
Finance income	2.577	4.624	7.201
Finance costs	(12.105)	(5.083)	(17.188)
Depreciation and amortisation	(45.163)	(1.150)	(46.313)
Share of loss of associates	(65)	(25)	(90)
Capital expenditure	115.326	9.682	125.008

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7. Discontinued operation

On 30 December 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

	2012	2011
Revenue	0	64.641
Expenses	0	(67.439)
Results from operating activities	0	(2.798)
Net finance costs	0	(359)
Income tax	0	(8)
Results from operating activities, net of income tax	0	(3.165)
Reversal of translation reserve	0	9.421
Guarantees of discontinued operation reversed	0	(3.254)
Profit for the year	0	3.002
Basic profit per share	0	0,07
Diluted profit per share	0	0,07

Cash flows from discontinued operation

	2012	2011
Net cash used in operating activities	0	(2.162)
Net cash used in investing activities	0	(3.206)
Net cash from financing activities	0	5.368
Net cash from discontinued operation	0	0

8. Assets and liabilities classified as held for sale

At year end 2012 assets held for sale consist of 30% share in Travel Service. In January 2013 an agreement was reached on the sale of the shares for USD 3.7 million. Loss in the amount of USD 0.3 million is recognized in 2012 finance costs.

Assets classified as held for sale

	2012	2011
Operating assets	0	2.407
Investment in other companies	3.689	4.078
	3.689	6.485

9. Operating income

Transport revenue is specified as follows:

	2012	2011
Passengers	564.886	470.767
Cargo and mail	39.613	36.696
Total transport revenue	604.499	507.463

Other operating revenue is specified as follows:

	2012	2011
Sale at airports and hotels	57.496	48.075
Revenue from tourism	61.235	46.591
Aircraft and cargo handling services	26.534	26.444
Revenue from maintenance and aircraft handling	11.416	8.328
Gain on sale of operating assets	2.805	2.577
Other operating revenue	14.066	14.560
Total other operating revenue	173.552	146.575

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10. Operating expenses

Salaries and other personnel expenses are specified as follows:

	2012	2011
Salaries	133.700	120.114
Contribution to pension funds	17.697	16.403
Other salary-related expenses	16.980	15.897
Other personnel expenses	35.438	33.630
Total salaries and other personnel expenses	203.815	186.044
Average number of full year equivalents	2.566	2.350

Other operating expenses are specified as follows:

	2012	2011
Operating cost of real estates and fixtures	18.921	15.962
Communication expenses	12.379	10.873
Advertising expenses	18.242	16.346
Booking fee and commission expenses	30.162	25.514
Cost of goods sold	19.366	15.489
Customer services	12.325	11.093
Tourism expenses	34.201	24.462
Other operating expenses	25.493	19.846
Total other operating expenses	171.089	139.585

11. Depreciation and amortisation

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

	2012	2011
Depreciation of operating assets, see note 13	57.733	44.617
Amortisation of intangible assets, see note 17	1.126	1.696
Depreciation, amortisation and impairment losses recognised in profit or loss	58.859	46.313

12. Finance income and finance costs

Finance income and finance costs are specified as follows:

	2012	2011
Interest income on bank deposits	1.219	1.256
Other interest income	2.196	5.945
Net currency exchange gain	14.163	0
Finance income total	17.578	7.201
Interest expense on loans and borrowings	9.900	11.052
Other interest expenses	302	598
Loss from sale of shares	349	0
Net currency exchange loss	0	5.538
Finance costs total	10.551	17.188
Net finance costs	7.027	(9.987)

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13. Operating assets

Operating assets are specified as follows:

Cost	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Balance at 1 January 2011	272.210	23.132	18.785	314.127
Additions during the year	87.194	530	6.705	94.429
Sales and disposals during the year	(22.626)	0	(253)	(22.879)
Effect of movements in exchange rates	12.210	0	8	12.218
Assets classified as held for sale	(3.825)	0	0	(3.825)
Balance at 31 December 2011	345.163	23.662	25.245	394.070
Additions during the year	57.264	4.306	4.959	66.529
Sales and disposals during the year	(29.669)	(106)	(756)	(30.531)
Reclassification from long-term cost	2.132	0	0	2.132
Reclassification from intangible assets	293	0	0	293
Reclassification	0	(1.153)	1.153	0
Effect of movements in exchange rates	(110)	(1.199)	(1.441)	(2.750)
Balance at 31 December 2012	375.073	25.510	29.160	429.743
Depreciation and impairment losses				
Balance at 1 January 2011	76.770	4.625	7.659	89.054
Depreciation for the year	39.959	1.330	3.328	44.617
Sales and disposals during the year	(18.279)	0	(212)	(18.491)
Effect of movements in exchange rates	4.242	(1)	16	4.257
Assets classified as held for sale	(1.542)	0	0	(1.542)
Balance at 31 December 2011	101.150	5.954	10.791	117.895
Depreciation for the year	53.019	1.246	3.468	57.733
Sales and disposals during the year	(26.861)	(106)	(709)	(27.676)
Reclassification	0	(408)	408	0
Effect of movements in exchange rates	(56)	(342)	(808)	(1.206)
Balance at 31 December 2012	127.252	6.344	13.150	146.746
Carrying amounts				
At 1 January 2011	195.440	18.507	11.126	225.073
At 31 December 2011	244.013	17.708	14.454	276.175
At 31 December 2012	247.821	19.166	16.010	282.997
Depreciation ratios	5-29%	2-6%	5-33%	

During the year the Group purchased three Boeing 757 aircraft of which two had been leased by the Group for a number of years. Total purchase price of these aircraft and additions due to investment in two Dash 8 aircraft, that were purchased in 2011, amounted to USD 31.6 million.

