75 | YEARS OF AVIATION

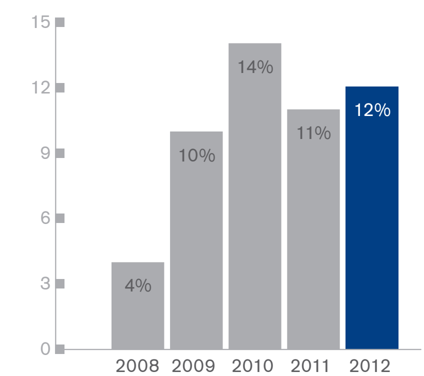
ICELANDAIR GROUP

Annual Report 2012

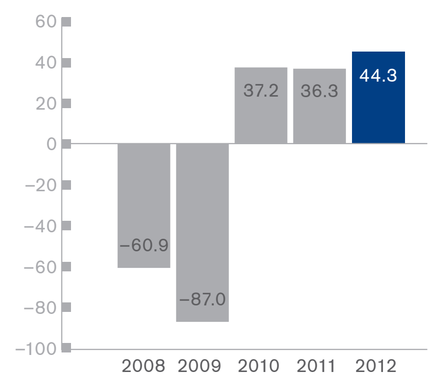
Key Figures

	2012	2011	2010	2009	2008
OPERATING RESULTS					
Total income	898,866	790,653	717,904	655,147	588,899
EBITDAR	165,772	144,788	173,361	142,210	71,949
EBITDA	109,646	84,935	102,594	66,354	24,902
EBIT	50,787	38,622	51,011	12,096	–59,959
EBT continuing operations	57,448	28,548	53,638	–36,452	–73,287
Profit (loss) for the period	44,275	36,310	37,162	–86,990	–60,914
BALANCE SHEET					
Total assets	762,895	729,739	687,104	726,786	815,228
Total equity	295,932	263,385	231,672	119,127	163,785
Interest bearing debt	150,906	196,868	200,685	351,843	355,914
Net interest bearing debt	18,112	90,179	94,698	336,272	322,757
CASH FLOW					
Net cash from operating activities	166,743	117,341	127,838	71,623	36,958
Net cash used in investing activities	–76,476	–106,175	–44,959	–63,613	–60,783
Net cash used in financing activities	–51,453	–27,602	–400	–26,778	25,865
Cash and cash equivalents end of period	117,060	79,405	95,334	15,571	33,157
KEY RATIOS					
Earnings per share USD cent	0.89	0.73	2.50	–8.92	–6.23
Intrinsic value of share capital	7.29	6.49	5.71	14.98	20.59
Equity ratio	39%	36%	34%	16%	20%
Current ratio	0.94	0.91	1.16	0.58	0.43
Capex USD thousand	95,874	125,008	40,905	48,303	64,502
Transport revenue as % of total revenues	67%	64%	61%	59%	58%
EBITDAR ratio	18%	18%	24%	22%	12%
EBITDA ratio	12%	11%	14%	10%	4%

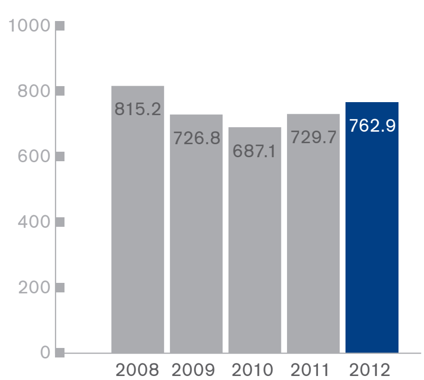
EBITDA % | 2008–2012



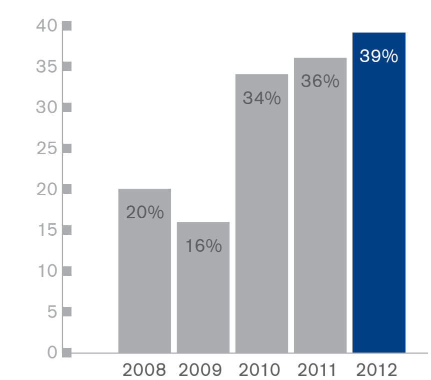
Net profit / loss USD million | 2008–2012



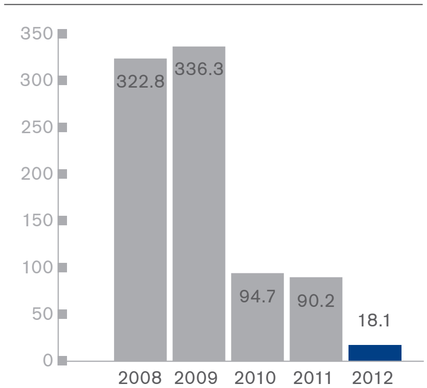
Total assets USD million | 2008–2012



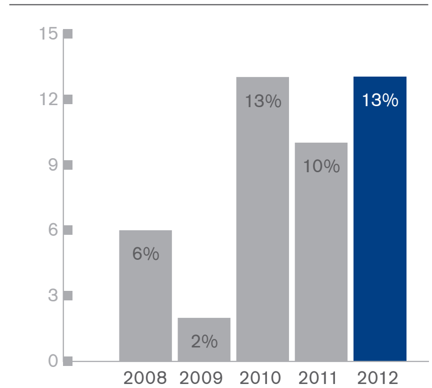
Equity ratio | 2008–2012



Net interest bearing debt USD million | 2008–2012



Cash as % of income | 2008–2012



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About the Annual Report
Icelandair Group's annual report for 2012 is inspired by the Icelandic seasons and their breathtaking natural beauty. The photographs in the report were taken around Iceland and they capture the unique atmosphere that Iceland has to offer. Come and be inspired by Iceland. ■

Design: Íslenska
Photos by AriMagg o.fl.
Printing: Oddi ehf.

01

DID YOU KNOW ... that 2012 was one of the sunniest years on record in Iceland, with 1,587 sunshine hours in Reykjavik.

Our Route Network

Iceland's uniquely central location between Europe and North America is the key to our hub-and-spoke network.

In 2013, our Route Network will connect 25 European cities with 10 North American cities through the Company's hub. The network is based on a 24-hour rotation, with morning and afternoon connections in Iceland.

OUR VALUES

The Group aspires to have a brand synonymous with efficient and reliable operations, sound and trustworthy management, and dependable and flexible services for the benefit of its stakeholders.

- **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.

OUR MISSION

- To operate an integrated network of companies in air travel and related services, providing quality services built on the 75 years´ experience and knowledge of its subsidiaries.
- To create value for customers and other stakeholders by focusing on efficiency and flexibility, as well as synergies between our companies.

Letter to our Shareholders

SIGURÐUR HELGASON,
CHAIRMAN OF THE BOARD OF DIRECTORS OF ICELANDAIR GROUP HF.

Fellow shareholders,

The year 2012 was yet another record year for Icelandair Group. Since 2009 there has been a growing momentum in our operations. This year we continued to deliver organic growth, and the balance sheet went from strength to strength. With a broader service offering than ever, our 75th anniversary year was the most profitable in Icelandair Group's history.

For a quarter of a century the Company has successfully leveraged Iceland's unique geographical position to operate its hub and spoke network through Keflavik International airport. By systematically expanding both the breadth and depth of the Route Network, we have significantly increased the number of passengers in the Route Network and thereby contributed hugely to the growth of tourism in Iceland.

In 2012 Icelandair Group's EBITDA amounted to USD 109.6 million, and net profit before taxes amounted to USD 57.4 million. The financial strength of the Company is indisputable with its equity ratio at 39% and net interest-bearing debt at USD 18.1 million, down by USD 72.1 million from the preceding year. The cash flow remains robust as net cash from operating activities in 2012 amounted to USD 166.7 million, up by USD 49.4 million as compared to 2011.

While we are proud of the operating results the Company has delivered in the last three years, we remain cautiously optimistic about the future. Airline operation and tourism are a seasonal business, and it remains at the top of our agenda to strive continually to increase the flexibility of our business model throughout the business cycle. We are confident that our strategy sets us apart from the competition and that Icelandair Group can adjust quickly to any changes in demand.

Icelandair Group continues to be well supported by its growing shareholder base. The stock market valuation of the Company increased by 63% in 2012, reflecting our strong balance sheet and clear strategy. Market capitalization increased by USD 124.0 million and amounted to USD 319.6 million at year end 2012. The Board of Directors of Icelandair Group has approved a proposal for submission to the Annual General Meeting to pay USD 11.7 million in dividends to our shareholders.

The Board of Directors is grateful to shareholders for their support and we value their commitment to the Company.

NEW FLEET – NEW OPPORTUNITIES

The culmination of the 75th anniversary of Icelandair Group was the announcement that the Company had signed a commitment with the Boeing Company for sixteen 737 MAX8 and 737 MAX9 aircraft with purchase rights for eight additional aircraft. The plan is to fund the acquisition partly through the Company's internal resources and partly through bank financing.

These are new variants of the Boeing 737 aircraft which will first enter service in 2017. The first delivery to Icelandair Group is scheduled for the first half of 2018. The commitment is for nine 737 MAX8 aircraft for 153 passengers in Icelandair's configuration and seven 737 MAX9 aircraft with a capacity of 172 passengers. In comparison, Icelandair's current Boeing 757-200 seats 183 passengers. We believe that the agreement with Boeing will further fortify our position as one of the leading niche operators in the North Atlantic.

The agreement marks a break from the single-type fleet strategy of Icelandair Group in the Route Network. The single-type fleet concept has been the cornerstone of our business strategy for over 15 years. However, Boeing 757s will continue to be the Company's future aircraft in addition to the new aircraft, as it suits the carrier's North Atlantic network perfectly, reaching both Europe and North America from Iceland. The new aircraft will be a great addition to the fleet and increase both flexibility and capacity for growth. The 737 MAX can reach destinations on both sides of the Atlantic and gives the Company new options for added frequency and new destinations, especially in the winter to even out seasonality.

DEDICATION TO ICELAND

Icelandair Group is an operating company engaging in diverse flight and tourist services. Dedication to Iceland lies at the core of our business model. We take pride in actively building up Iceland as a world-class destination. Supporting the growth of tourism in Iceland is good business – and continued sustainable shareholder value remains at the heart of our organic expansion strategy.

Through Icelandair Group's subsidiaries, we hold a strong position across the value chain in international aviation and leasing, in domestic air travel, the hotel market and other areas of tourist services. Our interests are interlinked with the success of Iceland as a tourist destination, and we pride ourselves in promoting Iceland abroad as a year-round destination.

We believe that the single most pressing issue in Icelandic tourism is to reduce inherent seasonal fluctuations. We have backed up our words with actions, as our increase in supply in international aviation has been disproportionally strong over the winter, spring and autumn. It is our vision to continue to invest in tourist infrastructure in Iceland in order to unlock the full potential of the destination. Icelandair Group has vast interests in building up Iceland as a preferred year-round destination, and our commitment to that goal has never wavered.

ONWARDS

The year 2012 was characterized by profitable organic growth. We anticipate still further expansion of our operations in 2013 with the most extensive international flight schedule in our history. Two new aircraft will be added to the Route Network fleet, which is anticipated to include 18 aircraft over the high season in 2013. With 25 destinations in Europe and 10 destinations in North America, we will be transporting more than 2.3 million passengers over the Atlantic.

Looking back at Icelandair Group's history, we have drawn strength from the flexibility of our operations. By serving our three core markets consisting of the TO-FROM-VIA segments, we have three demand pillars to support our operations. This adds to our flexibility and the business case for the hub and spoke system with Iceland as a cornerstone has proven its value time and again.

Our core values, with their focus on offering our customers reliable service, in harmony with our continuing effort to expand our service offering, are the hallmarks of Icelandair Group. We see ample opportunities to continue our profitable organic growth in Iceland and in other markets.

On behalf of the Board of Directors of Icelandair Group, I would like to extend our gratitude to our shareholders, employees and all our other stakeholders for their invaluable contribution to Icelandair Group's continuing success. ■

■ *The culmination of the 75th anniversary of Icelandair Group was the announcement that the Company had signed a commitment with the Boeing Company for sixteen 737 MAX8 and 737 MAX9 aircraft with purchase rights for eight additional aircraft.*

Letter from the President and CEO

BJÖRGÓLFUR JÓHANNSSON
PRESIDENT AND CEO
OF ICELANDAIR GROUP HF.

Fellow shareholders,

Icelandair Group's 75th anniversary year was an eventful one and the Company returned its best operating results ever. Icelandair Group is an operating company comprising subsidiaries that combine their resources to run an international Route Network and Tourist Services. Our approach is clearly reflected in our organizational structure, which facilitates Group synergies, accountability and results. We continue to emphasize operating efficiency through lean management and cost-saving initiatives.

Our focus is clearly set on delivering sustainable shareholder value throughout the business cycle. We are proud of our Company's success and we will strive to do even better next year to the benefit of all of our stakeholders. In all our endeavors we seek to strike a balance between the near-term success and long-term sustainability of our business model. As an operating company we have focused on realizing cost synergies across the Group. The aim is to provide the same or better service at a lower cost than before to the benefit of our shareholders and customers.

From 2009 the operating result of Icelandair Group has been strengthened every year and aggregate EBITDA since 2009 now stands at USD 363.5 million. Although our business environment is inherently seasonal we have systematically addressed the seasonality by deliberately weighting the increased supply in our Route Network in favour of winter, spring and autumn – to the benefit of Iceland as an all-year tourist destination.

BEST OPERATING RESULT EVER

The year was characterized by continued organic growth in our operations, and for the first time in the Company's history we transported more than 2 million passengers in our Route Network. This growth paved the way for a USD 108.2 million increase in total income, which amounted to USD 898.9 million, as compared to USD 790.7 million in 2011. The topline growth supported healthy EBITDA growth and EBIDTA in 2012 amounted to USD 109.6 million, as compared to USD 85 million in the preceding year. Earnings before taxes amounted to USD 57.4 million, as compared to USD 28.5 million in the preceding year.

At the end of 2012 the Company's balance sheet is strong and its liquidity position is good. Equity stands at USD 295.9 million and the equity ratio stands at 39%. Cash and marketable securities have increased by USD 26.1 million from the beginning of the year and amounted to ISK 132.8 million at year-end. Our debt maturity profile is well balanced and our long-term funding is sound.

The Company is therefore in good shape for continued profitable growth. Prospects in the Company's operations are favorable, and we forecast EBITDA in the range of USD 115–120 million in 2013.

Since the share issue at year-end 2010 the number of shareholders has continued to increase, and at year end 2012 the Company had 1,458 shareholders. A number of Icelandic pension funds hold more than half of the share capital, giving the majority of Icelanders an indirect stake in the Company. We take that responsibility seriously and are determined to continue to deserve their trust. The total return to shareholders in 2012 was 67%, as compared to 60% in 2011. The substantial increase in our market capitalization is welcomed by our shareholders who have never wavered in their support for the Company.

CONTINUED ORGANIC GROWTH

We believe we can always do better and we remain focused on organic growth and cost-saving initiatives. We continue to invest in our infrastructure to facilitate continued growth and to streamline our operations. We expect competitive pressures to continue to mount and we feel that the Company is well placed to meet the increasing competition going forward. We remain committed to our unique business model, which gives us a strong footing in a competitive landscape.

We are committed to the Group concept and we believe that our individual subsidiaries gain strength from operating as a part of Icelandair Group. We are stern believers in continuous improvement and we continue to review our approach and extend our targets. There are many examples to draw from, but the fact that we have the same number of employees in the Route Network in 2012 as we did in 2007 speaks volumes about the scalability of our business model.

DELIVERING ON PROMISES TO SHAREHOLDERS

Our mantra is to be short on promises but long on delivery. In 2009 we told our shareholders that we intended to expand Icelandair's operations, and in 2010, 2011 and 2012, respectively, we delivered an average internal growth of 16% with a further 15% growth projected in 2013.

Since 2010 we have informed the market of progress in establishing a future fleet strategy for the Group, and in December 2012 we completed an agreement with the Boeing Company to acquire sixteen new Boeing 737 MAX aircraft with an option to acquire eight more aircraft.

In my address to shareholders in 2011 I discussed the importance of maintaining a constructive dialogue with our shareholders and rebuilding confidence in the Icelandic stock market, and in 2012 the Centre for Corporate Governance at the University of Iceland selected Icelandair Group as the first Nasdaq OMX listed company in Iceland to receive its "Exemplary in Corporate Governance" award.

Finally, in accordance with the dividend policy set in 2011, the Board of Directors is proposing a payment of USD 11.7 million in dividends to shareholders in 2013.

These examples are evidence of our consistent implementation of a strategy based on a clear vision of delivering sustainable shareholder value.

WELL PLACED FOR FURTHER GROWTH

Our success is inextricably linked to the success of Iceland as a tourist destination. We believe that our contribution is valuable and we are committed to persisting in our efforts to market Iceland abroad. Although Icelandair Group has grown considerably in size in the last four years, we see ample opportunities for further profitable growth on the horizon.

The Icelandic winter is an underutilized potential resource which needs to be leveraged further to increase the efficiency and profitability of Icelandair Group and Icelandic tourism as a whole. We have taken decisive steps towards leveling the seasonal fluctuations inherent in our line of business and will continue to do so in 2013. To facilitate the growth in the number of tourists visiting Iceland we have indicated that in the near future we will support tourist infrastructure projects in Iceland that fit the criteria of further establishing Iceland as an all-year tourist destination.

We pride ourselves on our pioneering spirit. Our strong workforce remains dedicated to doing better each year. The pioneering spirit of our Company has never been stronger and our dedication to excellence remains steadfast. ■

■ We believe we can always do better and we remain focused on organic growth and cost-saving initiatives. We continue to invest in our infrastructure to facilitate continued growth and to streamline our operations. We expect competitive pressures to continue to mount and we feel that the Company is well placed to meet the increasing competition going forward. We remain committed to our unique business model, which gives us a strong footing in a competitive landscape.

■ 02

DID YOU KNOW … that at 81 years Iceland ranks 19th in the table of life expectancy among 222 nations.

Welcome to Icelandair Group

Icelandair Group focuses on the international airline and tourism sectors, with Iceland as the cornerstone of an international Route Network.

The business concept of Icelandair Group is based on the international Route Network and on marketing Iceland as a year-round destination. In the course of 2012 the Group employed an average of 2,532 full time employees, generated total revenues of USD 899 million and carried approximately 2.4 million passengers on its international and regional routes.

in the North Atlantic market is less than 1%, Icelandair is a key factor in the Group's operation, and its operating result is the largest determining factor in the Group's overall result. Due to its immense size and the nominal size of the market share held by Icelandair, the North Atlantic market serves in effect as a large, virtually untapped reservoir of passengers.

ICELANDAIR ROUTE NETWORK IS THE MAIN DRIVE IN ALL OF OUR OPERATIONS

Icelandair Group is the parent company of nine subsidiaries that form the two business segments of Route Network and Tourist Services.

The main focus of the Route Network is to operate flights based on the hub and spoke concept between Europe and North America, across the Atlantic, via Iceland. The focus of the Tourist Services business segment is on catering to the growing demand for universal services for tourists in Iceland and on offering a wide variety of support services relating to airline operations.

Icelandair, an international airline, is the Group's largest and most important subsidiary. Even though its market share

In addition to passenger flights operated by Icelandair, the Group has extensive interests in most of the ancillary segments of Icelandic tourism and aviation, including hotel chains, travel agencies, regional airline and cargo company, support services, ground handling and technical services, as well as a ACMI and lease operation.

OUR ORGANISATION

The Group's management emphasises the importance of collaboration between subsidiaries, as highlighted in the segmentation of the Group into the Route Network and Tourist Services. The business segmentation stresses the

ICELANDAIR GROUP HAS TWO BUSINESS SEGMENTS

ROUTE NETWORK

- Scheduled Airlines
- Cargo
- Ground Services
- Leasing and Charter
- Financial Services

TOURISM SERVICES

- Hotels
- Tour Operations
- Mice

GROUP FINANCE AND OPERATIONS

importance of subsidiaries focusing on a Group-wide approach in their day-to-day operations. The Company recognises that one of its principal strengths lies in its employees. Its operations require a wide range of knowledge and specialised personnel in fields such as aviation technology, international marketing, finance and management.

OUR STRATEGY

Icelandair Group's strategy is to focus on air travel, flight transport and aircraft fleet operations, as well as related operations that best serve our customers and strengthen our organization.

- We focus on organic growth and business development through investment in suitable opportunities;
- We improve efficiency and consolidate operations where appropriate;
- We strive to achieve greater synergies among our companies.

THE ROUTE NETWORK IS OUR CORNERSTONE

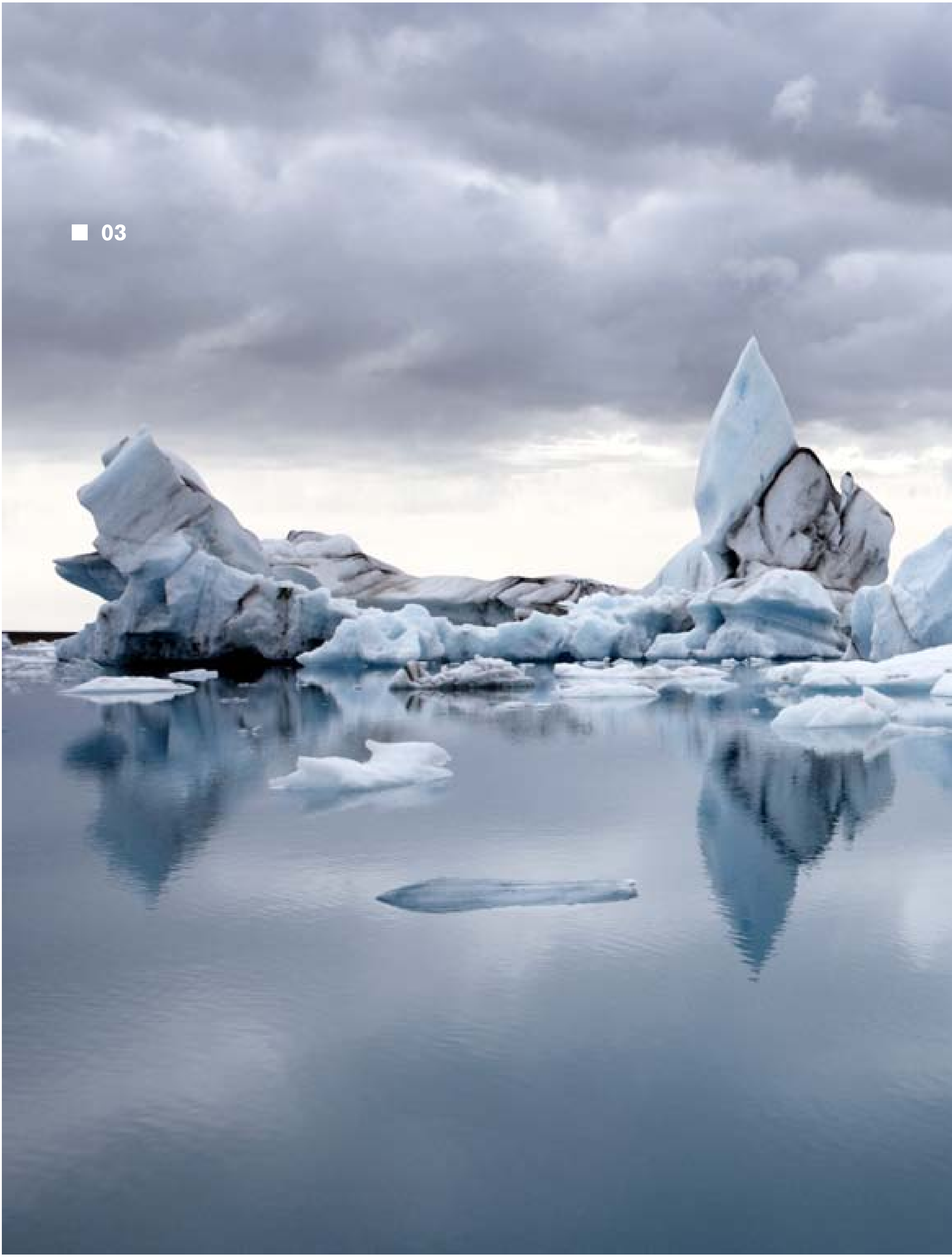
We fly to 35 destinations in our international Route Network: 10 destinations in the USA and Canada and 25 destinations in Europe. Our Route Network is based on a 24-hour rotation with morning and afternoon connections through our hub in Iceland.

In our international network we operate a single-type fleet of Boeing 757 aircraft, which fits extremely well with our operations and creates significant cost efficiency. At year-end 2012 the fleet consisted of 39 aircraft, with 24 aircraft owned by the Group and 15 aircraft on lease.

THE GROUP APPROACH

Icelandair Group is working to sharpen its focus on its core operations and actively encourages cross-selling between its two business segments. This includes utilising unused belly space on scheduled flights for freight and short- and long-term leasing of aircraft in low season, to name just two aspects of the Group's wide approach to the achievement of synergies.

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


03


DID YOU KNOW ...
that Iceland is the second largest island in Europe.

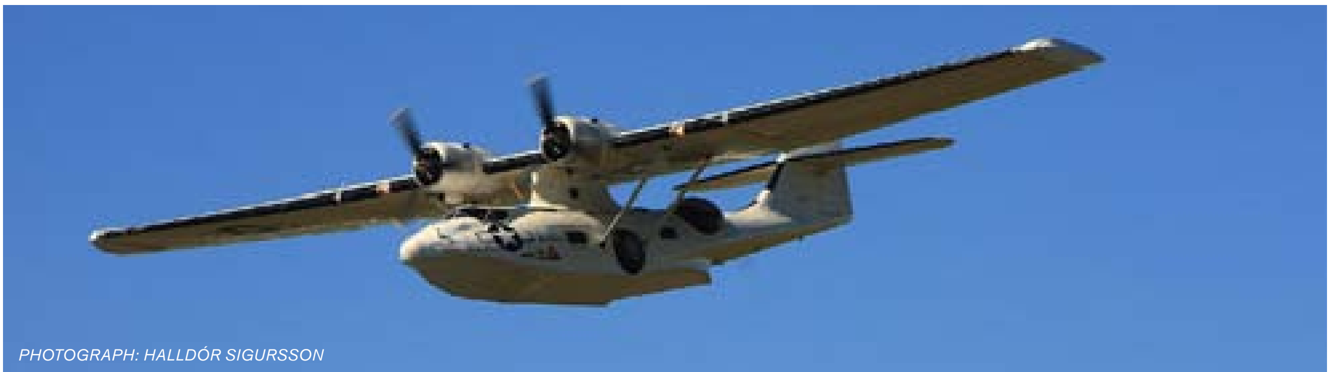
PHOTOGRAPH: SIGURÐUR ANTON ÓLAFSSON

The 75th Anniversary Year

Icelandair Group celebrated its 75th anniversary by drawing attention to its proud heritage of offering excellent service through a remarkable period of history, and by showcasing a company vibrant with the pioneering aviation spirit of its founders.

This was achieved by adding extra presence, colour and spice to regular activities such as advertising, meetings, publications and events, and by arranging a variety of special anniversary celebrations.

The 75th Anniversary Year, continued:



PHOTOGRAPH: HALLDÓR SIGURSSON

THE REYKJAVIK AIR SHOW at the end of May and a visit to Iceland by a Catalina flying boat were a great success. Tens of thousands of people visited the air show, mainly families, enjoying a day out. The Catalina has a special relevance for Icelandair, as it was for many years an important part of the Company's fleet.

A COMMEMORATIVE ICELANDAIR GROUP ANNIVERSARY BOARD MEETING

was held in Akureyri on June 2. At the meeting the Board of Directors agreed to support the University of Akureyri in its research into tourism in Iceland with a grant. The Board of Directors also agreed to achieve environmental certification for all companies within the Group in 2016.

AN "ICELANDAIR CAFÉ"

was opened for a few weeks during the summer at Lækjartorg, a popular spot in the center of Reykjavik to commemorate the anniversary. The café enjoyed great success.

IN REYKJAVÍK CITY HALL AN EXHIBITION

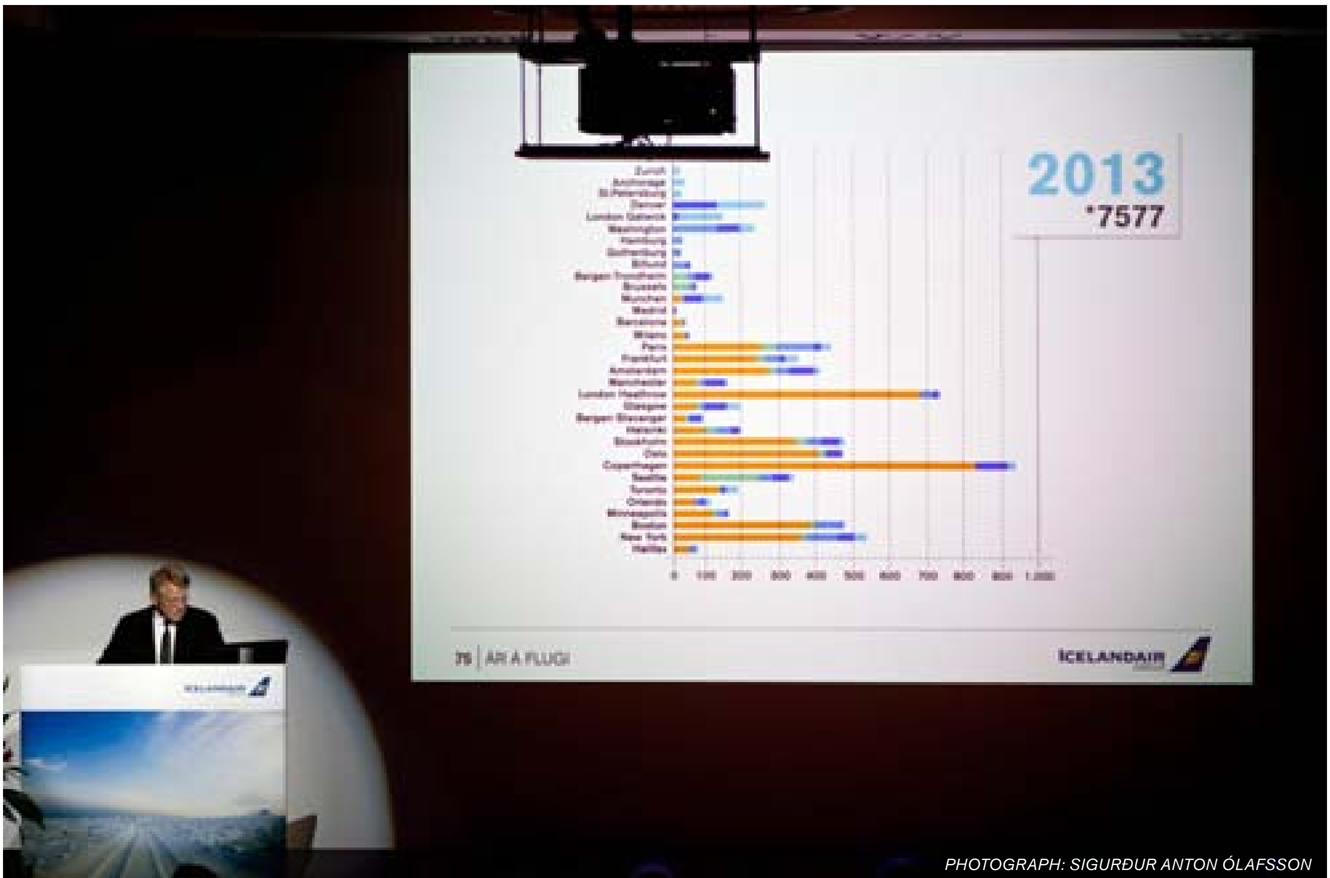
was opened which showcased historical cabin crew uniforms. Also on display were various historical items showing different procedures and equipment used through the 75 years of operations. The exhibition attracted great interest and was well attended.

FLYING BACK IN TIME

Museum of flight and uniform exhibition in Reykjavik City Hall
27 September to 7 October.

Formal anniversary celebrations ended with an employee get-together with the band **STUÐMENN**, on October 20.

The 75th Anniversary Year, continued:



PHOTOGRAPH: SIGURÐUR ANTON ÓLAFSSON

A CONFERENCE UNDER THE HEADING OF “THE FUTURE OF ICELANDIC TOURISM”

was held at the Hilton Reykjavik Nordica on 25 September, with over 500 guests. The conference featured discussions of the situation in the tourist sector and its future prospects from various perspectives.

Mr. Ólafur Ragnar Grímsson, President of Iceland:

AN INTERNATIONAL STOPPING POINT

In his address, the President recounted his experience and vision of the impact that the growing interest in Iceland is having on the national self-image and the country's future as a tourist destination, he predicted that a year of two million tourists was not far off.

Magnea Þórey Hjálmarsdóttir, Manging Director, Icelandair Hotels:

THE CHALLENGE OF GROWING PROPERLY

Magnea discussed the tourist infrastructure and the possibilities of achieving the objective of Iceland as a year-round destination and the interests at stake.

Søren Robert Lund, architect:

ICELAND AS A PARK

Søren Robert has been in charge of design and development at the Tivoli Amusement Park in Copenhagen for 15 years. He has visited Iceland numerous times and has interesting ideas on the ways in which architecture and design can change the experience of tourism in Iceland and elsewhere.

Gregg Andersen, General Manager at the New Zealand Tourist Board:

THE NEW ZEALAND STORY

For the people who work in tourism in Iceland, meeting a colleague from New Zealand is almost like looking in a mirror: although the countries are on different sides of the world, the tasks and the product are incredibly similar: small island nations with striking natural features at a considerable distance from their principal markets. Gregg has worked both in the UK and the US on marketing New Zealand as a tourist destination and he shared his experience and ideas with the audience.

Emiliano Duch, President of Competitiveness in Barcelona:

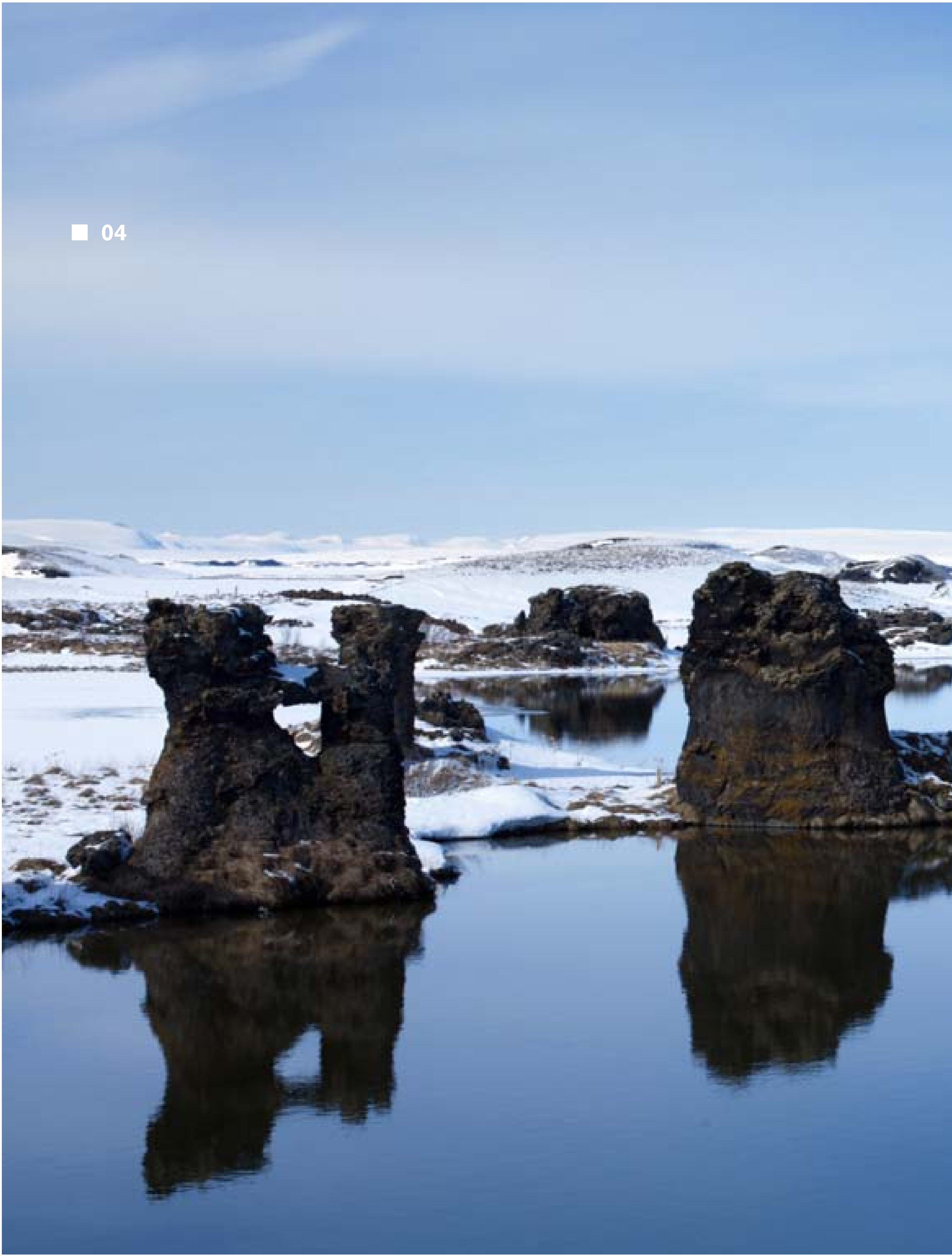
MEANS OF INCREASING PROFITS FROM TOURISM

Emiliano is not only one of the pioneers and leading experts on cluster theory; he is thoroughly familiar with conditions in Iceland and has for a number of years been observing the possibilities of the Icelandic tourist industry. He spoke about the competitive position and possibilities of co-operation between business undertakings and organisations with a focus on increased profitability and growth.

Björgólfur Jóhannsson, Icelandair Group President and CEO:

WHAT LIES AHEAD?

Icelandair Group's impact on tourism in Iceland is significant, and the ongoing developments within the Company will affect most of the people and businesses that work in the sector. Björgólfur gave an account of the Group's current situation and future vision – the development of the Route Network, the competitive position, marketing work abroad, profitability in the sector – and what we can expect in the coming months and years.


04


DID YOU KNOW …
that the highest tree in Iceland, a Sitka spruce planted in 1949 at Kirkjubæjarklaustur in South Iceland, streches up to 25.2 metres.

Quarterly Overview

Q1

PERFORMANCE EXCEEDED MANAGEMENT EXPECTATIONS

Icelandair Group returned a net loss of USD 13.2 million in Q1 2012, as compared to a net loss of USD 9.1 million in Q1 2011. The quarter was characterised by continued organic growth. The increase in income amounted to 21% between years, with passenger revenues up by 31%. The number of passengers increased in all of the Company's markets. The greatest increase was in the tourist market to Iceland, which had a positive impact on all Icelandic tourist services.

NEW LOUNGE IN KEFLAVIK

A new Saga Lounge was opened in the Leif Eiriksson Air Terminal in Keflavik following a complete renovation. In recent years, Icelandair Group has been strengthening its focus on Icelandic nature and culture in its services and corporate image, and this is reflected in the changes made to the lounge. One of the purposes of the new-look lounge is to promote Iceland as a destination for travellers en route across the North Atlantic with a brief stopover in Iceland.

LARGE PUBLIC LEVIES ON DOMESTIC AIR TRAVEL IN ICELAND

At the beginning of the year the government announced plans for significant increases in public charges on passengers travelling on domestic flights. The increases in these levies, which have doubled in the last three years, have been very burdensome for the company.

ICELANDAIR MOST PUNCTUAL EUROPEAN AIRLINE

Icelandair was ranked as the most punctual airline in the Association of European Airlines (AEA) with 90.6% punctuality on international flights in February. The company attaches great importance to punctuality, and the AEA comparison with the major European airlines shows that we are doing well.

	Measurement	Company	Q1 2012	Q1 2011	Change from LY
Revenues	USD million	Icelandair Group	157.7	130.6	27.1
EBITDA	USD million	Icelandair Group	−3.0	−1.6	−1.4
Net loss	USD million	Icelandair Group	−13.2	−9.1	−4.1
Assets	USD million	Icelandair Group	780.3	745.8	34.5
Equity ratio	%	Icelandair Group	31	30	0.9 ppt
Net interest bearing debt	USD million	Icelandair Group	25.6	42.3	−16.7
Passengers	thousand	International flights	305	258	18%
Load factor	%	International flights	75.4	71.1	4.3 ppt
Passengers	thousand	Regional and Greenland flights	78	75	4%
Load factor	%	Regional and Greenland flights	68.7	68.8	1.6 ppt
Freight tonn kilometres	thousand	Cargo	22	19	19%
Room utilization	%	Hotels	61.8	52.5	9.3 ppt

Q2

PROFITABLE ORGANIC GROWTH IN Q2 2012

The Company's results in the second quarter were good, and considerably better than in the same period of 2011. The quarter was characterised by profitable organic growth, particularly in the Company's international flight operations. The number of passengers grew significantly, especially in the market between Europe and North America.

CONTRACT SIGNED ON EQUIPPING THE ICELANDAIR FLEET WITH HIGH-SPEED WIFI CONNECTION FOR PASSENGERS

A contract with the American company Row 44 was signed in May to equip the fleet servicing the international Route Network with high-speed WiFi. The new connection will enable passengers to use their own WiFi-enabled devices to connect to the internet. The installation work is scheduled to be completed in autumn 2013.

NEW HOTEL OPENED IN DOWNTOWN REYKJAVIK

A new Hotel, Icelandair Hotel Reykjavik Marina, was opened in April, The hotel is well located in the harbour district of downtown Reykjavik. It has 108 rooms and features a gym, bar and restaurant and has been well received by guests.

ENVIRONMENTAL POLICY APPROVED

In early June the Board of Directors of Icelandair Group approved an environmental policy on the occasion of the Company's 75th anniversary. The policy highlights the Company's vision that nature is the principal attraction for tourists visiting Iceland, and that preservation and restoration of Iceland's environment and natural resources is essential to Icelandair Group's growth and success. Several of the Group's companies have achieved environmental certification, but with the adoption of the environmental policy the Board of Directors has set a goal for all the companies in the Group to complete the work needed for certification by 2016.

	Measurement	Company	Q2 2012	Q2 2011	Change from LY
Revenues	USD million	Icelandair Group	234.4	204.2	30.2
EBITDA	USD million	Icelandair Group	28.8	17.0	11.8
Net profit	USD million	Icelandair Group	14.3	3.3	11.0
Assets	USD million	Icelandair Group	821.7	771.5	50.2
Equity ratio	%	Icelandair Group	31	29	1.9 ppt
Net interest bearing debt	USD million	Icelandair Group	–22.0	27.5	–49.5
Passengers	thousand	International flights	548	464	18%
Load factor	%	International flights	82.1	79.4	2.7 ppt
Passengers	thousand	Regional and Greenland flights	88	87	0%
Load factor	%	Regional and Greenland flights	67.9	67.2	0.6 ppt
Freight tonn kilometres	thousand	Cargo	23	18	27%
Room utilization	%	Hotels	72.0	70.1	1.9 ppt

Quarterly Overview, continued:

Q3

STRONG RESULTS IN Q3

The Company's performance in Q3 was good, with net profit at USD 51.4 million, up by USD 7.6 million over the corresponding period of last year. The performance of a number of airline companies in the world has been deteriorating as a result of the unstable economic conditions and persistently high fuel prices. It was therefore particularly satisfying to observe the good results being achieved by Icelandair Group at the same time.