14. 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 USD 137.5 million at the end of the year 2012 (2011: USD 182.6 million).

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15. 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	
	2012	2011	2012	2011
Boeing - 15 / 12 aircraft	417.000	369.000	198.836	195.636
Other aircraft	64.000	62.000	29.691	25.722
Flight equipment	66.900	62.442	19.294	22.655
Total aircraft and flight equipment	547.900	493.442	247.821	244.013

16. Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

	Official assessment value		Insurance value		Carrying amount	
	2012	2011	2012	2011	2012	2011
Maintenance hangar, Keflavík	13.897	13.728	28.021	28.499	4.858	5.897
Freight building, Keflavík	3.197	3.197	6.400	6.900	2.367	2.618
Office building, Reykjavík	5.948	5.905	10.444	10.587	5.611	2.227
Service building, Keflavík	3.518	3.263	6.842	6.476	1.263	1.460
Other buildings in Reykjavik	4.475	4.486	9.050	9.160	2.020	2.170
Other buildings	3.134	3.148	9.410	9.194	3.047	3.336
Buildings total	34.169	33.727	70.167	70.816	19.166	17.708

Official valuation of the Group's leased land for buildings at 31 December 2012 amounted to USD 6.8 million (2011: USD 6.7 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 USD 46.8 million at year end 2012 (2011: USD 45.3 million). The carrying amount at the same time was USD 16.0 million (2011: USD 14.5 million).

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17. 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 2011	146.419	35.408	4.959	9.380	196.166
Additions during the year	0	0	0	1.427	1.427
Sales and disposals during the year	0	0	0	(865)	(865)
Effect of movements in exchange rates	3.075	563	269	9	3.916
Balance at 31 December 2011	149.494	35.971	5.228	9.951	200.644
Additions during the year	0	0	0	2.497	2.497
Sales and disposals during the year	0	0	(57)	(5.907)	(5.964)
Reclassification to operating assets	0	0	0	(293)	(293)
Effect of movements in exchange rates	(980)	(13)	(17)	(35)	(1.045)
Balance at 31 December 2012	148.514	35.958	5.154	6.213	195.839

Amortisation and impairment losses	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
Balance at 1 January 2011	11.427	2.602	3.483	5.636	23.148
Amortisation for the year	0	0	334	1.362	1.696
Sales and disposals during the year	0	0	0	(865)	(865)
Effect of movements in exchange rates	0	0	0	1	1
Balance at 31 December 2011	11.427	2.602	3.817	6.134	23.980
Amortisation for the year	0	0	348	778	1.126
Sales and disposals during the year	0	0	(57)	(5.907)	(5.964)
Effect of movements in exchange rates	4	3	(6)	(19)	(18)
Balance at 31 December 2012	11.431	2.605	4.102	986	19.124

Carrying amounts	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
At 1 January 2011	134.992	32.806	1.476	3.744	173.018
At 31 December 2011	138.067	33.369	1.411	3.817	176.664
At 31 December 2012	137.083	33.353	1.052	5.227	176.715

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18. 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:

	2012	2011
Goodwill	137.083	138.067
Trademarks and airport slots	33.353	33.369
Total	170.436	171.436

For the purpose of impairment testing, goodwill is allocated to the subsidiaries which represent the 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:

	Goodwill		Trademarks and slots	
	2012	2011	2012	2011
Route network	134.750	135.620	33.353	33.369
Tourism services	2.333	2.447	0	0
Total goodwill	137.083	138.067	33.353	33.369

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 - 10 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:

	2012	2011	2012	2011
	Route network		Tourism services	
Long term growth rate	2,5-4,0%	3,0-4,0%	4,0%	4,0%
Revenue growth:				
Weighted average 2012 / 2011	9,6%	12,5%	27,3%	26,2%
2013 - 2023 / 2012 - 2016	9,8%	5,3%	11,0%	8,0%
Budgeted EBITDA growth	11,1%	3,4%	9,0%	16,8%
WACC	8,7-13,7%	7,5 - 13,4%	11,9%	10,4%
Debt leverage	18 - 64%	29 - 72%	19,0%	21,2%
Interest rate	7,1-8,8%	5,4 - 7,3%	6,0%	5,2%

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

	2012	2011
Long term growth rate - 1%	(921)	0
WACC +1%	(2.352)	(2.251)
EBITDA - 5%	0	0

No impairment loss is recognised in the Financial Statements.

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19. Investments in associates

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

	Ownership 2012	2011
Ábyrg spilamennska ehf.	50%	50%
EBK ehf.	25%	25%
Gufa ehf.	35%	28%
Icelease ehf.	25%	33%
Tjarnir ehf.	22%	22%
Assets	4.863	854
Liabilities	3.188	504
Revenues	1.222	167
Expenses	2.015	205
Net loss	(793)	(38)
Share of loss of associates	(366)	(90)

20. 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:

	2012	2011
Long-term cost	8.365	11.403
Expensed in next year, classified as maintenance prepayments in receivables	(4.717)	(5.196)
Total long-term cost	3.648	6.207

Long-term cost will be expensed as follows:

	2012	2011
Expensed in 2012	-	5.196
Expensed in 2013	4.717	2.626
Expensed in 2014	3.187	1.990
Expensed in 2015	310	881
Expensed in 2016	46	506
Expensed in 2017	51	33
Subsequent	54	171
Total long-term cost, including current maturities	8.365	11.403

21. Non-current receivables and deposits

Non-current 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:	2012	2011
Loans, effective interest rate 6%	233	269
Interest bearing receivable, interest rate 5%	7.969	8.108
Deposits	15.275	16.403
	23.477	24.780
Current maturities of long-term receivables	(14.254)	(2.170)
Long-term receivables and deposits total	9.223	22.610

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21. contd.:

Long-term receivables contractual repayments are specified as follows:	2012	2011
Repayments in 2012	-	2.170
Repayments in 2013	14.254	13.263
Repayments in 2014	5.262	6.411
Repayments in 2015	649	1.109
Repayments in 2016	494	122
Repayments in 2017	475	8
Subsequent	2.343	1.697
Total receivables, including current maturities	23.477	24.780

Long-term receivables and deposits denominated in currencies other than the functional currency comprise USD 1.4 million (2011: USD 1.3 million).

22. Taxes

Tax recognised in profit or loss

	2012	2011
Deferred tax expense		
Origination and reversal of temporary differences	13.173	(4.763)
Total tax expense recognised in profit or loss	13.173	(4.763)

Tax recognised directly in equity

Operating assets	0	359
Currency exchange	33	0
Total tax recognised directly in equity	33	359

Tax recognised in other comprehensive income

Net profit on hedge of net investment in foreign operations	279	(310)
Effective portion of changes in fair value of cash flow hedge	328	(163)
Total tax recognised in other comprehensive income	607	(473)
Total tax recognised in equity	640	(114)

Reconciliation of effective tax rate

		2012		2011
Profit before tax and discontinued operation		57.448		28.545
Income tax according to current tax rate	20,0%	11.490	20,0%	5.710
Tax exempt revenue	(0,0%)	(18)	(29,9%)	(8.540)
Non-deductible expenses	0,3%	151	1,1%	310
Other items	2,7%	1.550	(7,9%)	(2.243)
Effective tax rate	22,9%	13.173	(16,7%)	(4.763)

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are specified as follows:	2012	2011
Deferred tax liabilities 1.1.	6.289	10.334
Exchange rate difference	849	604
Income tax recognised in profit or loss	13.173	(4.763)
Income tax recognised in equity	(640)	114
Deferred tax liabilities 31.12.	19.671	6.289

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22. contd.:

Deferred tax assets and liabilities is attributable to the following:

	Assets		Liabilities		Net	
	2012	2011	2012	2011	2012	2011
Operating assets	0	0	(22.732)	(21.452)	(22.732)	(21.452)
Intangible assets	0	0	(2.007)	(702)	(2.007)	(702)
Derivatives	90	0	0	(285)	90	(285)
Trade receivables	601	628	0	0	601	628
	691	628	(24.739)	(22.439)	(24.048)	(21.811)
Tax loss carry-forwards	4.967	14.396	0	0	4.967	14.396
Other items	0	1.126	(590)	0	(590)	1.126
Deferred income tax	5.658	16.150	(25.329)	(22.439)	(19.671)	(6.289)

Movement in deferred tax balance during the year

2012	1 January	Recognised in profit or loss	Exchange rate difference	Recognised in other comprehensive income and equity	31 December
Operating assets	(21.451)	(1.338)	57		(22.732)
Intangible assets	(702)	(1.291)	(14)		(2.007)
Derivatives	(285)	47		328	90
Trade receivables	628	(27)			601
Tax loss carry-forwards	14.396	(9.177)	(252)		4.967
Other items	1.125	(1.387)	(640)	312	(590)
	(6.289)	(13.173)	(849)	640	(19.671)

2011	1 January	Recognised in profit or loss	Exchange rate difference	Recognised in other comprehensive income and equity	31 December
Operating assets	(17.055)	(3.613)	(1.142)	359	(21.451)
Intangible assets	(90)	(612)			(702)
Deferred gains	(4.527)	4.527			0
Derivatives	(57)	57		(285)	(285)
Trade receivables	1.411	(653)	(130)		628
Tax loss carry-forwards	10.718	3.361	317		14.396
Other items	(734)	1.696	351	(188)	1.125
	(10.334)	4.763	(604)	(114)	(6.289)

Tax loss carry-forward can be utilized over 10 years from the date that the loss is incurred. Tax loss carry - forward at year end amounted to USD 24.8 million and is useable to the year 2019 (2011: USD 72,0 million). Management has concluded, based on their projections, that there will be sufficient taxable profit in the future to use the tax loss carried forward.