THREE NEW DESTINATIONS IN 2013 ANNOUNCED

The Company announced in August that three new destinations would be added to the international Route Network in 2013. The destinations are Anchorage, Alaska, St. Petersburg, Russia, and Zurich, Switzerland. Anchorage will offer passengers traveling between Alaska and Europe a shorter and more economical way of reaching their destinations. The flights to St. Petersburg will be the first direct scheduled flights in the Company's history from Iceland to Russia, a milestone in Iceland's aviation history. The flights to Zurich will strengthen the Company's position in the Mid-European tourist market and increase the options available to the Company's Trans-Atlantic passengers.

INCREASED CAPACITY IN INTERNATIONAL FLIGHTS IN 2013

The international flight schedule for Icelandair Group in the year 2013 will be 15% more extensive than the 2012 schedule and largest in the Company's history. The increase is mainly due to the greater frequency of flights to existing destinations. The number of passengers in 2013 is projected at close to 2.3 million, as compared to just over 2 million in 2012 . According to the flight schedule the growth is projected to be relatively greater over the winter than in the summer, which is in line with the Company's strategy of reducing seasonality in its operations.

	Measurement	Company	Q3 2012	Q3 2011	Change from LY
Revenues	USD million	Icelandair Group	317.4	292.6	24.8
EBITDA	USD million	Icelandair Group	77.9	70.6	7.3
Net profit	USD million	Icelandair Group	51.4	43.8	7.6
Assets	USD million	Icelandair Group	794.7	745.4	49.3
Equity ratio	%	Icelandair Group	39	36	2.1 ppt
Net interest bearing debt	USD million	Icelandair Group	–9.5	50.2	–59.7
Passengers	thousand	International flights	745	671	11%
Load factor	%	International flights	84.0	83.4	0.7 ppt
Passengers	thousand	Regional and Greenland flights	101	105	–4%
Load factor	%	Regional and Greenland flights	68.9	71.1	–2.3 ppt
Freight tonn kilometres	thousand	Cargo	21	19	8%
Room utilization	%	Hotels	85.5	83.2	2.3 ppt

Q4

FOURTH QUARTER PERFORMANCE IMPROVES BETWEEN YEARS

Operations in the fourth quarter were very successful, with EBITDA at USD 5.9 million, up by USD 7.0 million between years. The capacity on international flights was increased by 26% from the fourth quarter of last year, and the number of passengers increased by 21% in the same period. The increase was greatest on the North Atlantic routes, as it was in the previous quarters. It was extremely satisfying to observe the number of our passengers increasing, an important winter boost for the tourist undertakings in Iceland. The increase is in line with our strategy of reducing seasonal fluctuations still further and developing Iceland as a year-round destination.

EXEMPLARY IN CORPORATE GOVERNANCE

The Iceland Chamber of Commerce, the Confederation of Icelandic Employers and the Centre for Corporate Governance at the University of Iceland recognised Icelandair Group as "Exemplary in Corporate Governance" in December 2012. Icelandair Group is the first listed company in Iceland to receive this recognition.

ORDERS FOR NEW AIRCRAFT FROM BOEING

Icelandair Group and Boeing signed a commitment in December for 737 MAX aircraft with an option to purchase additional aircraft. The agreement was finalised in February 2013 and included sixteen 737 MAX8 and 737 MAX9 firm orders as well as purchase rights for eight additional 737 MAXs. The aircraft are new variants of the Boeing 737 aircraft, scheduled to enter into service in 2017. The first delivery to Icelandair Group is scheduled for the first half of 2018. The 737 MAX incorporates new and more efficient engines, and fuel savings compared to the present fleet of Boeing 757s are estimated at more than 20% per seat.

TWO MILLION PASSENGERS

On 22 December Icelandair Group transported its two millionth passenger of 2012. This is the first time in the Company's 75-year history that the number of passengers on scheduled flights exceeds two million in a year. The earlier record was set last year, when passengers numbered just short of 1.8 million. According to the Company's forecast for 2013, the number of passengers is projected to grow by 300 thousand, bringing the year's total to 2.3 million. The number of passengers in the Route Network has grown rapidly in recent years following the reductions in 2008 and 2009 resulting from the collapse of the banking sector in Iceland. ■

	Measurement	Company	Q4 2012	Q4 2011	Change from LY
Revenues	USD million	Icelandair Group	189.4	163.3	26.1
EBITDA	USD million	Icelandair Group	5.9	–1.1	7.0
Net loss	USD million	Icelandair Group	–8.2	–1.6	–6.6
Assets	USD million	Icelandair Group	762.9	729.7	33.2
Equity ratio	%	Icelandair Group	39	36	3.0 ppt
Net interest bearing debt	USD million	Icelandair Group	18.1	90.2	–72.1
Passengers	thousand	International flights	423	350	21%
Load factor	%	International flights	76.7	77.9	–1.2 ppt
Passengers	thousand	Regional and Greenland flights	77	80	–4%
Load factor	%	Regional and Greenland flights	72.1	65.7	6.4 ppt
Freight tonn kilometres	thousand	Cargo	23	22	6%
Room utilization	%	Hotels	58.5	54.4	4.1 ppt

05

DID YOU KNOW ... that 38% of the members of the Icelandic parliament, Alþingi, are women.

Performance in 2012

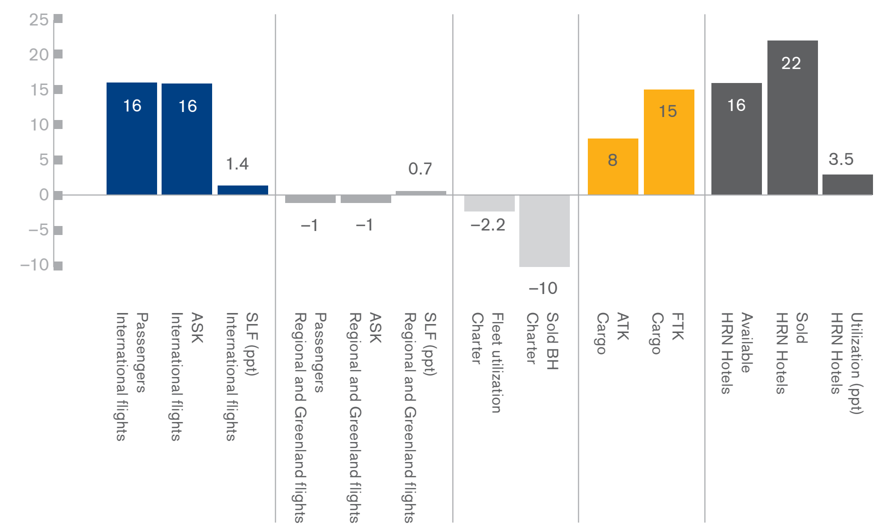
The year 2012 was characterised by profitable organic growth and successful operation of the Company's largest business units. Earnings before taxes amounted to USD 57.4 million, as compared to USD 28.5 million in the preceding year. It is apparent that the Company's clear strategy, its focus on core business operations and the dedication of our staff are the key to these excellent results.

TRANSPORT FIGURES

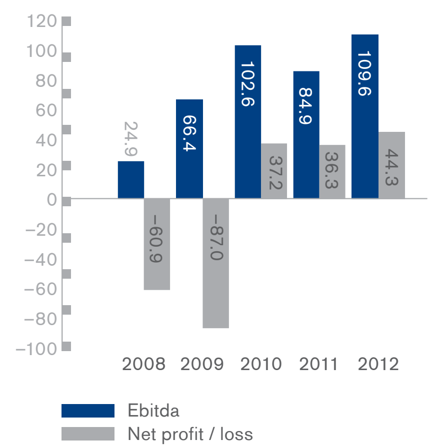
Capacity on international flights was increased by 16% from 2011. Passengers numbered 2.0 million, up by 277 thousand, or 16%, from the preceding year. The passenger load factor was the best in the Company's history, at 80.6%, by 1.4 percentage points. Passengers on regional and Greenland flights were 343 thousand, down by 1% between years. The number of sold hours in charter projects decreased by 10% from 2011. The decrease is due to the reduction by one aircraft deployed in charter cargo flights from last year and a reduced demand for charter services. Air freight on scheduled flights increased by 15% over the year. Available nights in our hotels were 294 thousand in all, up by 16% between years. The utilization of hotel rooms was 71.4%, as compared to 67.9% in 2011.

	2012	2011	Change
INTERNATIONAL FLIGHTS			
Number of passengers (´000)	2,020	1,744	16%
Load factor (%)	80.6	79.2	1.4 ppt
Available seat kilometers (ASK´000)	7,175,753	6,173,389	16%
REGIONAL AND GREENLAND FLIGHTS			
Number of passengers (´000)	343	347	–1%
Load factor (%)	69.2	68.5	0.7 ppt
Available seat kilometers (ASK´000)	177,786	180,103	–1%
CHARTER FLIGHTS			
Fleet utilization (%)	91.3	93.5	–2.2 ppt
Sold Block Hours	31,104	34,524	–10%
CARGO			
Available tonne kilometers (ATK´000)	181,902	168,759	8%
Freight tonne kilometers (FTK´000)	89,381	77,991	15%
HOTELS			
Available hotel room nights	294,240	253,052	16%
Sold hotel room nights	210,114	171,924	22%
Utilization of hotel rooms (%)	71.4	67.9	3.5 ppt

Traffic figures | YOY change in %



Ebitda and net profit /loss
USD million | 2008–2012



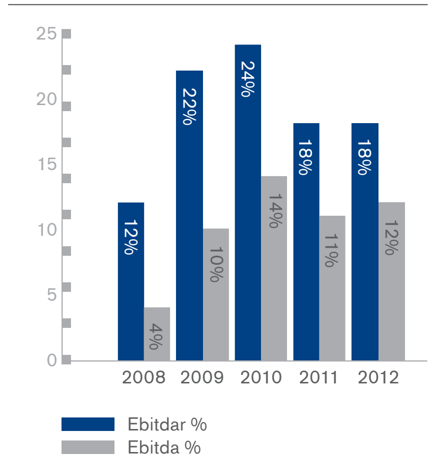
EARNINGS DEVELOPMENT

2012 result best ever

Icelandair Group returned the highest EBITDA in 2012 since its listing on the Nasdaq OMX Iceland Stock Exchange in 2006. The year was characterised by organic growth, and the operation of the Company's largest units was successful. Income increased by 14% from the preceding year. Net profit at year-end 2012 stood at USD 44.3 million, up by USD 8.0 million, between years. EBITDA was USD 109.6 million, in line with our forecast, increasing by USD 24.7 million between years.

USD thousand	2012	2011	Change
EBITDAR	165,772	144,788	20,984
EBITDA	109,646	84,935	24,711
EBIT	50,787	38,622	12,165
EBT	57,448	28,545	28,903
Profit for the period	44,275	36,310	7,965
EBITDAR %	18.4	18.3	0.1 ppt
EBITDA %	12.2	10.7	1.5 ppt

Ebitdar % and Ebitda % | 2008–2012



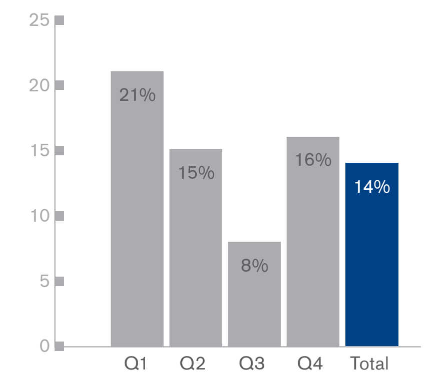
INCOME

Operating income amounted to USD 898.9 million in 2012, as compared to USD 790.7 million in 2011, increasing by 14% between years. Operating income is divided into three main categories as shown in the table below:

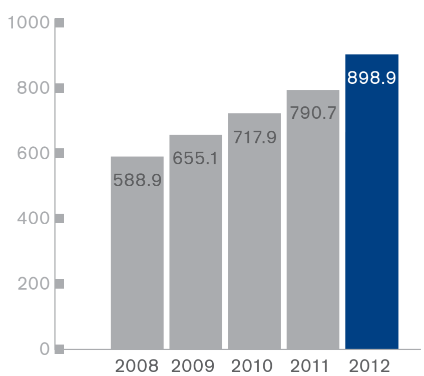
USD thousand	2012	2011	Change	Change in %	% of rev. '12
Transport revenue	604,499	507,463	97,036	19%	67%
Aircraft and aircrew lease	120,815	136,615	−15,800	−12%	13%
Other operating revenue	173,552	146,575	26,977	18%	19%
Total	**898,866**	**790,653**	**108,213**	**14%**	**100%**

Performance in 2012, continued:

Total income
Change per quarter | 2012 vs. 2011



Total income in USD million | 2008–2012



Organic growth

Transport revenue totalled USD 604.5 million, up by 19% from 2011. Transport revenue counts for 67% of Icelandair Group's total income. Of this figure, passenger revenues amounted to USD 564.9 million, increasing by 20%. The capacity increase in our Route Network in 2012 was 16%, placing the load factor at a record 80.6%, 1.4 percentage points above the 79.2% load factor in 2011. Passenger revenue increased on all of our three markets: the home market from Iceland, the tourist market to Iceland and the via market between Europe and North-America.

Decrease in aircraft and aircrew lease revenue

Aircraft and aircrew lease revenue amounted to USD 120.8 million in 2012, as compared to USD 136.6 million in 2011, down by 12%. The reason for the decrease is that the number of aircraft in the charter cargo fleet was reduced by one from last year and the demand for charter services declined.

Other revenue increased by 18%

Other revenue totalled USD 173.6 million in 2012, up by USD 27.0 million from last year. Icelandair Group has focused on increasing the number of tourists visiting Iceland. In the year 2012 the increase on the tourist market to Iceland was 17%, which had a positive impact on revenue from tourist-related services and sales of room nights in the Group's hotels.

EXPENSES

Operating expenses amounted to USD 789.2 million in 2012, as compared to USD 705.7 million in 2011, an increase of 12% between years.

USD thousand	**2012**	**2011**	**Change**	**Change in %**	**% of exp. '12**
Salaries and other personnel expenses	203,815	186,044	17,771	10%	26%
Aircraft fuel	219,877	179,560	40,317	22%	28%
Aircraft and aircrew lease	75,795	83,931	−8,136	−10%	10%
Aircraft handling, landing and communication	65,651	58,083	7,568	13%	8%
Aircraft maintenance expenses	52,993	58,515	-5,522	−9%	7%
Other operating expenses	171,089	139,585	31,504	23%	22%
Total	**789,220**	**705,718**	**83,502**	**12%**	**100%**

Employee cost increased by 10%
Salaries and other personnel expenses amounted to USD 203.8 million, increasing by USD 17.8 million from 2011. The reason is primarily the increased capacity on the Company's international flights and contractual salary increases between years. The average number of full-time employees was 2,532 in 2012, as compared to 2,350 in 2011.

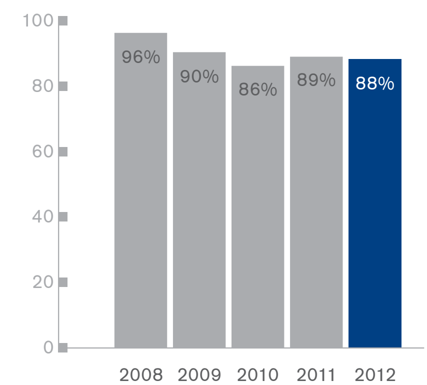
Fuel cost 28% of total cost
Fuel cost totalled USD 219.9 million in 2012, up by USD 40.3 million, which represents a 22% year-on-year increase. The difference is explained by the increase in production between years. The world market price of fuel remained high in 2012, with the average price increasing slightly between years. The average price in 2011 was USD 1,015/ton, as compared to USD 1,028/ton in 2012.

Other expenses increased by 23%
Aircraft and aircrew lease decreased by USD 8.1 million between years, or 10%, owing to the purchase of two Boeing 757-200 at the end of 2011 and one Boeing 757-200 at the close of the first quarter of 2012, which were all previously held on long-term lease contracts. One Boeing 757-200 cargo aircraft was returned in the first half of the year. Aircraft handling, landing and communication expenses amounted to USD 65.7 million, increasing by 13% between years as a result of the increase in capacity. Maintenance expenses amounted to a total of USD 53.0 million, decreasing by 9%. Other expenses amounted to USD 171.1 million, up by USD 31.5 million, or 23%, between years. The increase is mostly a result of contracted services required by the Company because of the increase in the number of tourists to Iceland and expenses relating to increased sales, such as booking fees, credit card fees and agents' costs.

Depreciation and amortisation amounted to USD 58.9 million
Total depreciation of operating assets amounted to USD 57.7 million in 2012, as compared to USD 44.6 million in 2011. Amortisation of intangible assets totalled USD 1.1 million, decreasing by USD 0.6 million from 2011. No impairments were made in 2012.

Net finance income increased in 2012
Net finance income totalled USD 7.0 million in 2012, as compared to a net financial cost of USD 10.0 million in 2011. The biggest contributing factor was the currency effect, which was positive in 2012, amounting to USD 14.2 million. The currency effect is a result of the fluctuations of the Company's principal business currencies against the USD. Interest income totalled USD 3.4 million, as compared to USD 7.2 million in the previous year. Interest cost decreased by USD 1.1 million, or 9%, from 2011 and amounted to USD 10.6 million. ■

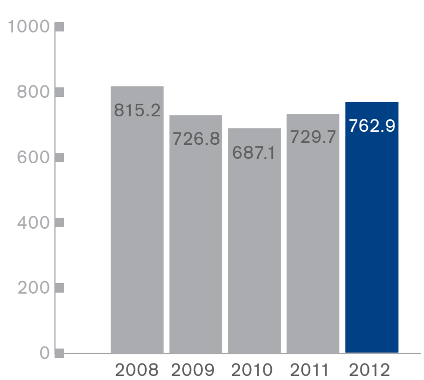
Total expenses before deprecation as % of total income | 2008–2012



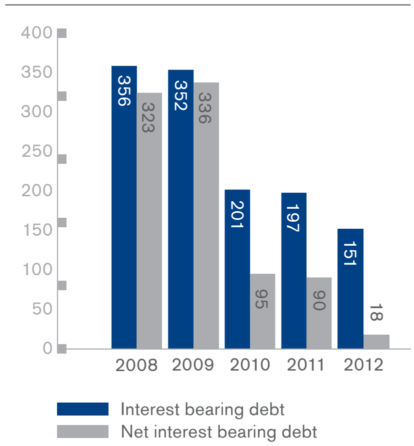
Financial Position

Icelandair Group's financial position is strong. Assets at year-end amounted to USD 762.9 million, up by 5% from from year-end 2011. Equity ratio was 39%, increasing by 3 percentage points from the beginning of the year. Cash and marketable securities totalled USD 132.8 million, and the net cash from operating activities amounted to USD 166.7 million.

Total assets USD million | 2008–2012



Interest bearing and net interest bearing debt USD million | 2008–2012



ASSETS

Total assets amounted to USD 762.9 million

At the end of the financial year 2012 total assets amounted to USD 762.9 million, up by USD 33.2 million or 5% from the beginning of the year.

Operating assets USD 283.0 million

Total non-current assets amounted to USD 473.9 million at year-end 2012, down by USD 9.2 million from last year. Of this figure operating assets amounted to USD 283.0 million, as compared to USD 276.2 million at the beginning of the year. The increase is largely a result of the acquisition of two Boeing 757 200 aircraft in the course of the year. Intangible assets and goodwill totalled USD 176.7 million, mainly comprising goodwill in amount of USD 137.1 million. Trademarks and airport slots amounted to USD 33.4 million. Other non-current assets amounted to USD 14.2 million at year-end, as compared to USD 30.2 million at the end of 2011.

Cash and marketable securities up by 24%

Total current assets totalled USD 289.0 million at the end of 2012, USD 42.3 million higher than in the preceding year. Trade and other receivables were USD 135.1 million at year-end, up from USD 118.4 million at the end of 2011. Cash and marketable securities increased from USD 106.7 million at year-end 2011 to USD 132.8 million at the end of 2012. Assets held for sale amounted to USD 3.7 million at year-end 2012.

LIABILITIES

Total liabilities USD 467.0 million

Non-current liabilities amounted to USD 161.1 million at year-end 2012. Loans and borrowings amounted to USD 119.4 million and other non-current liabilities to USD 41.7 million. Current liabilities were USD 305.9 million at year-end 2012. Of that figure, loans and borrowings amounted to USD 31.5 million, trade and other payables to USD 152.2 million and deferred income to USD 122.1 million.

Interest-bearing debt decreased by USD 46.0 million in 2012

Interest-bearing debt totalled USD 150.9 million at year-end 2012. Payments on long-term liabilities amounted to USD 45.1 million. Net interest-bearing debt amounted to USD 18.1 million at year-end, decreasing by USD 72.1 million from the previous year.

Calculation of net interest-bearing debt:

USD thousand	31.12.12	31.12.11	Change
Loans and borrowings non-current	119,358	163,124	–43,766
Loans and borrowings current	31,548	33,744	–2,196
Marketable securities	–15,734	–27,284	–11,550
Cash and cash equivalents	–117,060	–79,405	37,655
Net interest bearing debt	**18,112**	**90,179**	**–72,067**

EQUITY

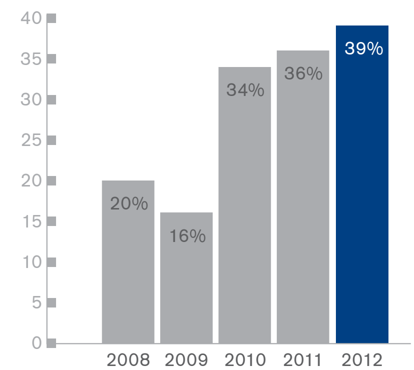
Equity ratio up to 39%

Icelandair Group's total equity amounted to USD 295.9 million on 31 December 2012, increasing by USD 32.5 million from the beginning of the year. This growth is principally due to the positive comprehensive income of USD 38.9 million. Dividend payment in 2012 amounted to USD 6.3 million, which equals 0.13 USD cent per share. The equity ratio rose as a result to 39%, from 36% in 2011. Share capital at year-end amounted to ISK 5,000 million in nominal value. The Company held own shares in the amount of ISK 25 million in nominal value at year-end 2012.

USD thousand	2012	2011	2010	2009	2008
Result*	38,854	32,093	17,488	−35,677	39,674
Profit/loss for the year	44,275	36,310	37,162	−86,990	−60,914
Equity	295,932	263,385	231,672	119,127	163,785
Equity Ratio	39%	36%	34%	16%	20%

* Comprehensive income

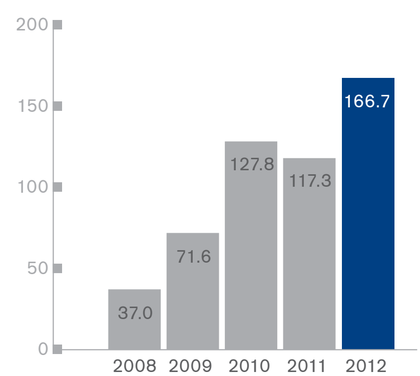
Equity ratio | 2008–2012



CASH FLOW AND INVESTMENTS

USD thousand	2012	2011	Change
Working capital from operations	141,490	102,292	39,198
Net cash from operating activities	166,743	117,341	49,402
Net cash used in investing activities	−76,476	−106,175	29,699
Net cash used in financing activities	−51,453	−27,602	−23,851
Cash and cash equivalents, change	38.814	−16,436	55,250
Cash and cash equivalents, 31.12.2012	**117,060**	**79,405**	**37,655**

Cash flow from operating activities
USD million | 2008–2012



USD 166.7 million generated from operating activities

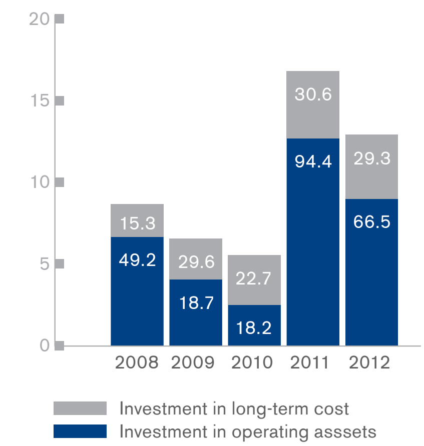
Working capital from operations amounted to USD 141.5 million in 2012, increasing by USD 39.2 million from 2011. Net cash from operating activities totalled USD 166.7 million in 2012, as compared to USD 117.3 million in 2011. Net cash used in financing activities amounted to USD 51.5 million. Of this figure, repayments of long-term borrowings amounted to USD 45.1 million. Cash and cash equivalents at year-end amounted to USD 117.1 million, as compared to USD 79.4 million in 2011.

Investment totalled USD 95.9 million in 2012

Investments in operating assets totalled USD 66.5 million. Of this figure, investment in aircraft and aircraft components amounted to USD 44.7 million and investments in engine overhauls on own aircraft USD 12.3 million over the period. Investments in long-term expenses, that is to say overhauls of leased engines, amounted to USD 26.8 million. Investments in intangible assets amounted to USD 2.5 million. Expensed long-term cost in the profit/loss statement amounted to USD 26.3 million in 2012.

Financial Position, continued:

Total investment
USD million | 2008–2012



FLEET

The fleet is the Group´s largest asset and a core operating resource. A single-type fleet of Boeing 757 aircraft is operated in the Company's international Network. The type fits extremely well with the Route Network and a single-type fleet creates significant cost efficiency in terms of maintenance and training for crew and mechanics. This has been one of the sources of the Company's on-going competitive advantages.

At year-end 2012, Icelandair Group's fleet comprised 39 aircraft. Of these aircraft 24 were owned by the Company and 15 were leased. The table below provides an overview of the Company's fleet of aircraft:

Type	Iceland-air	Cargo	Loft-leidir	Air iceland	Group fleet 31.12.12	Of which owned	Of which leased	Ch. as at 31.12.11
B757 200	16	4	3		23	14	9	2
B757 300	1				1	1	0	0
B767 300			5		5	0	5	0
B737 800			1		1	0	1	1
Fokker F-50				6	6	6	0	0
Dash 8-200				2	2	2	0	2
Dash 8-100					0	0	0	-1
A-320					1	1	0	0
Total	**17**	**4**	**9**	**8**	**39**	**24**	**15**	**4**

Icelandair Group announced in February 2013 its finalisation of an agreement with the Boeing Company for sixteen 737 MAX8 and 737 MAX9 firm orders as well as options on eight additional 737 MAXs. The value of all sixteen aircraft is USD 1.6 billion at Boeing list prices, but the actual purchase price is confidential.

These are new types of aircraft, with the first expected to become operational in 2017. The aircraft will be delivered in 2018-2021. The order is for nine 737 MAX8 aircraft, with a seating capacity of 153 passengers, and seven 737 MAX9 aircraft, with a seating capacity of 172 passengers. In comparison, Icelandair Group's current Boeing 757-200 aircraft have a seating capacity 183 passengers.

The Boeing 737 MAX aircraft are a new and improved version of the current Boeing 737 aircraft. They will be fitted with new and more economical engines, which will reduce fuel consumption by an estimated 20% per seat in comparison with the Boeing 757-200 aircraft currently used on the Company's international routes.

Boeing 757 aircraft will continue to be used on international routes together with the new aircraft, as they have proven extremely well suited for the Route Network extending to Europe and North America. The new aircraft will enlarge the fleet and improve both flexibility and the potential for further growth. Their range will permit them to fly to destinations in both North America and Europe, opening new possibilities for increased flight frequency and an increased number of destinations, particularly in the wintertime, which will reduce the seasonal fluctuations in the Company's operations. ■

Outlook

ORGANIC GROWTH CONTINUES

The prospects for Icelandair Group's operations are good. Continued organic growth is projected in 2013, with a 15% larger international flight schedule than in 2012. The growth is anticipated to be proportionally greater over the winter months than in the summer, which is in line with the Company's strategy of levelling seasonal fluctuations and developing Iceland as a year-round destination.

The number of passengers on international flights in 2013 is projected at 2.3 million, as compared to just over 2 million in 2012. The booking status for the coming months is in line with the growth plan. It is projected that the greatest increase in the number of passengers flying with the Company will be on the route across the North Atlantic, but the number of passengers to Iceland is expected to grow as well.

THE ROUTE NETWORK OUR KEY SUCCESS FACTOR

The principal driving force in Icelandair Group's operations is its international Route Network. An increase in capacity and in the number of passengers in the Route Network impacts the Company's other business activities, whether hotel operations, services to tourists in Iceland, ground handling services or international freight carriage, so the Company is anticipating growth in all of these businesses.

REGIONAL FLIGHT OPERATIONS IN CHALLENGING OPERATING ENVIRONMENT

The Company's regional flight operations are enduring a challenging operating environment as a result of the steep rises in public levies in Iceland in recent years. The increases have been onerous and resulted in reduced demand. The reduction in demand has been met by a reduction in capacity. For these reasons the Company has decided to reduce its regional flight schedule by 4% from 2012.

EBITDA FORCAST 2013 AT USD 115–120 MILION

The forecasted EBITDA for 2013 is in the range of 115–120 million USD. The projection assumes an average price of 1.30 for the EUR against the USD. Fuel cost estimates are based on a price of USD 1,050/ton. Unit cost in the international Route Network, net of fuel cost, is expected to decrease by 1.4% from 2012, and unit revenues are projected to increase by 1.1%. ■

■ *The number of passengers on international flights in 2013 is projected at 2.3 million, as compared to just over 2 million in 2012. The booking status for the coming months is in line with the growth plan. It is projected that the greatest increase in the number of passengers flying with the Company will be on the route across the North Atlantic, but the number of passengers to Iceland is expected to grow as well.*

Risk Management

Icelandair Group's objective in its risk management is to manage and control risk exposures and keep them within acceptable parameters, subject to optimised returns, by using derivatives and other available means. All risk management is carried out within guidelines set by the Board of Directors.

Various financial and enterprise-related risks can impact the Group's operations. The Board of Directors is responsible for defining policy measures to reduce exposure to financial and enterprise risk. These measures outline the parameters and framework which need to be considered when managing risk, especially those arising from price volatility and liquidity fluctuations. An internal Risk Management Committee, chaired by the President and CEO, seeks to reduce risk exposure to the maximum feasible extent within the Board's policy limits. The main policy objectives determine the methods to be used to reduce costs and disadvantages arising from any instability and uncertainty in the Company's operating environment.

FOREIGN CURRENCY RISK

The Group seeks to reduce its foreign exchange exposure arising from its business dealings in diverse currencies through a policy of matching receipts and payments in each individual currency to the extent possible. Any mismatch is dealt with using currency trades within the Group before turning to outside parties. The biggest currency mismatch involves the USD, where the US dollar cash inflow falls short of the dollar outflow by approximately USD 90 million due to fuel costs, lease payments and capital-related payments, which are to a large extent denominated in US dollars. This shortage is financed by a surplus of European currencies, most importantly the euro and Scandinavian currencies. The Group follows a policy of hedging 40-80% of a rolling 9-month currency exposure with spot and forward contracts and options. In addition to the cash flow currency risk exposure, risk exposure of this kind affects the Balance Sheet. The risk committee monitors on a monthly basis the net currency mismatch and mitigates the exposure through short-term management of assets, loans and liabilities to the extent feasible and within the scope of the cash flow objectives.

FUEL PRICE RISK

The risk policy requires a hedge ratio between 40% and 60% 6 months forward and 20% 7–9 months forward. Account is taken of the ratio of forward ticket sales as a minimum cover if it exceeds the 40% lower band. The policy entails a mixture of swaps and options, which are allocated in accordance with the degree of risk exposure. The policy and hedge strategy take account of several factors apart from the pure volume-based exposure. The correlation between jet fuel and other influential components are identified, and the same goes for pricing, production management and contractual risk transfer where possible.

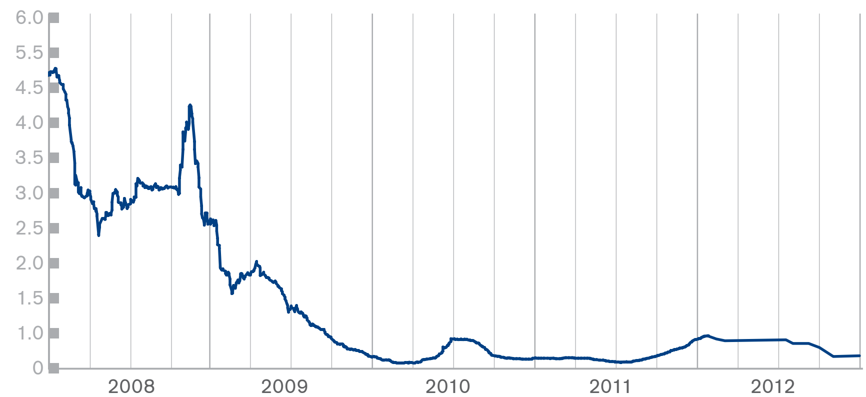
INTEREST RATE RISK

A considerable share of the Group's outstanding loans is directly related to aircraft financing and denominated in US dollars. The Group follows a policy of hedging 40–80% of the interest rate exposure of long-term financing with up to a 5-year horizon. Currently, foreign loans are hedged against interest rate fluctuations with fixed-rate loan contracts or swap contracts, where the floating rate is exchanged for fixed interest rates. When evaluating the interest risk exposure and the optimal level of contractual protection account is taken of the level of cash and marketable securities and various other offsetting economic factors.

CARBON PRICE RISK

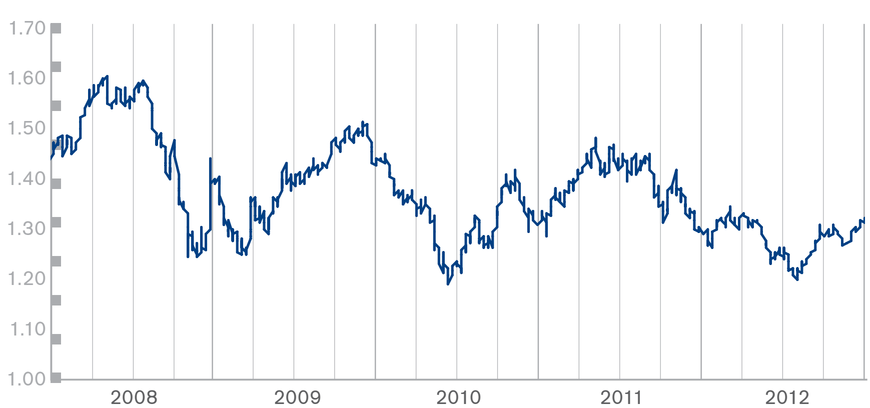
From the beginning of 2012 all airlines offering European destinations were required to comply with the EU Emissions Trading Scheme (ETS), which commits them to raise their carbon permits in proportion to their emission of carbon. Icelandair Group is already

Six month USD libor | 2008–2012



Jet fuel price per tonne | 2008–2012

EUR/USD exchange rate | 2008–2012



Various financial and enterprise-related risks can impact the Group's operations. The Board of Directors is responsible for defining policy measures to reduce exposure to financial and enterprise risk.

Risk Management, continued:

From the beginning of 2012 all airlines offering European destinations were required to comply with the EU Emissions Trading Scheme (ETS), which commits them to raise their carbon permits in proportion to their emission of carbon. Icelandair Group is already hedged against roughly 50% of its 2013 exposure through the EU allocations of emissions quotas.

hedged against roughly 50% of its 2013 exposure through the EU allocations of emissions quotas. In November 2012 the EU decided to offer airlines flying to and from European destinations exemption from the Scheme with respect to international flights. Icelandair has accepted this offer and its commitment is therefore confined to internal European flights. Having only to cover the EU flights with emissions permits, the original obligation has been reduced considerably. However, the exemption is only secure for one year and its extension is uncertain. With respect to risk management, the Group's 2013 estimated carbon shortfall had not been hedged in 2012, but various arrangements were made to prepare for the forthcoming obligations regarding trading and procurement. As part of that preparation, a decision was made to follow a policy of compliance by trading in carbon permits in line with fuel consumption and consequent carbon emissions on a rolling monthly basis.

LIQUIDITY RISK

The Group's policy on liquidity risk extends to three asset classes determined by duration. Those classes are matched against the Group's liquidity targets as laid down by the Board of Directors on an annual basis. Classes one and two include the estimated minimum of accessible funds for immediate operational liquidity and reserve purposes. Class three includes assets of longer duration for strategic liquidity, such as medium-term investments. The target amounts in each class of assets are set once a year with reference to a number of economic indicators, most importantly the annual level of fixed costs, 3 month operational costs and turnover.

CREDIT RISK

Credit risk is linked to the amount of outstanding trade receivables, allocation of liquid funds and financial assets and agreements with financial institutions relating to financial operations, e.g. credit support annexes concerning 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 by the Group's counterparties. The Group is aware of potential losses relating to credit risk exposure and chooses its counterparties based on business experience and acceptable credit ratings.

INDUSTRY-RELATED RISK FACTORS

At Group and subsidiary levels, management monitors and assesses the airline industry's risk exposure, which has historically posed uncertainty, even in normal operating conditions. A part of the Company's culture stems from its long history, including a general recognition of the value of learning from past experience. Yet, in addition to the retrospective view, management systematically focuses attention on potential threats from a prospective viewpoint, as the environment is extremely changeable. The Group operates and thrives in well-established and defined markets. As such, they can be regarded as invaluable intangible assets which require attention. The credibility and reputation of Iceland-air is crucial for its market status and growth. But the markets are also sensitive to external factors, such as the macroeconomic elements governing aggregate demand. An economic downturn usually reduces the general purchasing power of potential customers and thereby the demand for air travel. Airlines are prone to even greater vulnerability when it comes to other types of shocks which are more sudden and forceful. The cold winters in Europe and volcanic eruptions in recent years have caused costly and unanticipated disruptions of this kind. Terrorist incidents and pandemics are also examples of events which need to be considered at all times. Those factors that can be analysed and monitored with respect to reasonable risk of occurrence and impact call for close monitoring and readily available contingency plans. The ash cloud experience 2009 and 2010 put the risk management systems of Icelandair Group to the test and they proved successful. The Company owes its adaptive potential and flexibility of operations chiefly to its capable human resources, contingency policies and economies of scale. The quality of the Company's responsive processes enables us to cope with other adverse circumstances and industry factors, such as seasonality, competition, insurance and new taxes, such as the recently enacted carbon emission charges.

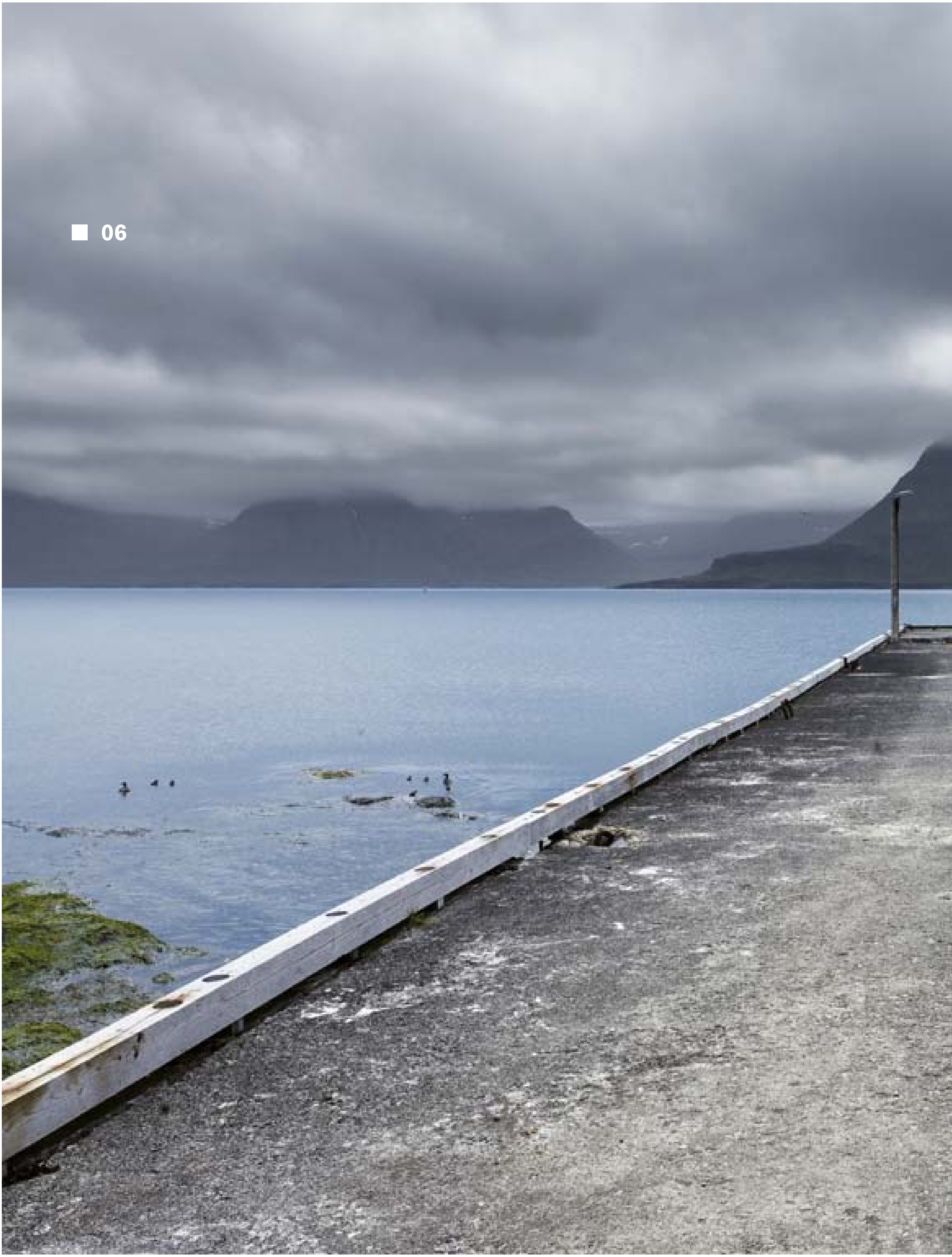
OPERATIONAL RISK

The Group distinguishes between industry-related risks and those which expose the subsidiaries on an individual company level. Methods of coping with threats of disruptions and disturbances are more decentralized when it comes to operational hazards. Again, the long and successful history of Icelandair Group and its companies is a valuable asset, which serves both as the foundation and the benchmark, for many of the policies and contingency plans used across the Group. The Group's computer and communication systems are crucial for sales and market activities, but also for undisrupted internal operations. Equipment maintenance is needed to guarantee airworthiness. Third-party services may become bottlenecks in the production chain, whether in catering, ground services or flight control. Human resources need to be managed, labour disputes resolved and work stoppages prevented. Management constantly evaluates the risks involved and the potential consequences of individual events. Scenarios are projected, charted and contemplated and action plans launched based on possible outcomes, where collaboration is maintained between the Group and individual companies.