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23. Inventories

Inventories are specified as follows:

	2012	2011
Spare parts	13.444	10.979
Other inventories	3.973	4.102
Inventories total	17.417	15.081

24. Trade and other receivables

Trade and other receivables are specified as follows:

Trade receivables	90.764	70.277
Maintenance prepayments	4.717	5.163
Other prepayments	3.812	2.447
Restricted cash	2.452	2.716
Current maturities of long term-receivables	14.254	2.170
Other receivables	19.086	35.644
Trade and other receivables total	135.085	118.417

At 31 December 2012 trade receivables are shown net of an allowance for doubtful debts of USD 8.7 million (2011: USD 8.5 million).

Prepaid expenses which relate to subsequent periods amounted to USD 3.8 million (2011: USD 2.4 million) at year end. The prepayments consist mainly of insurance expenses and prepaid rental expenses.

Restricted cash is from bank accounts pledged against credit card, derivative and tourism guarantees.

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in note 34.

25. Marketable securities

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

26. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2012	2011
Marketable securities	17.414	15.873
Bank deposits	99.217	63.238
Cash on hand	429	294
Cash and cash equivalents total	117.060	79.405

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27. Equity

(i) Share capital

The Company's share capital amounts to ISK 5,0 billion 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 2012 (2011: 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.

(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 currency differences arising from the translation of the financial statements of subsidiaries using different functional currency, as well as from the translation of liabilities that hedge net investment.

Other reserves are specified as follows:

	Hedging reserve	Translation reserve	Total reserves
Balance 1 January 2011	(228)	36.011	35.783
Currency translation differences		3.833	3.833
Currency translation differences reclassified to profit or loss		(9.780)	(9.780)
Net profit on hedge of investment, net of tax		1.158	1.158
Effective portion of changes in fair value of cash flow hedges, net of tax	563		563
Balance at 31 December 2011	335	31.222	31.557
Currency translation differences		(2.257)	(2.257)
Net profit on hedge of investment, net of tax		(46)	(46)
Net investment hedge reclassified to profit or loss		(1.417)	(1.417)
Effective portion of changes in far value of cash flow hedges, net of tax	(1.673)		(1.673)
Balance at 31 December 2012	(1.338)	27.502	26.164

(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."

Dividend amounting to USD 6.3 million was paid to shareholders in the year 2012.

The Board of Directors proposes a dividend payment to shareholdersor in the year 2013 of ISK 1.500 million, equal to USD 11.7 million, which represents 30% of total comprehensive income for the year 2012.

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28. 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.

	2012	2011
Basic earnings per share:		
Profit for the year attributable to equity holders of the Parent	44.228	36.310
Average share capital	4.974.540	4.974.540
Basic earnings per share of ISK 1 expressed in USD cent per share	0,89	0,73
Profit attributable to ordinary equity holders of the parent company:		
Profit for the year attributable to equity holders of the Parent	44.228	36.310
Discontinued operations	0	(3.002)
Total	44.228	33.308
Weighted average number of shares		
in thousands shares		
Issued shares at beginning of year	4.975.540	4.974.540
Weighted average number of shares at for the year	4.975.540	4.974.540
Earnings per share:		
Basic earnings per share expressed in USD cent per share	0,89	0,73
Diluted earnings per share expressed in USD cent per share	0,89	0,73
Earnings per share from continuing operations:		
Basic earnings per share expressed in USD cent per share	0,89	0,67
Diluted earnings per share expressed in USD cent per share	0,89	0,67

29. 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 34.

Non-current loans and borrowings are specified as follows:	2012	2011
Secured bank loans	137.532	182.594
Unsecured loans	13.374	14.274
	150.906	196.868
Current maturities	(31.548)	(33.744)
Total non-current loans and borrowings	119.358	163.124

Current loans and borrowings are specified as follows:

	2012	2011
Current maturities of non-current liabilities	31.548	33.744
Total current loans and borrowings	31.548	33.744
Total loans and borrowings	150.906	196.868

30. Terms and debt repayment schedule

	Currency	Nominal interest rates year end 2012	Year of maturity	Total remaining balance 2012	2011
Secured bank loan	USD	4,4%	2014-2018	103.110	138.597
Secured bank loan	EUR	4,0%	2017	16.972	18.703
Secured bank loan	ISK	7,6%	2017-2023	16.538	24.299
Secured bank loan, indexed	ISK	6,3%	2021-2028	912	995
Unsecured bond issue, indexed	ISK	5,7%	2023	13.374	14.274
Total interest-bearing liabilities				150.906	196.868

Repayments of loans and borrowings are specified as follows:

	2012	2011
Repayments in 2012	-	33.744
Repayments in 2013	31.548	42.210
Repayments in 2014	44.678	45.245
Repayments in 2015	15.379	15.816
Repayments in 2016	15.851	15.897
Repayments in 2017	28.055	28.285
Subsequent repayments	15.395	15.671
Total loans and borrowings	150.906	196.868

31. Non-current payables

Non-current payables correspond to accrued engine overhaul cost of leased aircraft and security deposits from lease contracts to be realized after 2013. Non-current obligations at year end 2012 amount to USD 22.1 million (2011: USD 27.2 million) and short term obligations, which are included in trade and other payables amount to USD 27.2 million (2011: USD 23.7 million).

32. Trade and other payables

Trade and other payables are specified as follows:

	2012	2011
Trade payables	43.985	34.486
Provision for engine overhaul	23.018	20.138
Security deposits from lease contracts	4.170	3.542
Derivatives used for hedging	1.610	408
Other payables	79.454	76.426
Total trade and other payables	152.237	135.000

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 34.

33. 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:

	2012	2011
Sold unused tickets	95.431	73.785
Frequent flyer points	12.677	13.230
Other prepayments	13.981	14.004
Total deferred income	122.089	101.019

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34. Financial risk management

Overview

The Group has exposure to the following financial risks:

- 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.

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	**2012**	**2011**
Long-term receivables and deposits	21	9.223	22.610
Trade and other receivables	24	135.085	118.417
Marketable securities	25	15.734	27.284
Cash and cash equivalents	26	117.060	79.405
		277.102	247.716

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.

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34. contd.:

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 2012 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 Group's financial restructuring in the year 2010.

The Group is a guarantor in terms of the return cost of two Airbus 320 aircraft and one Boeing 767. These aircraft are operated under SmartLynx's air operator's certificate. Possible cost of these guarantees has been provided for in the financial statements.

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

	Gross 2012	Impairment 2012	Gross 2011	Impairment 2011
Not past due	61.784	(239)	45.294	(367)
Past due 0-30 days	6.327	(185)	9.910	(179)
Past due 31-120 days	22.637	(3.644)	11.778	(2.936)
Past due 121-365 days	6.572	(3.271)	9.225	(2.724)
More than one year	2.112	(1.329)	2.577	(2.300)
Total	99.432	(8.668)	78.785	(8.507)

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

	2012	2011
Balance at 1 January	8.507	8.760
Exchange rate difference	(26)	0
Impairment loss recognized (reversed)	187	(253)
Balance at 31 December	8.668	8.507

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.

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34. contd.:

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 types and 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, the level of three month operational costs and turnover.

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

31 December 2012	**Carrying amount**	**Contractual cash flows**	**Within 12 months**	**1-2 years**	**2-5 years**	**More than 5 years**
Financial liabilities						
Unsecured bank loans	13.374	18.369	1.665	1.670	5.011	10.023
Secured bank loans	137.532	159.703	37.222	49.141	66.180	7.160
Payables & prepayments	174.297	174.297	152.237	6.913	15.147	0
	325.203	352.369	191.124	57.724	86.338	17.183
Off balance sheet liabilities						
Operating lease payments	0	268.613	46.118	29.974	63.128	129.393
Exposure to liquidity risk	325.203	620.982	237.242	87.698	149.466	146.576
31 December 2011						
Financial liabilities						
Unsecured bond issue	14.274	20.147	1.713	1.672	5.024	11.738
Secured bank loans	182.594	214.984	41.966	48.956	85.979	38.083
Payables & prepayments	162.178	162.177	135.000	14.715	12.462	0
	359.046	397.308	178.679	65.343	103.465	49.821
Off balance sheet liabilities						
Operating lease payments	0	235.121	56.729	34.796	53.108	90.488
Exposure to liquidity risk	359.046	632.429	235.408	100.139	156.573	140.309

Unused loan commitments at year end 2012 amounted to USD 3.9 million (2011: USD 4.1 million).

Market risk

Market risk emerges from changes in market prices, such as foreign exchange rates, interest rates, carbon prices and fuel prices, as those changes 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 spot and forward trading, swaps and 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.

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34. 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 far 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 9 month horizon and uses most importantly spot and forwards, but also options.