ENTERPRISE RISK MANAGEMENT

Risk management needs access to a secure and steady flow of information about all enterprise-related risks at the Group level and thus requires centralized mapping and detailed registration of risk items and their estimated inherent financial values and potential consequences. The Group's Risk Management Committee has focused increased attention on enterprise-related risk assessment in collaboration with Internal Audit and concentrated on aligning risk records across all subsidiaries for consistency and compliance. The key objective of Enterprise Risk Management is to enhance motivation in risk analysis and improve risk awareness, standardize the quantification of risk and establish the Company culture that is needed to promote everyday risk awareness and risk-reduction measures. ■

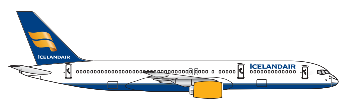
■ The Group operates and thrives in well-established and defined markets. As such, they can be regarded as invaluable intangible assets which require attention. The credibility and reputation of Icelandair is crucial for its market status and growth. But the markets are also sensitive to external factors, such as the macroeconomic elements governing aggregate demand.


06

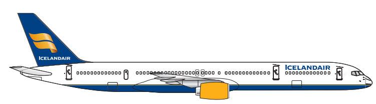
DID YOU KNOW ... that the Icelander known to have lived longest was a woman, born in 1888, who died in 1998 when she was 109 years and 310 days old.

Icelandair

Number of aircraft by aircraft type 31.12.2012
Icelandair

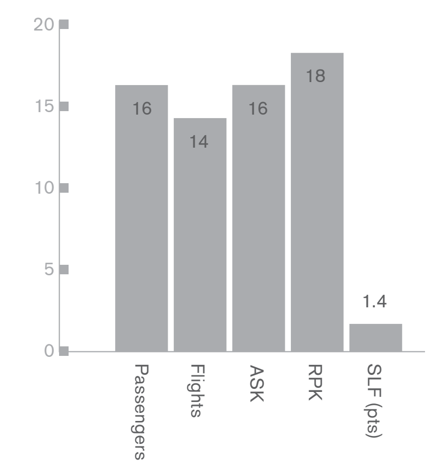


16 Boeing 757-200

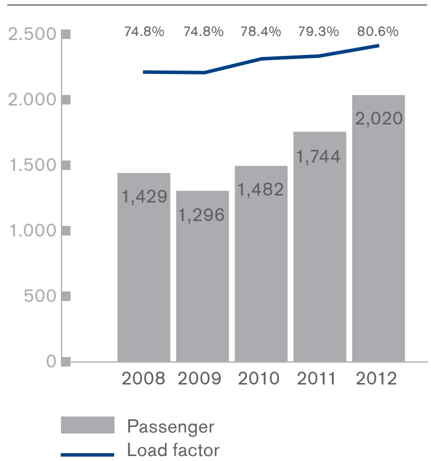


1 Boeing 757-300

Traffic data Icelandair | YOY change in %



Number of passengers (thousands) and load factor | 2008–2012



Icelandair business strategy is based on leveraging Iceland's geographic position on the flight routes between northern Europe and North America to create and develop an international hub-and-spoke airline network.

Operating on three different and independent passenger markets (the North Atlantic market, From Iceland market and To Iceland market) gives the company a variety of options in Route Network development and revenue management.

Apart from marketing and sales efforts, demand for air travel in the region mainly depends on economic trends, exchange rates, destination popularity and the cost of flying. Operating in different markets makes the company less vulnerable to fluctuations in demand for any particular market segment. Continued emphasis is placed on a lean organisational structure, quick decision-making and flexibility as the company continues its constant work on optimising the current Route Network and exploring new markets.

In its summer schedule 2013 Icelandair will connect 25 European cities with 10 North American cities through the company's hub in Iceland. The network is based on a 24-hour rotation, with morning and afternoon connections in Iceland.

Icelandair is a key component of Icelandair Group. Its strategy is to use its efficiency and flexibility to be the airline of choice for travel to and from Iceland and a unique and exciting alternative for air travel across the North Atlantic. Icelandair mission is to operate a first-rate airline and maintain a reliable quality service through the experience and knowledge gained in 75 years of operation.

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

In addition to aircraft flown on its scheduled network, Icelandair operates aircraft for Loftleidir-Icelandic and Icelandair Cargo, thereby benefiting from economies of scale. Earlier this year Icelandair signed an agreement with Boeing to add 16 Boeing 737 Max aircraft to its fleet of Boeing 757 aircraft as of 2018 with an option to buy an additional eight aircraft.

The company's business activities have seen substantial growth since 2008, and the increase in scheduled flights between the years 2009 and 2013 is projected at just under 70%.

Icelandair Technical Services provides maintenance and technical services for the Icelandair aircraft fleet and is an integral part of Icelandair. Most of the work is performed at the Service Centre at Keflavik Airport.

Some highlights of Icelandair´s operations in 2012

The beginning of the year was marked by major growth. Icelandair transported 18% more passengers in the first three months than the year before. The load factor was 75.3% compared to 71.1% in the corresponding period in 2011. This was reflected in the increased number of tourists to Iceland in the 2011–2012 winter season. The effort Icelandair and other travel service companies with the Icelandic government and Reykjavik City through Inspired By Iceland winter promotion was therefore off to a flying start. This was in turn linked to Icelandair's increased Route Network offerings during the winter and the build-up of Iceland as a year-round destination.

Mid-Atlantic seminar larger than ever

An important part of Icelandair's marketing effort each year is the Mid-Atlantic seminar and trade show, held in February. Last year's show was the twentieth in sequence and by far the largest, with 650 participants from 15 countries. The show is organized by Icelandair for the purpose of bringing together buyers and sellers of travel services in order to strengthen and increase Icelandair sales in all markets.

New Icelandair Saga lounge opened
A new "Saga lounge" was opened by Icelandair last spring at the Keflavík International Airport Terminal after extensive changes. The lounge is located in the same place in the terminal building, but is now larger, brighter and more open. The new interior and furnishings reflect the strong Icelandic roots of Icelandair.

Conference with IATA on the importance of aviation
In spring 2012 Icelandair held a conference with IATA on the occasion of the publication of a report on the economic benefits of aviation for various countries. The report revealed, among other things, that the national economic importance of aviation is nowhere greater than in Iceland. Iceland is the country with the greatest "air connectivity" in the world. Aviation is an important support of Iceland's economy, and nearly 80% of this support is provided by Icelandair and Air Iceland. This sector creates 20 thousand jobs, if the tourism industry is included, and its impact is many times greater in Iceland than in the other Nordic countries.

Frequent flyer program becomes Saga Club
Icelandair made changes to its frequent flyer program, increasing member benefits and changing the name to Icelandair Saga Club. Saga Club has 310 thousand members, including 180 thousand in Iceland. This means that a significant part of the Icelandic population belongs to the club. Club services are developed in accordance with the wishes of its members; following the change, members can now use their points toward payment for all Icelandair flights and services on board. Point donations also contribute significantly to Icelandair's Children Travel Fund benefit program, which had a very good year in 2012.

Amadeus partnership renewed
One of Icelandair's longest standing and most important partners is the travel distribution company Amadeus. Last summer Icelandair renewed its partnership regarding solutions for booking, check-in and inventory, as well as for revenue management, electronic ticketing, internet sales etc. This gives the company both technical advantages and security.

New agreement with sports associations
Icelandair also renewed its partnership with the Icelandic national sports associations by signing the largest sponsorship deal in their history. Icelandair transports thousands of travellers on sports-related trips each year, both competitors and spectators. The country's foremost athletes and musicians are good representatives of Iceland. Icelandair has accordingly emphasized both sports and music in its sponsorships.

Year-round schedule to Denver starts in May
Flights to Denver, Colorado, began on 10 May and have continued successfully since. Denver is a beautiful and inviting city in a magnificent natural setting. Icelandair added this destination to its scheduled network largely because of the excellent connections it can offer between Denver and Europe, but Iceland also receives many tourists from the Denver area. Denver's mayor, Michael Hancock, along with other key officials from the city and the state of Colorado, showed great goodwill to Icelandair and honoured the company by visiting Iceland with a large delegation to take part in the inaugural flight.

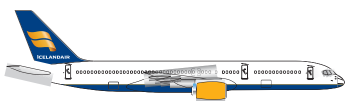
Summer flights between Keflavik Airport and Akureyri
In the summer of 2012 Icelandair offered new scheduled flights between Keflavik and Akureyri. The flights were carried out by Air Iceland and offered good connections with flights to both Europe and America. Several thousand foreign tourists took advantage of this new alternative. This service will be offered again this year.

Increasing fleet size to 16 aircraft during summer
Icelandair added two Boeing 757's to its fleet this year and used 16 aircraft on the scheduled routes in 2012, more than ever before. Last summer Icelandair employed 1,450 staff, 350 of whom were added in the spring. Some of these had worked for the company before, while others were new employees. All beginners were well trained and prepared, being guided by more senior and experienced employees through their first steps.

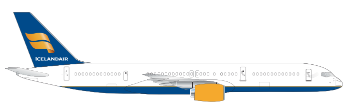
75-year anniversary
The company's 75-year anniversary celebrations took various forms throughout the year. The Reykjavik Air Show at the end of May and the visit by the Catalina flying boat were a great success. Thousands of people visited the air show, mainly families, enjoying a great day out. An Icelandair café was established for a few weeks to commemorate the anniversary, in cooperation with the exclusive coffee brand Te og kaffi. The Icelandair Group anniversary convention was held at the Hilton in September, and at Reykjavík City Hall an exhibition was opened to commemorate the 75th anniversary. Formal celebrations ended with an employee get-together with the band Stuðmenn, on 20 October. ■

Loftleidir

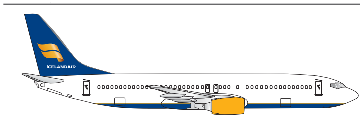
Number of aircraft by aircraft type 31.12.2012
Loftleidir



3 Boeing 757-200

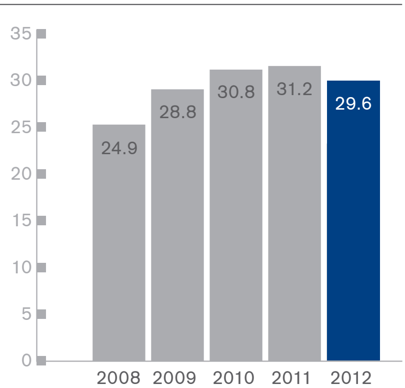


5 Boeing 767-300



1 Boeing 737-800

Numbers of sold block hours (thousands) | 2008–2012



Loftleidir–Icelandic is a capacity solution company for international passenger airlines and tour operators. Loftleidir-Icelandic was formed in 2002, although international charter operations had been part of the general operations of the airline and its predecessors for decades. Loftleidir–Icelandic has developed from being a marketing vehicle operating in the international ACMI (Aircraft Crew Maintenance and Insurance) and charter markets, to become a capacity solution provider focusing mainly on AM projects and consulting services. The company has expanded its horizon beyond the aircraft types traditionally operated under the Icelandair AOC with the recent introduction of the first B737-800 aircraft into the fleet.

The company currently operates AM (Aircraft and Maintenance), ACMI (aircraft, crew, maintenance and insurance) and full charter contracts in Asia, the South Pacific and North and South America. In addition, Loftleidir-Icelandic has established itself as a business class specialist by operating first-class flights around the world in an all-VIP business class configuration. The company had at year-end 2012 three Boeing 757-200, five Boeing 767-300 and one B737-800 aircraft.

In mid-2003 Loftleidir-Icelandic added its first wide-body aircraft when it introduced a Boeing 767 in its fleet, which opened up new markets. This led to an increase in the proportion of ACMI projects at the expense of all-inclusive projects, which has helped to increase profitability and reduce sensitivity to external fluctuations. This trend has continued, with longer-term AM leases becoming ever more prominent in the company's contract portfolio. The company enjoys increasing visibility in both the North and South American markets. Also, the company has been successful in penetrating the CIS (Commonwealth of Independent States), market where the demand for western-built aircraft continues to grow.

Loftleidir-Icelandic will seek to utilise its extensive market knowledge to widen its spectrum of services further in order to secure continued growth in revenue and profitability. ■

Icelandair Cargo

Icelandair Cargo is an air freight company offering services to and from Iceland based on a strong route network. The freighters are registered to Icelandair. Air Operators Certificate (AOC) and crews are leased from Icelandair. Aircraft maintenance, warehousing, cargo handling and a part of cargo sales are outsourced.

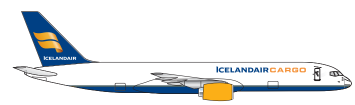
Icelandair Cargo was established in late 1999 and is the largest air freight service provider in Iceland.

The company bases its business on scheduled services between Iceland, Europe and North America, supported by charters and wet leases (ACMI). In addition to marketing and selling space on its own freighters, Icelandair Cargo sells cargo hold space on Icelandair passenger aircraft. Icelandair Cargo has four Boeing 757-200 freighters in its fleet. The company uses two cargo aircraft on its schedule and two cargo aircraft for its ACMI product offerings. At the beginning of 2012 the management of Icelandair Cargo decided to return one of its aircraft operating in the ACMI business as the market outlook, particularly in Europe, was not very positive. This aircraft exited the fleet in March 2012.

The company offers its customers competitive and quick global services through extensive interline and special pro rata agreements with other airlines. The operation is supported by trucking networks in Europe and in the USA. Sales are mainly handled by Icelandair Cargo staff in Iceland. The New York branch handles sales for all the Americas. The company has its own subsidiary, Icelandair Logistic, which handles sales in the Benelux countries, while General Sales Agents (GSAs) oversee other markets. The company has GSAs in all larger and growing markets in Asia and most of Europe.

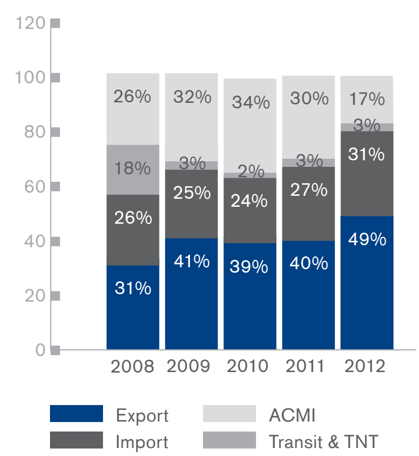
Approximately 90% of exports from Iceland consist of fresh seafood, whereas imports include a variety of perishable products, fashion products, high-tech products and spare parts. For a number of years Icelandair Cargo has carried express freight for the courier companies TNT, DHL and FedEx to and from Iceland and within Europe. ■

Number of aircraft by aircraft type 31.12.2012
Icelandair Cargo



4 Boeing 757-200

Revenue split | 2008–2012

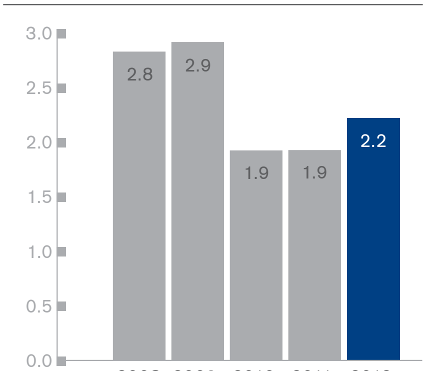


Icelandair Ground Services

Icelandair Ground Services (IGS) provides comprehensive airport ground handling services for airlines and passengers at Keflavík International Airport. IGS was formed in 2001, but airport and ground operations in Iceland have been a part of the airline operation since the foundation of Icelandair Group's predecessors.

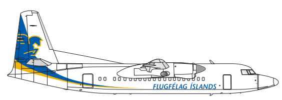
IGS provides aircraft ground handling services for all types of aircraft, a first-class flight kitchen and bonded stores, a state-of-the-art cargo centre and a restaurant and bar division in the Leifur Eiriksson Air Terminal. IGS is a universal service provider that enables airlines and other customers to obtain all the services they require from a single source. Icelandair is by far IGS's largest client, although the company has also been contracted by other airlines. Opportunities for growth go hand in hand with the growth in the number of flights and passengers passing through the airport. ■

Number of produced servings (millions) | 2008–2012

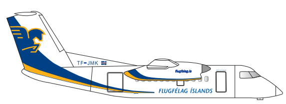


Air Iceland

Number of aircraft by aircraft type 31.12.2012
Air Iceland

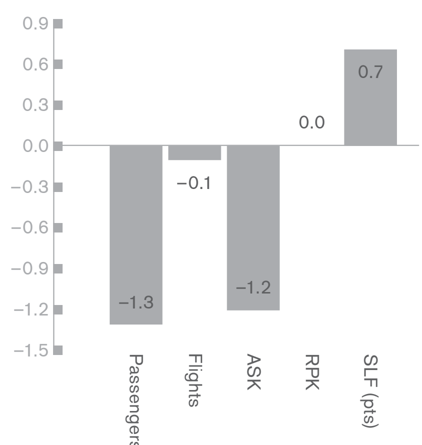


6 Fokker Friendship



2 Dash 8-200

Traffic data Air Iceland | YOY change in %



Air Iceland is a dynamic airline which has set itself the goal of providing strong but flexible airline services to the West Nordic countries with scheduled regional flights within Iceland as well as routes from Iceland to Greenland. The airline was formed in 1997, when Icelandair Domestic merged with Flugfélag Nordurlands; the airline traces its roots back to 1937.

With flights from Reykjavik to Akureyri, Egilsstaðir and Isafjordur Air Iceland covers all the major towns in Iceland, as well as a number of the smaller settlements through a general sales agent agreement with Norlandair, a Twin Otter operator in Akureyri. Air Iceland offers flights to five destinations in Greenland, with year-round routes to Kulusuk and Nuuk, the capital of Greenland. In the summer, Air Iceland offers flights to Narsarsuaq, Ilulissat and, in cooperation with Norlandair, to Nerlerit Inaat. In cooperation with Atlantic Airways Air Iceland offers flights between Iceland and the Faroe Islands all year round. The fleet of aircraft consists of six Fokker 50 and two DASH 8-200 aircraft.

Air Iceland's operating environment has changed in recent years as a result of substantial increases in taxes on regional flights in Iceland. These increases have been extremely onerous and resulted in a reduction in passenger numbers. In early 2012 it appeared as if there might by some increase in the number of passengers, however, the start of the second quarter saw the entry into effect of several large increases in public levies, such as landing charges, navigation charges and passenger taxes. In addition to these levies, flights were, as of the year 2012, subject to the payment of an emissions charge under the European Emission Trading Scheme. A part of these increases has inevitably found its way into the air fares, which in turn has led to a drop in the number of passengers between years.

Air Iceland holds a strong position on the Icelandic regional air transport market. Demand is strong for all destinations in Greenland, the company's most promising external market. Air Iceland aims to bolster its position as an airline servicing the West Nordic region. ■

Icelandair Hotels

Icelandair Hotels is Iceland's leading hotel chain, with 21 hotels located throughout the country. The company directly operates the Hilton Reykjavik Nordica, four Icelandair Hotels and twelve Edda hotels. In addition, the company has four franchised Icelandair Hotels, strategically located in all the prime destinations outside the capital city of Reykjavik.

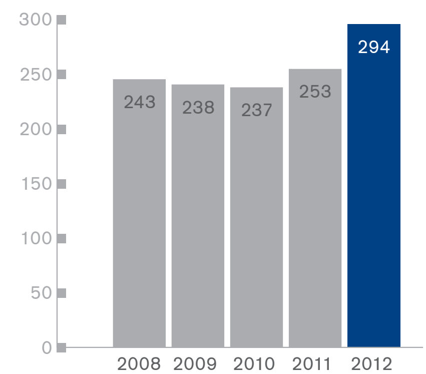
Icelandair Hotels delivers hospitality through a cohesive family of international and local brands. The hotel chain fuses traditional hotel hospitality with innovative trends in services to keep up with the requirements of the modern traveler's lifestyle and needs. The vision of Icelandair Hotels is to create an authentic Icelandic experience, leveraging the unique qualities of Iceland as a tourist destination to provide our owners and sister companies with added value.

2012 was a good year for Icelandair Hotels' operations, with increased occupancy at all hotels. Following the rebranding of the hotel chain last year, further infrastructure improvements have been made and the chain continues to grow and flourish as the rebranding continues to strengthen individual properties. The highlight of 2012 was the opening of a new hotel in the heart of downtown Reykjavik. The new hotel was given the name Icelandair Hotel Reykjavik Marina, a reference to its close proximity to the city's historic harbour. Reykjavik Marina enjoyed immediate success with its colourful and quirky Icelandic design and fun and vibrant atmosphere. The finishing touches on our cozy and comfortable Icelandair Hotel Akureyri was put by adding family rooms and deluxe rooms.

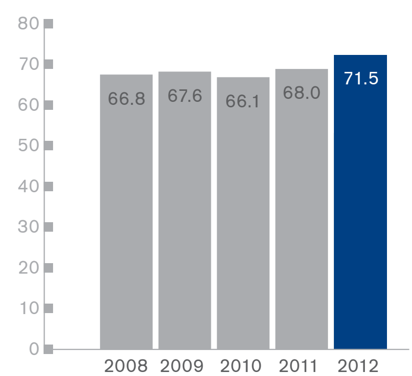
Edda Hotels is a popular chain of 12 summer hotels, all located on the doorsteps of the country's most visited natural wonders and historic sites. In 2013, a new Edda Hotel will open in the small seaside town of Höfn.

Further improvements planned for 2013 include the continued renovation of Reykjavik Natura, Herad and Klaustur. The renovation of Hilton Reykjavik Nordica will mark the celebration of its 10th anniversary. In addition to work on renovations on our properties, Icelandair Hotels continues to work on hotel renovations, as well as improved booking procedures, increased online visibility and enhanced brand strength. ■

Available hotel room nights (thousands) | 2008–2012

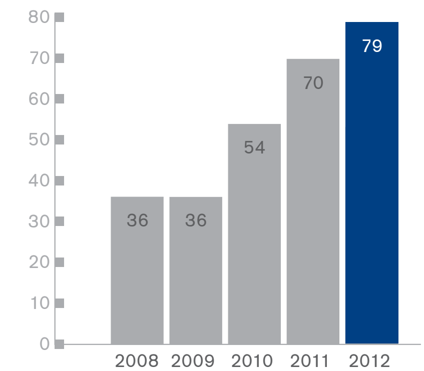


Occupancy (%) | 2008–2012



Iceland Travel

Number of tourists to Iceland through IT (thousands) | 2008–2012



Iceland Travel is Iceland's largest travel agency, offering a wide range of high-quality services for travellers from all over the world, including vacation packages, scheduled tours, day tours and other activities, as well as planning conferences, events, incentive programs and cruise services.

For over 30 years the company has grown and prospered. Iceland Travel is a member of a number of domestic and international associations, including the Icelandic Travel Industry Association, the Iceland Convention and Incentive Bureau, the United States Tour Operators Association (USTOA), the Japan Association of Travel Agents (JATA), and many more. Iceland Travel is registered trademark in the USA.

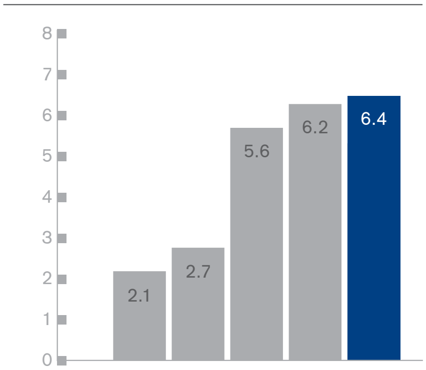
Iceland Travel's core market is business-to-business, but the company has now sharpened its focus on direct-to-customer business using web solutions and internet ticket sales. New distribution channels include the operation of tour desks in hotels as a part of the company's new policy of serving clients directly. ■

Feria

FERIA operates two tourist service brands, VITA travel and Ferd.is. FERIA's mission is to offer a variety of leisure tours to Icelanders travelling abroad through high-quality services supplied at a competitive price. VITA and Ferd.is take advantage of opportunities that arise through the company's partnership with Icelandair, thereby offering a secure and attractive option for Icelanders seeking services and assistance for organised groups and individual tours, such as vacation tours, golf and ski trips and city breaks. Ferd.is is an online tour operator focusing on low-cost packages and seat-only sales on charter flights. Ferd.is was launched in the autumn of 2011. VITA was established in the summer of 2008 and started operations in December 2008. VITA and Ferd.is were part of Iceland Travel until the end of 2011. At the beginning of 2012 Iceland Travel was split into two independent subsidiaries, with FERIA focusing solely on services to Icelanders travelling abroad. ■

Fjárvakur – Icelandair Shared Services

Number of pax tickets processed in millions | 2008–2012



Fjárvakur – Icelandair Shared Services – offers "one stop" financial services to its customers and features the flexibility of being able to provide extra support or reduce services quickly as circumstances may require. Services include accounting, credit management, reporting and HR (human resources) processes for customers in Iceland and revenue accounting for foreign airline customers. The company was established in 2002 as a finance support department for Icelandair Group companies with the shared services concept as a cornerstone. In 2006 the company acquired Airline Services Estonia and began offering services outside the Group. The company has shown steady growth from the beginning. Business outside Icelandair Group represented 40% of total turnover in 2012. ■

Investment in winter tourism in Iceland

ICELAND A YEAR-ROUND TOURIST DESTINATION

Icelandair Group's long-term strategy is to establish Iceland further as a year-round tourist destination. The Icelandic winter is an underutilized resource that needs to be leveraged further to increase the efficiency and profitability of the Company and Icelandic tourism as a whole. Icelandair Group has taken decisive steps towards reducing the seasonal fluctuations inherent in its business and will continue its efforts in 2013.

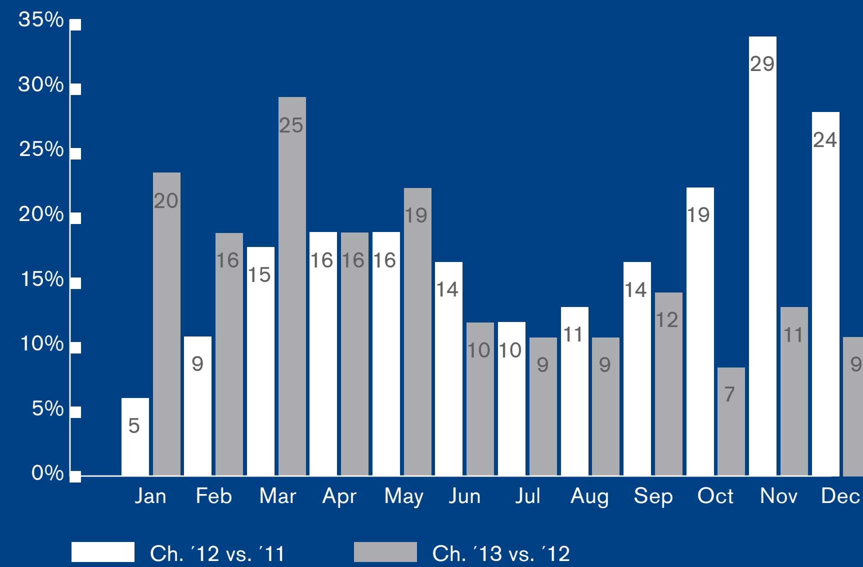
EXPERIENCING WINTER

Visiting Iceland in winter is a totally different experience from summer visits. The natural spectacle of the Northern Lights, walks behind half-frozen waterfalls and strolls along black, volcanic sand beaches are unforgettable experiences – or just enjoying Reykjavik, with its vibrant nightlife and unique Icelandic events such as Food and Fun and the Iceland Airwaves music festival.

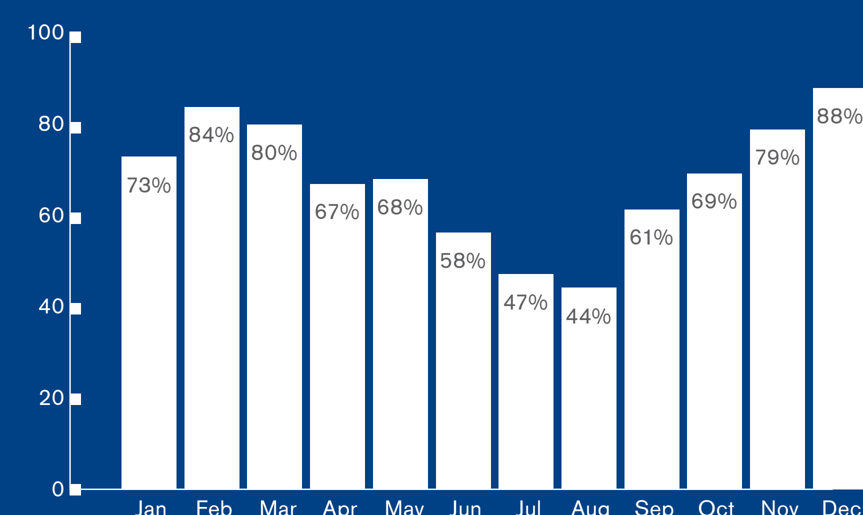
UNDEREXLOITED OPPORTUNITY

Icelandair Group is confident that many opportunities remain to be exploited in selling the Icelandic winter, both in terms of culture and nature. The Company leads the campaign to present Iceland to the world as a year-round destination and annually spends large amounts on advertisements and promotions.
The chart on the right shows how the increase in the supply of seats in the international network has been proportionally greatest over the winter months.

Change in available seats on the Groups's International flights | 2011–2013



Icelandair market share at Keflavik Airport in % per month 2012




07

DID YOU KNOW ... that Icelanders are great book lovers and, in 2012, nearly 1,000 books were published in Iceland.

Corporate Governance

AUDIT COMMITEE:

Katrín Olga Jóhannesdóttir, Chairman

Herdís Dröfn Fjeldsted

Ásthildur Otharsdóttir

COMPENSATION COMMITTEE:

Sigurður Helgason, Chairman

Úlfar Steindórsson

EXEMPLARY IN CORPORATE GOVERNANCE

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 available on the Company's website and the Guidelines and Rules for Issuers can be accessed on the NASDAQ OMX Iceland website.

The Iceland Chamber of Commerce, the Confederation of Icelandic Employers and the Center for Corporate Governance at the University of Iceland selected Icelandair Group for their "Exemplary in Corporate Governance" recognition in 2013. Icelandair Group is the first listed company in Iceland to receive this recognition.

The Company complies in all main respects with the rules mentioned above. However, the Company does not have a Nomination Committee, as the Board of Directors has not seen the need for such a committee. No regulatory authority has found the Company to be in violation of any rule or regulation.

INTERNAL AUDIT AND RISK MANAGEMENT

The Group's Audit Committee oversees management's monitoring of 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 is entrusted with oversight of the Group's consolidated accounts. The committee is responsible for evaluation of the independence and eligibility of both the Company´s auditor and auditing firm. The committee submits recommendations to the Board of Directors regarding the selection of the Company´s auditor. The Audit Committee meets on average six times a year.

VALUES, 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, which was amended on 5 January 2011. The Code of Ethics is accessible to all the Company's employees through the Icelandair Group intranet, MyWork.

COMPENSATION COMMITTEE

The purpose of the Compensation Committee is to avoid the Company's management being placed in control of their own remuneration and to ensure that 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 meets on average four times a year.

The Board of Directors and Executive Committee

SIGURÐUR HELGASON, CHAIRMAN

Sigurður Helgason was born in 1976. He was President & CEO of Flugleidir/Icelandair 1985–2005. He was Director Cash Management 1974–1980, Senior Vice-President Finance 1980–1983, General Manager The Americas 1983–1985 at Flugleidir/Icelandair. He was a member of the IATA Board of Governors 2004/2005. He was a Member of the Board of Directors at Finnair 2007–2012. He was Chairman of the Board of The Icelandic International Development Agency 2005–2008. He has been Chairman of the Icelandair Special Children Travel Fund since 2005. He has served on various boards in Icelandic business since 1974. He graduated with an MBA degree from The University of North Carolina, Chapel Hill, USA in 1973 and completed a Cand. Oecon. degree at the University of Iceland in 1971. He joined the Board on 6 August 2009.

ÚLFAR STEINDÓRSSON, DEPUTY CHAIRMAN

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

ÁSTHILDUR M. OTHARSDÓTTIR, BOARD MEMBER

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. She joined the Board on 23 March 2012.

HERDÍS DRÖFN FJELDSTED, BOARD MEMBER

Herdís Dröfn Fjeldsted, investment manager at the Iceland Enterprise Investment Fund, holds a B.Sc. degree in business administration, an M.Sc. degree in corporate finance from Reykjavik University and is a certified securities broker. Herdis has years of experience in the private equity sector. Most recently, she was a member of the investment team at Thule Investments. Herdis is Chairman of the Board of Icelandic Group, Chairman of the Board of Wave Operations and a member of the Board of Promens. She joined the Board on 14 December 2010.

KATRÍN OLGA JÓHANNESDÓTTIR, BOARD MEMBER

Katrín Olga Jóhannesdóttir was born in 1962 and is the former Chief Strategy Officer of Skipti hf and the current Chairman of Já upplýsingaveitur hf. Before that she was 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 currently serves on the boards of directors of the Central Bank of Iceland, Ölgerðin hf., Reykjavik University, the Iceland Chamber of Commerce, and Njála ehf., having previously served on the boards of Sirius IT and SkjáMiðlar. She holds a Cand.Oecon degree from the University of Iceland and an M.Sc. in Business Economics from Odense University. She joined the Board on 6 August 2009.

The Board of Directors, continued:

EXECUTIVE COMMITEE:

Björgólfur Jóhannsson, President and CEO

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

Bogi Nils Bogason, CFO

Magnea Þórey Hjálmarsdóttir, Managing Director of Icelandair Hotels

Birkir Hólm Guðnason, CEO of Icelandair

The Company's Board of Directors exercises the supreme authority in the Company's affairs between shareholders' meetings and 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 on 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 is required to ensure that there is adequate supervision at all times of the Company's accounts and the use of its assets and shall adopt working procedures in compliance with the Companies Act. Only the Board of Directors has the authority to 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 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 is composed of five members and one alternate member, elected at the annual general meeting for a term of one year. Prospective candidates must inform the Board in writing of their intention to stand for election at least five days before the annual general meeting or extraordinary shareholders' meeting at which elections are scheduled. Only candidates who have informed the Board in advance are eligible.

The Board of Directors elects a Chairman and Deputy Chairman from among its members, and otherwise allocates its duties among its members as needed. The Chairman calls Board meetings. A meeting must also be called at the request of 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; in the event of an equality of votes a motion 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 shareholders and he shall inform the Board of views held by shareholders.

On 12 September 2007 the Board of Directors approved Working Procedures for the Board of Directors, which were amended on 15 November 2010. The Rules on Working Procedures are accessible to the Board of Directors and the management through the Board's intranet, Coredata. In accordance with article 14 of the Rules on Working Procedures, the Board of Directors must annually evaluate its own work, number of members, composition and practices, and must also evaluate the performance of the President and CEO and other managers 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 includes evaluation of the strengths and weaknesses of the Board's work and practices and examination of areas where the Board believes there is room for improvement.

The Board of Directors elects the members of two sub-committees: the Compensation Committee and the Audit Committee. The sub-committees are subject to the Rules on Working Procedures. The Board of Directors meets on average twelve times a year. This year, the Board of Directors met 25 times with full participation at nearly all meetings. All the Members of the Board of Directors are independent of the Company, except from Ásthildur Margrét Otharsdóttir. Sigurður Helgason, Ásthildur Otharsdóttir, Katrín Olga Jóhannesdóttir and Úlfar Steindórsson were independent of the Company's major shareholders in 2012. ■

■ *The Company's Board of Directors exercises the supreme authority in the Company's affairs between shareholders' meetings and 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.*

Shareholder Information

Icelandair Group's objective is to create sustainable long term value for its shareholders. In 2012 the Company's shares increased in value by 63% and earnings per share were USD cent 0.89. The market capitalization of the Company was ISK 41.1 billion at year end.

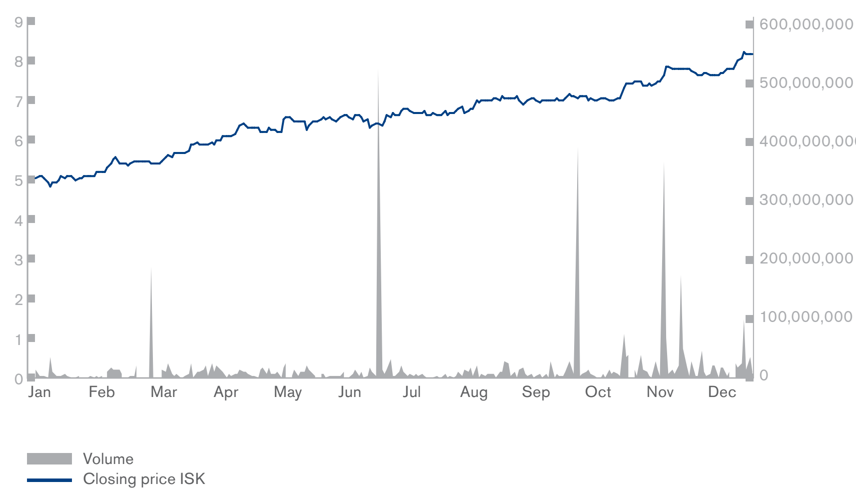
SHARE CAPITAL

Icelandair Group's share capital as at 31 December 2012 amounted to ISK 5,000 million in nominal value. All shares are of the same class and hold equal rights; each share has a nominal value of ISK 1 and entitles its holder to one vote. Shareholders are entitled to receive dividends as declared from time to time. The Company held own shares in the amount of ISK 25 million in nominal value at year-end 2012. The Group shares are listed under the code ICEAIR on the NASDAQ OMX Iceland.

SHARE PERFORMANCE

Over the year Icelandair Group's share price rose from ISK 5.03 to ISK 8.22, an increase of 63%. The highest closing price in 2012 was ISK 8.24 per share, the lowest closing price was ISK 4.83 per share and the average closing price over the year was ISK 6.57 per share.

Closing price and traded volume



All amounts in ISK	2012	2011	2010	2009	2008
Market capitalization million	41,100	25,150	15,750	3,650	13,250
Share price at year-end	8.2	5.0	3.2	3.7	13.3
Highest closing price	8.2	5.8	3.9	13.4	28.0
Lowest closing price	4.8	3.1	2.8	1.8	12.9
No. of issued shares million	5,000	5,000	5,000	1,000	1,000
No. of outstanding shares million	4,975	4,975	4,975	975	975
Average no. of outstanding shares million	4,975	4,975	1,486	975	978

SHARE LIQUIDITY

Icelandair Group has entered into an agreement with Landsbanki hf. and MP bank hf. regarding market making for the issued shares of Icelandair Group. The agreement is of unspecified duration and may be terminated with one month's notice. The purpose of the agreement is to improve liquidity and to enhance transparent price formation in the Company's shares on NASDAQ OMX Iceland. Shares in Icelandair Group were traded 1,712 times in 2012 for a total market value of ISK 26.3 billion (up from ISK 14.2 billion in 2011). Icelandair Group's market capitalization at the end of 2012 had reached ISK 41.1 billion.

KEY RATIOS

Icelandair Group reported net shareholder earnings of USD 44.3 million in 2012, corresponding to USD cent 0.89 in earnings per share. The Company's total equity at year-end was USD 295.9 million. The P/E ratio at the same time was 7.2 and the P/B ratio was 1.1.

	2012	2011	2010	2009	2008
Earnings per share USD cent	0.9	0.7	2.5	−8.9	−6.2
Intrinsic value of share capital	7.3	6.5	5.7	15.0	20.5
P/B ratio	1.1	0.8	0.6	0.2	0.6
P/E ratio	7.2	5.6	1.0	−0.3	−1.7
Number of shareholders	1,458	1,269	871	834	851

SHAREHOLDERS

At the end of 2012 the number of shareholders was 1,458, as compared to 1,269 at the beginning of the year. 0.8% of the total shareholder base held 72.1% of the shares in the Company.

Number of shares	Shareholders	%	Shares	%
1–10,000	438	30.0%	1,968,048	0.0%
10,001–100,000	479	32.9%	14,679,306	0.3%
100,001–1,000,000	414	28.4%	166,282,729	3.3%
1000,001 - 10,000,000	88	6.0%	302,560,879	6.1%
10,000,001 - 100,000,000	28	1.9%	911,169,628	18.2%
100,000,001 +	11	0.8%	3,603,339,410	72.1%
Total	**1,458**	**100.0%**	**5,000,000,000**	**100.0%**

FINANCIAL CALENDAR

Q1 2013 – week 18 2013

Q2 2013 – week 31 2013

Q3 2013 – week 44 2013

Q4 2013 – week 06 2014

Shareholder Information, continued:

20 Largest shareholders 31 December 2012:

Name	Shares	%
Lífeyrissjóður verslunarmanna	718,136,116	14.36
Framtakssjóður Íslands	600,539,559	12.01
Íslandsbanki hf.	461,218,253	9.22
Lífeyrissj.starfsm.rík. A-deild	390,000,000	7.80
Stefnir – ÍS 5	373,881,155	7.48
Stefnir – ÍS 15	247,300,165	4.95
Lífeyrissj.starfsm.rík. B-deild	227,500,000	4.55
Gildi – lífeyrissjóður	210,188,658	4.20
Stafir lífeyrissjóður	143,375,546	2.87
Sameinaði lífeyrissjóðurinn	129,061,268	2.58
Íslandssjóðir hf.	102,138,690	2.04
Úrvalsbréf Landsbankans	97,361,878	1.95
Söfnunarsjóður lífeyrisréttinda	69,809,622	1.40
MP banki hf.	62,773,999	1.26
Auður Capital safnreikningur	62,426,977	1.25
Stapi lífeyrissjóður	46,591,106	0.93
Lífeyrissjóður starfsm. sveitarf.	45,911,071	0.92
ÍS - 6 (Júpíter rekstrarfélag)	45,740,500	0.91
MP Banki – Safnreikningur 4	42,653,870	0.85
Eftirlaunasj atvinnuflugmanna	41,302,643	0.83
Other	882,088,924	17.64
Total	**5,000,000,000**	**100.00**

DIVIDEND AND DIVIDEND POLICY

Icelandair Group's goal is to pay 20-40% of each year's net profit in dividends. Final annual dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions. This year Icelandair Group's Board of Directors proposes that dividends for the year 2012 totalling ISK 1.5 billion or USD 11.7 million, should be paid out to shareholders, an amount representing 30% of comprehensive income for the year. Based on Icelandair Group's share price as at 31 December 2012, ISK 8.2, the dividends correspond to 3,6% of market capitalization.

INVESTOR RELATIONS

It is the objective of Icelandair Group to ensure that timely and correct information about the Company is made available to all interested parties simultaneously, regularly and consistently. All press releases, financial disclosures and Company announcements are published through GlobeNewswire, a NASDAQ OMX company.

The Investors' website at www.icelandairgroup.com/Investors/ provides extensive news and background information on Icelandair Group for both analysts and investors. The site contains archived regulatory announcements, financial reports and presentations, shareholder, share price, and dividend information and the financial calendar. ■

The three pillars of our international Route Network

Since 1937 Icelandair Group has connected Icelanders with the rest of the world. The key to the Group's success is its international Route Network, which is based on the geographical position of Iceland on the flight route between Northern Europe and North America. By combining in the same aircraft passengers traveling to and from Iceland and passengers crossing the Atlantic via Iceland, the Company has expanded and reinforced its network steadily over the last decades. In 2013 the Company will connect 25 cities in Europe with 10 cities in North America through Iceland as a hub. Every morning an aircraft leaves Keflavik International Airport heading for Europe and returns to Iceland later the same day to continue its journey to North America and return to Iceland the next morning. And so it goes on, every day – the whole year round.