Exposure to currency risk

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

2012	**ISK**	**EUR**	**DKK**	**SEK**	**NOK**
Net balance sheet exposure	(31.402)	(18.824)	12.123	7.561	8.684
Forecast revenue	314.927	227.843	37.616	43.468	45.331
Forecast purchases	(347.343)	(160.576)	(13.017)	(3.351)	(4.939)
Forward FX contracts	0	(25.882)	0	0	0
Net currency exposure	(63.818)	22.561	36.722	47.678	49.076

2011	**USD**	**EUR**	**DKK**	**SEK**	**NOK**
Net balance sheet exposure	4.821	(19.804)	2.561	(498)	914
Forecast revenue	342.635	216.232	35.873	40.685	43.303
Forecast purchases	(445.824)	(132.912)	(11.427)	3.336	(5.065)
Forward FX contracts	13.931	(12.594)	0	0	0
Net currency exposure	(84.437)	50.922	27.007	43.524	39.152

The following significant exchange rates of USD applied during the year:

	Average rate		**Reporting date spot rate**	
	2012	**2011**	**2012**	**2011**
ISK	0,0080	0,0086	0,0078	0,0082
EUR	1,29	1,32	1,32	1,33
DKK	0,17	0,18	0,18	0,18
SEK	0,15	0,15	0,15	0,14
NOK	0,17	0,17	0,18	0,17

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34. contd.:

Sensitivity analysis

A 10% strengthening of the USD 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 2011.

	Equity	Profit or loss
2012		
ISK	5.105	5.294
EUR	(1.805)	(2.022)
DKK	(2.938)	(2.938)
SEK	(3.926)	(3.926)
NOK	(3.814)	(3.814)
2011		
USD	6.754	9.731
EUR	(4.070)	(4.282)
DKK	(2.162)	(2.162)
SEK	(3.132)	(3.132)
NOK	(3.483)	(3.483)

A 10% weakening of the USD 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 to 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 2012 amounts to USD 10 thousands.

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

	Carrying amount	
	2012	**2011**
Fixed rate instruments		
Financial assets	21.540	14.502
Financial liabilities	(50.205)	(57.904)
	(28.665)	(43.402)
Variable rate instruments		
Financial liabilities	(100.701)	(138.964)
	(100.701)	(138.964)

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34. 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 2012		
Variable rate instruments	(156)	156
Cash flow sensitivity (net)	(156)	156
31 December 2011		
Variable rate instruments	(424)	424
Cash flow sensitivity (net)	(424)	424

Other market price risk

Fuel price risk

The Group maintains a policy of hedging fuel price exposure by a ratio from 40% and up to 60%, 6 months forward and 20% from 7 to 9 months forward.

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:

	2012	2011	2012	2011
	Effect on equity		Effect on profit before tax	
Increase in fuel prices by 10%	2.909	1.648	0	0
Decrease in fuel prices by 10%	(2.909)	(1.648)	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.

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35. 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:

	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables	144.308	144.308	141.027	141.027
Marketable securities	15.734	15.734	27.284	27.284
Cash and cash equivalents	117.060	117.060	79.405	79.405
Unsecured bond issue	(13.374)	(16.378)	(14.274)	(17.970)
Secured bond loans	(137.532)	(153.598)	(182.594)	(206.708)
Payables and prepayments	(174.297)	(174.297)	(162.178)	(162.178)
Total	(48.101)	(67.171)	(111.331)	(139.141)

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

36. 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 2012. The leases are for 1 Boeing 737, 9 Boeing 757 aircraft and 5 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 2037. During the year USD 56.1 million was recognised as an expense in profit or loss in respect of operating leases (2011: USD 59.9 million). At the end of December 2012 the leases are payable as follows in nominal amounts for each year:

	Real estate	Aircraft	Other	Total 2012	Total 2011
In the year 2012	-	-	-	-	56.729
In the year 2013	11.250	32.293	2.575	46.118	34.796
In the year 2014	11.838	17.238	897	29.973	22.039
In the year 2015	11.224	13.861	728	25.813	19.486
In the year 2016	10.948	8.406	631	19.985	11.582
In the year 2017	10.982	5.700	649	17.331	9.695
Subsequent	123.938	5.455	0	129.393	80.794
Total	180.180	82.953	5.480	268.613	235.121

37. 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 2012 amounted to USD 120.8 million (2011; USD 136.6 million). Contracted leases at year end were as follows:

	2012	2011
In the year 2012	-	83.866
In the year 2013	63.632	45.016
In the year 2014	37.982	17.684
In the year 2015	30.093	16.550
In the year 2016	26.224	8.336
In the year 2017	26.618	0
Subsequent	26.196	0
Total	210.745	171.452

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38. 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 service to Group companies during the year 2012 and the number of shares in the Company held by management are specified below:

Board of Directors:	Salaries and benefits		Number of shares held at year-end 2012 in thousands
Sigurður Helgason, chairman of the board	52.9		10.000
Ásthildur Margrét Otharsdóttir	25.7		
Herdís Dröfn Fjeldsted	29.1	*	
Katrín Olga Jóhannesdóttir	39.7		413
Úlfar Steindórsson	39.2		
Finnbogi Jónsson, former board member	3.5	*	
Magnús Magnússon, alternative board member	7.9	**	
Anna Guðný Aradóttir, former alternative board member	0.6		
Auður Björk Guðmundsdóttir, former alternative board member	0.6		
Key employees:			
Björgólfur Jóhannsson CEO of Icelandair Group hf.	342.3		1.000
Bogi Nils Bogason, CFO of Icelandair Group hf.	282.2		1.000
Birkir Hólm Guðnason, CEO of Icelandair ehf.	285.2		
Guðni Hreinsson, MD of Loftleidir - Icelandic ehf.	210.1		
Seven MD of group companies	1,216.8		6.111

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

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

**One board member has waived his rights to salaries, instead the board agreed to contribute equal amounts to Icelandair's Special Children's Travel Fund.

Transaction with associates

During the year 2012 the Group purchased services from associates for USD 0.1 million (2011: USD 0.2 million). The Group's revenues were USD 0.2 million from associates (2011: USD 0.1 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

There are no shareholders with significant influence at year end 2012. Companies which members of the Board and key employees control have been identified as being eleven. These companies have been identified as related. Transactions with them consist of purchase and sale of services in the ordinary course of business on an arm's length basis. Total purchases in 2012 from these entities amounted to USD 0.1 million (2011: USD 0.1 million). Total sales amounted to USD 0.1 million (2011: USD 0.1 million).

39. Capital commitments

In December 2012 Icelandair Group accepted Boeing's proposal, subject to finalizing a mutual agreement, for the purchase of twelve 737 MAX8 and 737 MAX9 aircraft with purchase rights for additional 12 aircraft. The first delivery to Icelandair is scheduled in the first half of 2018. The commitment for all 12 aircraft is valued at USD 1.2 billion at Boeing list prices in 2011 USD. Through negotiations with Boeing, the Company received acceptable discounts which due to confidentiality agreements cannot be disclosed. Scheduled payments in the year 2013 and 2014 due to the agreement amounts to USD 5.6 million and USD 1.8 million respectively. The Company intends to fund the acquisition partly by internal resources of the Company and partly by loans from commercial banks.

In December 2012 a contract was signed for the purchase of one B757 aircraft which was delivered in January 2013. Total purchase price amounted to USD 8.5 million, of which USD 1.7 million had been paid at year end.

40. Guarantees

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 2015. 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 USD 59.1 million (ISK 7.6 billion). Icelandair Group guarantees that the final sale price will be at least USD 31.1 million (ISK 4.0 billion), however the maximum guarantee is USD 3.9 million (ISK 0.5 billion). If the creditors will receive USD 59.1 million (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. Group entities

The Company holds eleven subsidiaries at the year end 2012. Addition from last year is Feria ehf., a company in Route network segment which started operation in January 2012. The subsidiaries included in the consolidated interim financial statements are as follows:

	Ownership interest	
	2012	**2011**
Route network:		
Air Iceland ehf.	100%	100%
Fjárvakur - Icelandair Shared Services ehf.	100%	100%
Feria ehf.	100%	-
Icelandair ehf.	100%	100%
Icelandair Cargo ehf.	100%	100%
IGS ehf.	100%	100%
Loftleiðir - Icelandic ehf.	100%	100%
Tourism services:		
Iceland Travel ehf.	100%	100%
Icelandair Hotels ehf.	100%	100%
Other operation:		
A320 ehf.	100%	100%
IceCap Ltd., Guernsey	100%	100%
Discontinued operation:		
Smart Lynx, 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.

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42. Statement of cash flows

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

	2012	2011
Expensed long term cost	26.250	31.835
Exchange rate difference and indexation of liabilities and assets	1.023	(277)
Gain from assets held for sale	0	(6.158)
Gain on the sale of operating assets	(2.805)	(2.577)
Share of loss of associates	366	90
Income tax	13.173	(4.763)
Other items	349	1.519
Total other operating items in the statement of cash flows	38.356	19.669

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

Inventories, increase	(2.337)	(2.194)
Trade and other receivables, increase	(11.471)	(5.579)
Trade and other payables, increase (decrease)	17.991	(6.362)
Deferred income, increase	21.070	29.184
Net change in operating assets and liabilities in the statement of cash flows	25.253	15.049

44. Additional cash flow information:

Interest paid	10.129	12.153
Interest received	3.715	5.644

45. Ratios

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

Current ratio	0,94	0,91
Equity ratio	0,39	0,36
Intrinsic value of share capital	7,29	6,49

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Corporate Governance Statement

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. No government organization has found the Company to be in breach with any rule or regulation.

The Iceland Chamber of Commerce, the Confederation for Icelandic Employers and Nasdaq OMX Iceland hf. have granted the Company a recognition for "Exemplary in corporate governance". The aim with the recognition is to increase credibility and transparency of Icelandic companies' corporate governance with respect to shareholders and interested parties.

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
Ásthildur Margrét Otharsdóttir
Herdís Dröfn Fjeldsted

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
Úlfar Steindórsson

The Board of Directors and Executive Committee

Board of Directors

Sigurður Helgason, chairman

Sigurdur Helgason was born in 1946 and he joined the Board on 6 August 2009. 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.

Úlfar Steindórsson, deputy chairman

Úlfar Steindórsson was born in 1956 and he joined the Board on 15 September 2010. He 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.