PASSENGERS TO ICELAND

Iceland has enjoyed increasing popularity as a tourist destination over the past 30 years. The number of tourists visiting Iceland grew from 78 thousand in 1983 to 660 thousand in 2012, an average increase of about 8% annually. The vast majority of these tourists travel to Iceland using Icelandair Group's services. The Company has encouraged this increase by developing its Route Network with a growing frequency of flights to Iceland, and by maintaining strong marketing efforts in Europe and North America. The number of passengers in this market was 38% of the Group's total passengers on international flights in 2012.

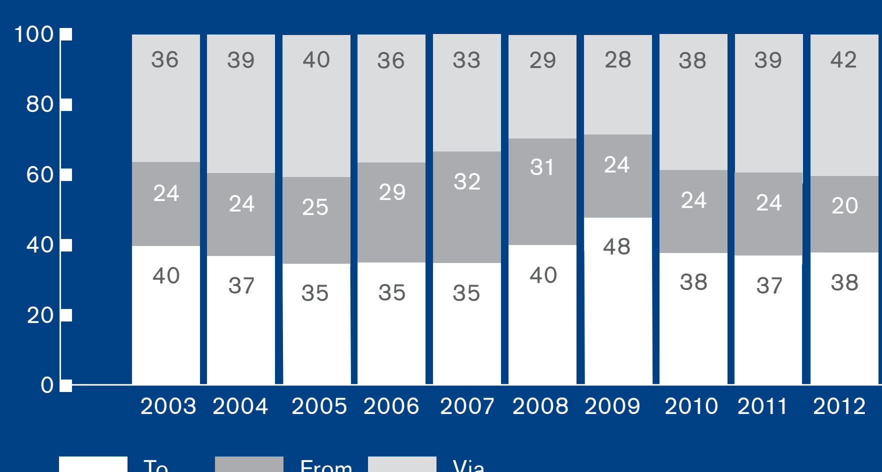
PASSENGERS FROM ICELAND

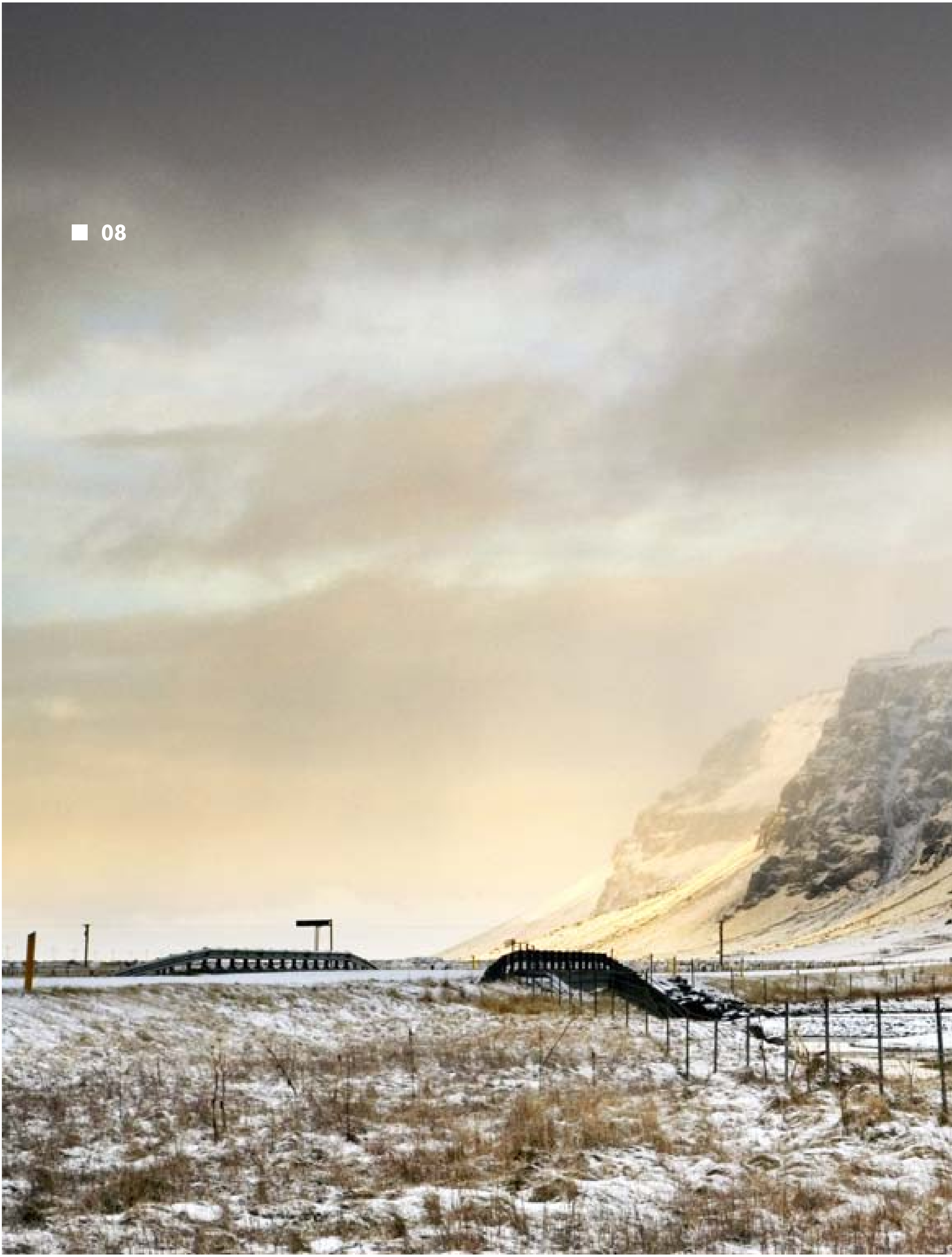
With its international Route Network Icelandair Group is able to offer Icelandic customers direct scheduled flights to 35 destinations in Europe and North-America, which is an astounding range of options for a market of only 320 thousand people. The Company's pricing policy and flight schedule are designed to attract both business travellers, who schedule their trips at short notice, and leisure/tourist traffic. Passengers from the home market accounted for 20% of the Company's total passengers on international flights in 2012.

PASSENGERS VIA ICELAND

Transatlantic travel via Iceland is a key element of Icelandair Group's international scheduled flight operation. Due to the immense size of this market it serves as a gigantic reservoir of passengers. The focus in the "via" market is on city pairs with limited direct flights. With the Company's centrally located hub and quick turnaround times at Keflavik International Airport the Company is able to offer competitive prices and convenient flying times. This is the Company's largest market with the number of passengers in 2012 corresponding to 42% of the total number of passengers.

Passenger mix on international flights (%) | 2003–2012




08

DID YOU KNOW … that “Little Talks”, the lead single of the Icelandic band “Of Monsters and Men”, was an international success, reaching the Top 20 in over five countries and No. 1 on US Alternative Songs.

Icelandair Group and the Community

With a network providing Icelanders with direct regular flights to 35 major cities in Europe and North America, Icelandair Group has been responsible for providing its small home island nation with transport services that are second to none; at the same time the Company has built up tourism as an important sector of the Icelandic economy.

For more than 75 years Icelandair Group has had an extensive influence on Icelandic history, and through its operations the Company has played a key role in shaping modern Iceland.

The transportation of passengers and freight creates value for individuals, corporations and society at large. It aims to provide a favourable working environment and opportunities for all its employees to develop as professionals and as people. By its existence and activities, the Group also contributes to economic welfare in the countries and societies where it operates.

The various companies within Icelandair Group also support a wide variety of community activities year-round. They are among the main sponsors of various public events, as well as directly supporting the activities of numerous organisations. Here are some of the principal beneficiaries of Icelandair Group's companies, but in addition to these organisations and events, support is granted to a number of smaller organisations and events each year.

SPECIAL CHILDREN TRAVEL FUND

The main objective of this fund is to help children suffering from long-term illness or other difficult circumstances to see the world. The fund is supported both directly by Icelandair and through the generous gifts of our customers. Each year the Icelandair Travel Fund enables 20 children and their families, from all over the world, to go on their "dream journey". Vigdís Finnbogadóttir, former President of Iceland, is the protector of the fund. For more details see www.vildarborn.is

ICELAND MUSIC EXPERIMENTS

Icelandair is proud to offer young and talented musicians an opportunity to shine through Iceland Music Experiments (IME). IME is a musical event where young people make their musical début and get their first chance to step into the limelight and play their music. Icelandair rewards IME victors by offering them the opportunity to perform at the annual Iceland Airwaves festival.

ICELAND AIRWAVES

Icelandair is the founder and main sponsor of Iceland Airwaves, a music festival held in October each year in Reykjavik. Iceland Airwaves is an annual music event that started in 1999 as a talent show for foreign record company executives; since then Airwaves has grown and blossomed and is now an integral part of the cultural life of Reykjavík. The fruits of the festival's labour have been ripening, and today many Icelandic artists, such as Sigur Ros, Apparat Organ Quartet, Trabant, Of Monsters and Men and more, have made their way to the international music scene. For more details see the festival website www.icelandairwaves.com.

REYKJAVIK AIRBRIDGE

Icelandair supports Icelandic musical talent beyond Iceland Airwaves. Through cooperation with the city of Reykjavik, Icelandair has established a fund that helps Icelandic musicians to market themselves abroad. This allows them to tour and/or engage in other marketing activities outside Iceland.

FOOD AND FUN

Food and Fun is an event which combines outstanding culinary skills, fresh natural ingredients, Icelandic outdoor adventure and the world-famous Reykjavik nightlife to create the ultimate recipe for fun. The core element of the festival involves world acclaimed chefs who collaborate with Reykjavik's best restaurants. Each chef is assigned to one of the participating restaurants, where they prepare a special menu, made out of Icelandic ingredients only. The menu is featured at all the restaurants for an entire week. In addition, the chefs themselves are on site for three nights during the festival week. Icelandair is the founder and owner of the Food and Fun event. More details online at www.foodandfun.is

EYRARRÓSIN

Air Iceland is the principal sponsor of Eyrarrós – a prize awarded annually to enterprises or persons who have made outstanding contributions to cultural activities in rural Iceland.

ICELAND SPORTS ASSOCIATION FOR THE DISABLED

The Iceland Sports Association for the Disabled (IF) is the supreme authority in sports for the disabled under the auspices of the National and Olympic Sports Association of Iceland. IF organises and oversees Iceland's participation in the Paralympics, the Special Olympics and other major sports events for disabled athletes. Icelandair has supported the IF for 25 years and is one of the association's five largest sponsors and partners.

WORLD CHAMPIONSHIP OF THE ICELANDIC HORSE

Icelandair Cargo is the principal sponsor of the World Championship of the Icelandic Horse, which is held annually at various locations in Europe.

THE NATIONAL OLYMPIC AND SPORTS ASSOCIATION OF ICELAND

The National Olympic and Sports Association of Iceland (ÍSÍ) is the only universal organisation of the sports movement in Iceland and the supreme authority in all voluntary sports activities in Iceland under the Sports Act. ÍSÍ organises and oversees Iceland's participation in the Olympic Games, Games of the Small States of Europe and other sports events held under the auspices of the International Olympic Committee (IOC). Icelandair has been a long-time supporter of ÍSÍ and is one of the four companies forming the ÍSÍ Olympic Family.

ICELANDIC HANDBALL FEDERATION

The Icelandic Handball Federation has sent its athletes across the world in team colours that prominently feature the Icelandic flag and the Icelandair Logo. Team handball is an extremely popular sport in Iceland, and Icelandic players have achieved outstanding results, both in Iceland and abroad. The Icelandic men's team took the silver at the Beijing Olympics in 2008 and the bronze at the European Championship in Austria in 2010.

ICELAND FOOTBALL ASSOCIATION

The Iceland Football Association (KSI) was founded in 1947, and Icelandair has been a long-time faithful sponsor of the Association. The Icelandic national teams, the men's and women's A-teams and the U21, U19 and U17 teams fly with Icelandair with the company's logo on their travel attire.

ICELAND BASKETBALL ASSOCIATION

The Iceland Basketball Association is responsible for all basketball activities in Iceland, and Icelandair sponsors the Association and its affiliated basketball teams in competitions in Iceland and abroad. Basketball is one of the world's most popular sports; it is also popular in Iceland and the national team has been competing with growing success.

ICELANDIC GOLF ASSOCIATION

Golf is an extremely popular sport in Iceland, and the Icelandic Golf Association is one of the largest sports associations in Iceland. Icelandair has actively supported the work of the Association in recent years, and Icelandic elite golfers have flown with Icelandair and borne the company's logo on their competition attire. Icelandair has for a long time focused on providing leisure golfers with the services that they need, and the successful co-operation with the Icelandic Golf Association is an extension of those services. ■

■ The various companies within Icelandair Group also support a wide variety of community activities year-round. They are among the main sponsors of various public events, as well as directly supporting the activities of numerous organisations.

Environment

Icelandair Group is dedicated to its responsibility for the protection of the environment and a sustainable future. The Group is committed to the design and implementation of innovative solutions and initiatives to reduce its impact on human health and promote preservation of the global environment.

THE GROUP IS GOING GREEN

Icelandair Group aims to obtain ISO-14001 Environmental Management System certification for all Icelandair Group companies by 2016.

The organisation is dedicated to its mission of implementing programs of continuing environmental education for its staff and exposing customers to information on the importance of environmental awareness.

Icelandair Group's environmental impact is not limited to flight operations. It also involves ground facilities, offices and maintenance areas. The goal of Icelandair Group is to maximize green energy and minimise waste in all operations by adopting sustainable solutions.

THE ENVIRONMENTAL POLICY

Icelandair Group's Environmental Policy describes our approaches to protect and preserve the environment. The Chief Executive and all employees of the Company are responsible for ensuring compliance with the Company policy. Management at all locations within the Group will adopt guidelines and procedures to comply with the following environmental statement.

The Company intends to:

- Comply with all environmental laws and regulations;
- Obtain ISO-14001 EMS certification for all companies in the Group by 2016;
- Regularly communicate environmental awareness matters to employees, customers, contractors and the public;
- Protect the environment by adopting sustainable business practices, technologies and procedures that maximize use of green energy, minimise pollution and greenhouse gas emissions and manage waste;
- Report publicly on the Company's environmental performance, including greenhouse gas emissions;
- Continuously improve the Company's environmental performance in compliance with ISO-14001, by setting specific environmental improvement targets, monitoring progress and communicating results internally;
- Conduct regular audits and reviews to assess the environmental program and facilitate preventive and corrective measures;
- Provide all employees with appropriate training in environmental awareness and our compliance with environmental rules and regulations in our operations to minimise our impact on the environment;
- Require every employee to comply with this statement and procedures relating to environmental sustainability;
- Encourage employees to point out environmentally friendly methods to enhance our daily operations.

ENVIRONMENTAL AWARENESS

All employees will be trained in environmental awareness and environmental rules and regulations in our operations to minimise our impact on the environment. We will also communicate environmental awareness to our customers, contractors and the general public. Icelandair Group has already implemented an environmental awareness training program designed to highlight the value and special qualities of our planet, the sensitivity of groundwater, the risks of greenhouse gas emissions and the importance of recycling and re-using materials to preserve Earth's resources.

PROTECT THE ATMOSPHERE AND MAXIMIZE THE USE OF GREEN ENERGY

Climate change is one of the main challenges faced by society. Industry, science, politics and the public need to reduce greenhouse gas emissions and promote the efficient use of natural resources. Due to the nature of our business, climate preservation is an important mission of Icelandair Group. To attain its goals Icelandair Group has established numerous programs to maximize fuel efficiency and invested in new technology that reduces fuel consumption. The Company's overall aim is to reduce greenhouse gas emissions and maximize the use of green energy in our fleet.

FUEL CONSUMPTION AND FUEL EFFICIENCY

Icelandair Group is aware of the importance of conserving fuel and minimising CO2 emissions. Icelandair monitors and evaluates all new ideas and solutions in this regard and all departments participate in this activity. The main goal of the Icelandair Fuel Management Committee is to reduce fuel burn and thereby CO2 emissions. During the past few years numerous changes have been made to both the Company's operation and its aircraft. For example, most aircraft are now fitted with winglets that reduce fuel burn. Icelandair constantly pursues new ways of improving fuel burn in Icelandair operations by analysing every aspect of all flights and flight planning. Accordingly, fuel burn in 2012 was 3.8 litres per 100 RPK (revenue passenger kilometre), as compared to 3.9 litres in 2011 and 4.0 litres in 2010.

AIRCRAFT NOISE

International requirements in this field are laid down in ICAO Annex 16, "Environmental Protection", Vol. I, which prescribes certain maximum noise levels for aircraft at three designated noise-measuring points. All aircraft operated by Icelandair have since October 1990 fully complied with the most stringent international requirements laid down in ICAO Annex 16, Vol. I.

AIRCRAFT ENGINE EMISSIONS

According to ICAO Annex 16, "Environmental Protection", Vol. II, unburned hydrocarbons (HC), carbon monoxide (CO), oxides of nitrogen (NOx) and smoke emitted by aircraft engines must be controlled. All aircraft operated by Icelandair have since October 1990 fully complied with the most stringent requirements laid down in ICAO Annex 16, Vol. II concerning aircraft engine emissions.

MINIMISING WASTE AND MANAGING UTILITIES

Icelandair Group is aware of its responsibility to reduce the amount of waste resulting from its operations, whether it is aluminium tins, paper or used parts in maintenance areas. Icelandair Group has launched a Waste Management Program to reduce, recycle and reuse materials across its organisation. The Group is committed to reviewing processes and operations that identify possible ways to reduce unnecessary waste. Icelandair Group airlines, ground facilities, offices and maintenance areas are dedicated to minimalising the Company's environmental footprint with regard to energy, materials and related emissions and waste. The organisation will focus on best practices by implementing initiatives to minimise the use of resources and identify cost savings throughout the system.

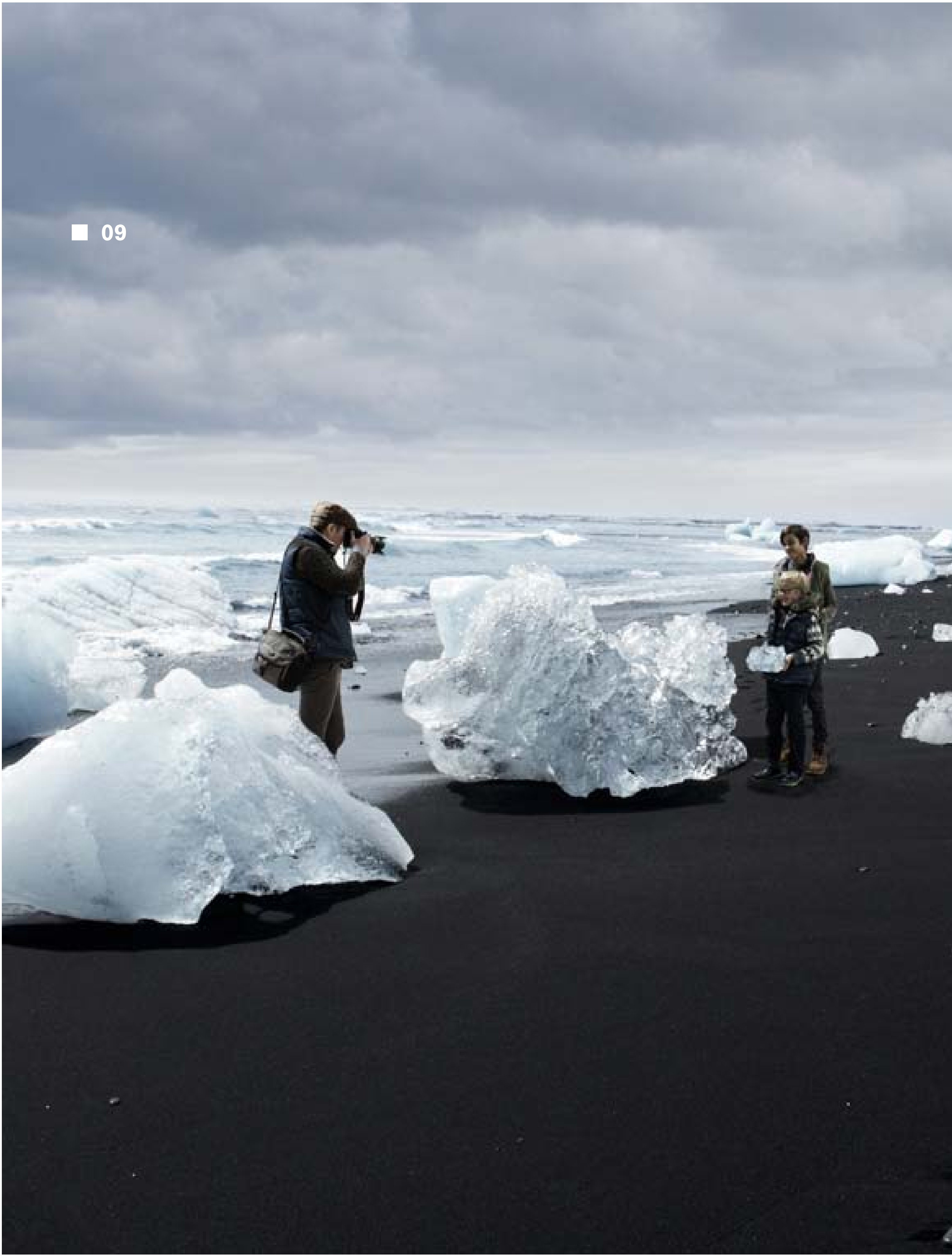
The Waste Management Programme has been implemented throughout our entire organisation, and we will continue to promote, develop and encourage waste reduction, reuse and recycling on site in a systematic and cost-effective manner. We will use suitable, regulated waste management contractors to secure safe management and handling of hazardous and non-hazardous waste sent off-site in accordance with best environmental practice. Reducing waste, reusing, recycling, conserving energy and reducing pollution and greenhouse gas emissions are the goals of the Company. Accordingly, our offices follow a "print by need" policy and buy supplies manufactured from recycled material. Icelandair Group offices recycle paper, plastic, metal, batteries and used printer cartridges in an effort to reduce general waste.