Ásthildur Margrét Otharsdottir

Ásthildur Margrét Otharsdottir was born in 1968 and she joined the Board on 23 March 2012. Ásthildur is an independent management consultant with prior business experience as Global Director of Treasury and Corporate Development at Össur hf., Senior Account Manager at Kaupthing Bank hf. and Management Consultant at Accenture in Copenhagen. She is Vice-Chairman of the Board of Directors of Marel hf. and a member of the Board of Directors of Marorka ehf., Lagerinn Dutch Holding BV and the Research Center for Business Ethics at The University of Iceland. Ásthildur has an MBA degree from the Rotterdam School of Management, Erasmus University and a Cand. Oecon degree from the University of Iceland.

Herdís Dröfn Fjeldsted

Herdis Drofn Fjeldsted was born in 1971 and she joined the Board on 14 December 2010. She is an investment manager at Framtakssjodur Islands and holds a BSc degree in business administration, a MSc degree in corporate finance from Reykjavik University and is a certified securities broker. Herdis has years of experience in the private equity industry. Most recently, she was a member of the investment team at Thule Investments. Herdis is the Chairman of the Board of Icelandic Group, Chairman of the Board of Wave Operations and a member of the Board of Promens.

Katrín Olga Jóhannesdóttir

Katrin Olga Johannesdóttir was born in 1962 and she joined the Board on 6 August 2009. She 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.

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
Birkir Hólm Guðnason, CEO of Icelandair
Magnea Thórey Hjálmarsdóttir, Managing Director of Icelandair Hotels

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 one 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 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 10 August 2012. 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 twenty five 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, except Ásthildur Margrét Otharsdottir. Sigurdur Helgason, Katrin Olga Johannesdottir, Ásthildur Margrét Otharsdottir and Ulfar Steindorsson were independent from the Company's major shareholders in 2012.

Quarterly statements (unaudited)

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

	Q1	Q2	Q3	Q4	Total
Year 2012					
Operating income	157.698	234.395	317.351	189.422	898.866
Operating expenses without depreciation	(160.746)	(205.577)	(239.412)	(183.485)	(789.220)
Operating (loss) profit bef. depr. (EBITDA)	(3.048)	28.818	77.939	5.937	109.646
Depreciation	(13.675)	(14.304)	(16.792)	(14.088)	(58.859)
Operating (loss) profit (EBIT)	(16.723)	14.514	61.147	(8.151)	50.787
Net finance (expense) income	139	3.317	3.767	(196)	7.027
Share of profit (loss) of associates	(43)	(20)	(157)	(146)	(366)
Profit (loss) before income tax	(16.627)	17.811	64.757	(8.493)	57.448
Income tax	3.438	(3.492)	(13.395)	276	(13.173)
(Loss) profit from continuing operations	(13.189)	14.319	51.362	(8.217)	44.275
Profit from discontinued operation	0	0	0	0	0
(Loss) profit	(13.189)	14.319	51.362	(8.217)	44.275
Other comprehensive income (loss)	(2.570)	(1.945)	1.314	(2.220)	(5.421)
Total comprehensive income (loss)	(15.759)	12.374	52.676	(10.437)	38.854
Working capital (used in) from operations	2.457	38.429	89.771	10.833	141.490
Net cash from (used in) operating activities	86.138	72.214	10.106	(1.715)	166.743
Net cash used in investing activities	(12.509)	(16.826)	(21.489)	(25.652)	(76.476)
Net cash from (used in) financing activities	(25.714)	(10.214)	(9.401)	(6.124)	(51.453)
Translated*					
Year 2011					
Operating income	130.644	204.152	292.561	163.296	790.653
Operating expenses without depreciation	(132.259)	(187.129)	(221.982)	(164.348)	(705.718)
Operating profit (loss) bef. depr. (EBITDA)	(1.615)	17.023	70.579	(1.052)	84.935
Depreciation	(10.090)	(11.941)	(12.798)	(11.484)	(46.313)
Operating (loss) profit (EBIT)	(11.705)	5.082	57.781	(12.536)	38.622
Net finance (expense) income	(3.458)	(1.468)	(3.703)	(1.358)	(9.987)
Share of profit (loss) of associates	8	73	33	(204)	(90)
Profit (loss) before income tax	(15.155)	3.687	54.111	(14.098)	28.545
Income tax	6.011	(351)	(10.359)	9.462	4.763
(Loss) profit from continuing operations	(9.144)	3.336	43.752	(4.636)	33.308
Loss from discontinued operation	0	0	0	3.002	3.002
(Loss) profit	(9.144)	3.336	43.752	(1.634)	36.310
Other comprehensive income (loss)	1.803	(2.659)	3.042	(6.403)	(4.217)
Total comprehensive income (loss)	(7.341)	677	46.794	(8.037)	32.093
Working capital from operations	(4.951)	25.204	76.223	5.816	102.292
Net cash from operating activities	70.000	42.896	(5.285)	9.730	117.341
Net cash used in investing activities	(52.529)	(13.018)	(16.909)	(23.719)	(106.175)
Net cash (used in) from financing activities	9.078	(27.977)	(19.315)	10.612	(27.602)

* See note 2c

Consolidated Financial Statements of Icelandair Group hf. 2012 52 Amounts are in USD thousand