ENVIRONMENTALLY FRIENDLY PURCHASING

Icelandair Group will implement a purchasing policy in which we support contractors that have adopted the best environmental practices. Our contractors will be audited with regard to environmental awareness and the level of environmental control they have implemented in their operation in order to support our environmental policy. We will communicate environmental matters to our contractors as necessary while contracts are in effect.

BENEFITS OF COMMUTING

Icelandair Group will implement an environmentally sound commuting policy, as switching to public transportation, carpooling, biking, or telecommuting can save energy and reduce greenhouse gas emissions on employees' travels to and from work. We will encourage our employees to consider options other than drive-alone commuting in our effort to reduce greenhouse gas emissions and adopt more environmentally friendly practices. ■


09

DID YOU KNOW … that the bottom of Þríhnúkagígur, a crater in the centre of a dormant volcano, 30 km east of Reykjavík, is the size of a football field and about 120 metres below the surface of the earth.

Employees

The employees are one of the main pillars of Icelandair Group and an integral part of its success. Their quality, dedication and team-spirit have been put to the test and have come through with flying colours. They possess a broad range of skills and knowledge as required by the diverse nature of our operations, and which benefits the Group as a whole. We need to provide our employees with attractive and challenging opportunities so we may continue to grow and remain successful.

The turbulent times of recent years have provided an invaluable testing ground for our employees. The financial crisis of 2008 hit Iceland especially hard and two subsequent volcanic eruptions disrupted air traffic and put a strain on our services. Our employees responded with admirable resilience and energy, showing initiative and flexibility and great team spirit, thus underlining their commitment to the Company.

From our home base in Iceland, we constantly try to maintain the strong culture that is needed to link different corporate units and employees and instil a team spirit, and make every effort to bring all our employees, from all companies within the Group, in Iceland and abroad, into our family.

The financial crisis of 2008 forced us to cut the size of our staff severely. We quickly started growing again, and now the number of employees (FTEs) at Icelandair Group is around the same as it was in 2007 when they totalled 2,544.

RECRUITMENT

As one of Iceland's largest private employers, we are able to recruit well-qualified personnel from a large pool of talented and dedicated individuals within Iceland who are eager to work for the Company. We can offer them a wide range of jobs for highly trained professionals at competitive salaries in an international working environment.

To meet our special needs we have designed a thorough and tailored recruitment process to ensure that we select the people best suited for each specific type of job, not only based on professional qualifications, but also on our perception of how they will fit into our results-driven corporate culture. Because of the seasonality of our business we need to take on around 1,000 extra staff over the high tourist season in Iceland. Many return to work for us year after year and later join us as full-time employees.

Icelandair Group employees, full time equivalents (FTEs) by company | 2008–2012

	2012	2011	2010	2009	2008
Icelandair	1,236	1,179	981	1,028	1,179
IGS	425	386	354	343	435
Icelandair Cargo	47	44	37	49	57
Loftleidir	11	11	11	10	8
Air Iceland	224	224	225	231	269
Icelandair Hotels	384	313	234	218	247
Iceland Travel	64	64	76	64	63
Feria (Vita and Ferd.is)	21				
Fjárvakur – Icelandair Shared Services	107	95	105	95	97
Icelandair Group	13	13	14	15	15
Total	**2,532**	**2,350**	**2,028**	**2,053**	**2,370**

Icelandair Group employees, full-time equivalents (FTEs), by company

	Jan. 2012	Jul. 2012
Icelandair	1,100	1,450
IGS	330	522
Icelandair Cargo	38	45
Loftleidir	11	11
Air Iceland	209	271
Icelandair Hotels	287	644
Iceland Travel	58	66
Feria (Vita and Ferd.is)	21	21
Fjárvakur - Icelandair Shared Services	104	109
Icelandair Group	13	13
Total	**2,171**	**3,152**

PROFESSIONAL DEVELOPMENT

We want to make the best use of the talents of those we recruit and therefore emphasize their professional development. We want to employ people who find satisfaction in developing their skills, adding to their knowledge, and then putting these skills and knowledge to meaningful use in their work. We therefore provide our employees with a variety of training opportunities and courses that suit their needs. This fits well with another aspect of our policy, which is to recruit a large part of our management team from within the Company. This ensures that our managers are well versed in our culture and have a thorough knowledge of the Company from the outset. Over the last three years more than 70% of new managers have been promoted from within Company ranks.

JOB SATISFACTION

Every other year the Company takes part in employee surveys conducted by an independent firm, Capacent Gallup. The Company scores among the top companies in its market in both job satisfaction and employee loyalty and pride (commitment). This is manifested by the low employee turnover rate for Icelandair, 4.9% (which includes 3.1% due to retirement and other 'natural' causes). At present, the average employee has been with Icelandair Group for 12 years (for 17 years with Icelandair). This means that the average employee has remained with the Company throughout the turbulent times of recent years, and has already proved his loyalty and mettle.

Employees, by job tenure

31.12.2012	Average employment
Icelandair	16.7
IGS	8.5
Icelandair Cargo	14.9
Loftleiðir	11.5
Air Iceland	9.6
Icelandair Hotels	4.0
Iceland Travel	8.4
Fjárvakur – Icelandair Shared Services	14.7
Icelandair Group	11.9
Average employment in years	12.2

COMMUNICATION

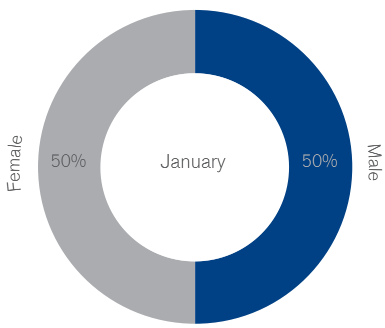
To keep the employees committed and maintain a team spirit within the Company it is necessary to keep them constantly informed with timely and accurate reports on Company affairs. This is especially important in our case, because our operations are so diverse and dispersed over so many countries. Information is shared through newsletters, employee meetings and over the Company intranet, MyWork, which also acts as a conduit for sharing work-related knowledge between employees.

The Company's employees represent a great reservoir of experience and knowledge. In MyWork we have created a way to store this reservoir and channel it efficiently so that those who need it can tap into it at will. MyWork is steadily being enhanced and improved. Giving employees easy access to the information they need, when they need it, improves efficiency and leads to greater job satisfaction, saving both time and money.

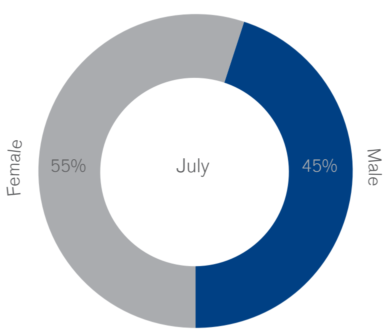
We want to make the best use of the talents of those we recruit and therefore emphasize their professional development. We want to employ people who find satisfaction in developing their skills, adding to their knowledge, and then putting these skills and knowledge to meaningful use in their work.

Employees, continued:

Male / female ratio Icelandair Group
January 2012



Male / female ratio Icelandair Group
July 2012



In addition to this, we hold regular meetings with employees where they can discuss their ideas and concerns directly with top management, including the CEO. Through such exchanges we are able to build trust between employees and management, which in turn is the basis for achieving maximum results.

HR STRATEGY

The Company seeks to maintain the same qualities among its employees as those that have served it so well in the past. At the same time we want to attract qualified personnel who can help us meet the challenges of the future. In order to attract ambitious and qualified people we try to create a superior workplace, challenging and demanding, yet also welcoming and satisfying, so that we are always able select the best person for every job.

Equality and non-discrimination are an integral part of our HR strategy and we welcome diversity in our workforce. All employees must respect our non-discrimination policy and conduct themselves accordingly. We have put in place detailed action plans to ensure that our goals are met. We will encourage and assist our employees in maintaining their strengths as they acquire more skills and knowledge through training and experience. We will also ensure that they receive equal opportunities to further their career. And, above all, we will make sure that all our employees will feel they are part of a team.

CORPORATE CULTURE

The corporate culture of Icelandair Group is based on the awareness that the Company is engaged in providing an essential service, with every employee being important and part of a team and every customer of great value. We are also aware of being a big player in a small market and, at the same time, a small but unique player on the global scale. Our strengths have been flexibility, efficiency, responsiveness, drive and quick decision-making. Our culture is imbued with a can-do attitude, so that all our employees are able to flourish and achieve their highest potential. We know we need to be at our best so that we may serve our customers best.

Our conduct is the outward manifestation of our brand. What we do, what we say, and how we behave. ■

Executive Committee

BJÖRGÓLFUR JÓHANNSSON,
PRESIDENT AND CEO OF ICELANDAIR GROUP
Before joining Icelandair Group Björgólfur was CEO of Icelandic Group from March 2006. From 1992-1996 he was CFO of UA, a fisheries company in Akureyri. He was appointed CEO of Síldarvinnslan in 1999 and served as Director of Innovation and Development at Samherji from 1996, having worked as a chartered accountant for two auditing firms from 1980. Björgólfur served as 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 qualified as a chartered accountant in 1985.

BOGI NILS BOGASON,
CFO OF ICELANDAIR GROUP
Bogi Nils began his career with Icelandair Group in October 2008. He was CFO of Askar Capital from January 2007 until he joined Icelandair Group, and CFO of Icelandic Group from 2004-2006. Bogi Nils was an auditor and partner at KPMG in Iceland in 1993-2004. Bogi Nils holds a Cand. Oecon. degree in Business from the University of Iceland and qualified as a chartered accountant in 1998.

BIRKIR HÓLM GUÐNASON,
CEO OF ICELANDAIR
Birkir Hólm Guðnason was appointed CEO of Icelandair in May 2008. Birkir has been with Icelandair since 2000. Earlier posts include Sales Manager in Iceland 2000-2002, Sales & Marketing Manager in North America 2002–2005, General Manager for Central Europe, situated in Frankfurt 2005–2006 and General Manager for Scandinavia, situated in Copenhagen from 2006. Birkir studied in Aalborg Denmark 1995–2000 and holds an Bsc degree in Business Economics and MBA degree in International Business Economics from Aalborg University, and has since then worked for Icelandair.

MAGNEA ÞÓREY HJÁLMARSDÓTTIR
MANAGING DIRECTOR OF ICELANDIR HOTELS
Magnea was appointed Managing Director in July 2005, having joined Icelandair Hotels in 1994. Magnea has worked in the hotel industry since 1991 and has held management positions at hotels in Iceland, Switzerland and Japan. She completed her MBA at the University of Surrey, UK, in 2003.

Subsidiaries Management

ÁRNI GUNNARSSON
MANAGING DIRECTOR OF AIR ICELAND
Árni was appointed Managing Director of Air Iceland in March 2005. He previously worked as Director of Sales and Marketing at Air Iceland, Managing Director at Ferdaskrifstofa Íslands / ITB, Managing Director of Iceland Travel, and Director of Icelandair Holidays. He worked for the German Tour Operator FTI in Munich as Director of Risk Management in 1993-1997. Árni holds an M.Sc. degree in Economics from Augsburg University, Germany. He has been Chairman of the Icelandic Travel Industry Association since 2008.

GUÐNI HREINSSON
MANAGING DIRECTOR OF LOFTLEIDIR ICELANDIC
Guðni was appointed Managing Director of Loftleiðir Icelandic in July 2006. He joined Icelandair Group in 1997 as a marketing representative in Sales Control, and from 2000-2003 he worked at the Icelandic Web Agency. In 2003 Guðni was appointed Director of Marketing at Loftleidir Icelandic. Guðni holds a Bachelor's degree in Humanistic Informatics & Communication from Aalborg University, Denmark.

GUNNAR MÁR SIGURFINNSSON
MANAGING DIRECTOR OF ICELANDAIR CARGO
Gunnar Már was appointed Managing Director of Icelandair Cargo in May 2008. Before that time he was SVP of Sales and Marketing at Icelandair from 2005. Gunnar Már started at Icelandair Domestic in Vestmannaeyjar in 1986, and in 1994 he became Sales and Marketing Manager for Icelandair Domestic. In 1997 he took over as Sales Manager for Icelandair in Germany, based in Frankfurt. Gunnar Már became Director of Sales Planning and Control in 2000, and in 2001 he became General Manager of the Germany, Netherlands & Central Europe regions. Gunnar Már has a degree in Business from the University of Iceland.

GUNNAR S. OLSEN

MANAGING DIRECTOR OF ICELANDAIR GROUND SERVICES

Gunnar was appointed Managing Director when an independent company was formed around Icelandair's ground services in Keflavík in 2001. He has held various managerial positions within Icelandair Group in Iceland and abroad.

HELGI EYSTEINSSON

MANAGING DIRECTOR OF FERIA

Helgi became Managing Director of Feria in January 2012. Feria took over the outgoing operations of Iceland Travel, i.e. the brand names Vita and Ferd.is. Before that, Helgi was Managing Director of Iceland Travel from June 2008 until December 2011. From 2006-2008 he was employed at Glitnir Bank as a securities broker. He was Director of Sales & Marketing at Iceland Travel from 2004-2006. Before that, he worked at the advertising agency Íslenska Auglýsingastofan and Glitnir Bank. Helgi graduated with a degree in Business Administration from the University of Iceland in 1999.

HÖRÐUR GUNNARSSON

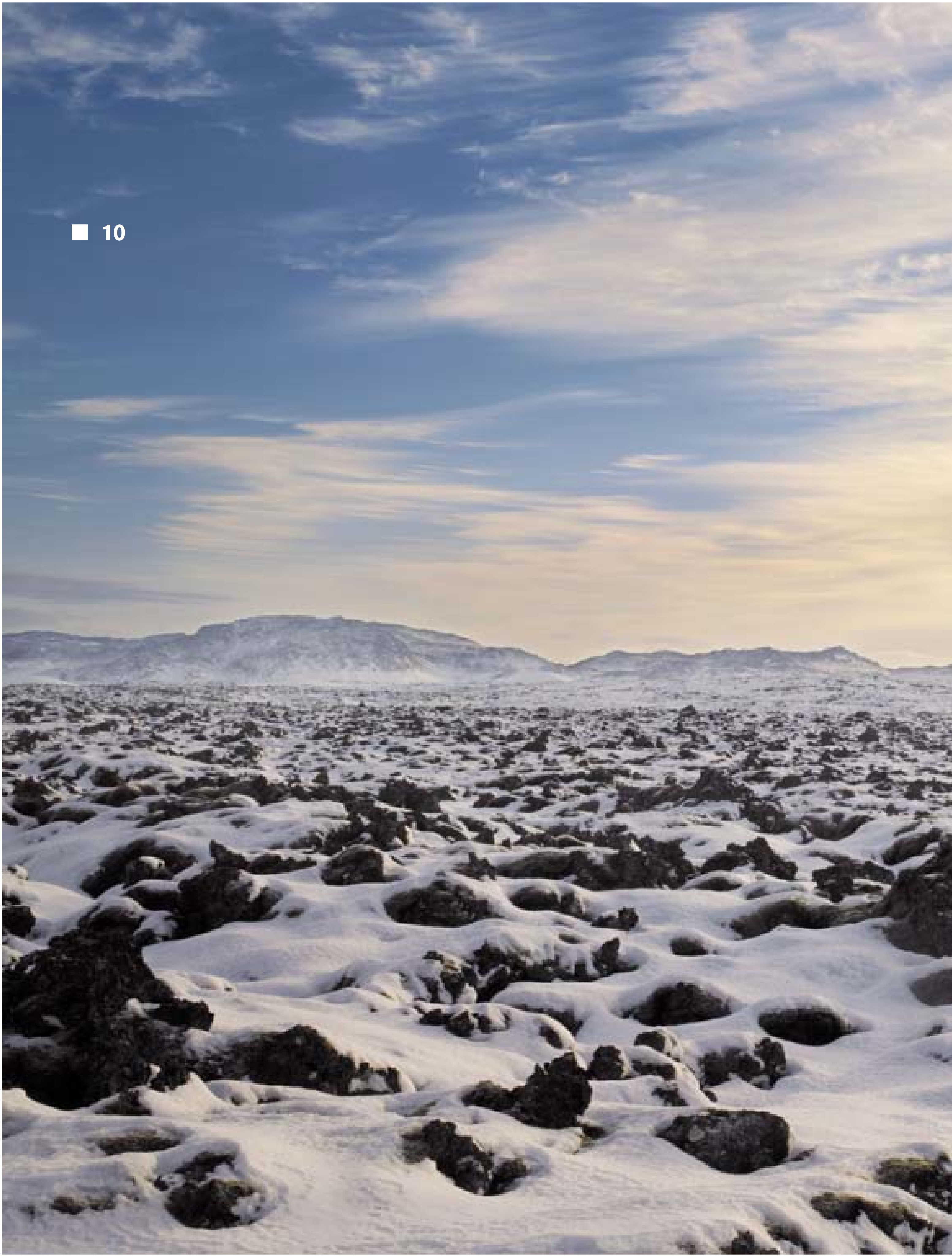
MANAGING DIRECTOR OF ICELAND TRAVEL

Hörður Gunnarsson was appointed Managing Director of Iceland Travel in January 2012 after working for Icelandair Group subsidiaries for over 20 years. He first joined Icelandair Group in 1990 as Managing Director of Úrval Útsyn (later Ferdaskrifstofa Islands), a tour operator owned by the Group, and held that position until 2006. From 2008 he was chairman of the board of Iceland Travel, with the main task of developing the brand VITA, which has been a, independent subsidiary of Icelandair Group since January 2012.

MAGNÚS KR. INGASON

MANAGING DIRECTOR OF ICELANDIR SHARED SERVICES

Magnús has been Managing Director of Fjárvakur - Icelandair Shared Services since its incorporation at year-end 2002. He joined Icelandair Group in 1998. Before that, he was Director of Icelandair Group's accounting department. Magnús received his Cand. Oceon from the University of Iceland in 1993 and qualified as a certified public accountant in 1999.


■ 10

DID YOU KNOW ... that the depth of the famous glacier lagoon Jokulsarlon is about 260 metres, and that it is the deepest lake in Iceland.

Endorsement and Statement by the Board of Directors and the CEO

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.

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 shareholders 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.

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 Jóhannsson

Independent Auditors' Report

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

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Icelandair Group hf., which comprise the consolidated statement of financial position as at 31 December 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.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Icelandair Group as at 31 December 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 Eðvarðsson

Guðný H. Guðmundsdóttir

Consolidated Financial Statements

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 87 to 122 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Consolidated Statement of Comprehensive Income for the year 2012, continued:

	Notes	2012	2011 Translated*
Profit attributable to:			
Owners of the Company		44,228	36,301
Non-controlling interests		47	9
Profit for the year		44,275	36,310
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 87 to 122 are an integral part of these consolidated financial statements.

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 goodwil	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 87 to 122 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Consolidated Statement of Changes in Equity for the year 2012

	Attributable to equity holders of the Company						
	Share capital	Share premium	Reserves	Retained earnings	Total	Non-controlling interest	Total equity
2011							
Translated*							
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 87 to 122 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

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 87 to 122 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Notes

01 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.

02 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

03 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.

Notes, continued:

03 a. continued:

(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.

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.

Notes, continued:

03 continued:

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.

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.

(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.

Notes, continued:

03 c. continued:

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.

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.

Notes, continued:

03 d. continued:

(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.

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.

Notes, continued:

03 continued:

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.

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.

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.

Notes, continued:

03 continued:

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.

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.

Notes, continued:

03 n. continued:

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.

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.

04 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.

Notes, continued:

05 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.

Notes, continued:

06 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 invetsees	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.

Amounts are in USD thousand

Notes, continued:

06 continued:

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**	**Adjustments**	**Consolidated 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

Amounts are in USD thousand

Notes, continued:

07 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		
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

08 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

09 Operating income

Transport revenue is specified as follows:

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:

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

Amounts are in USD thousand

Notes, continued:

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)

Amounts are in USD thousand

Notes, continued:

13 Operating assets

Operating assets are specified as follows:

	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Cost				
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).

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

Amounts are in USD thousand

Notes, continued:

16 Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

	Official assessment		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).

17 Intangible assets and goodwill

Intangible assets and goodwill are specified as follows:

	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
Cost					
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					
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					
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

Amounts are in USD thousand

Notes, continued:

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:

	Route Network		Tourism services	
	2012	2011	2012	2011
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.

Amounts are in USD thousand

Notes, continued:

19 Investments in associates

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

	Ownership 2012	Ownership 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:		
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

Amounts are in USD thousand

Notes, continued:

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

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 loans, 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)

Amounts are in USD thousand

Notes, continued:

22 continued:

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

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

	1 January	Recognised in profit or loss	Exchange rate difference	Recognised in other compre-hensive income and equity	31 December
2012					
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					
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.

Amounts are in USD thousand

Notes continued:

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:

	2012	2011
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 OMX Nordic 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

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.

Amounts are in USD thousand

Notes continued:

27 (iii) continued:

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.

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	36,301
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	36,301
Discontinued operations	0	(3,002)
Total	44,228	33,299
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 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

Notes, continued:

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:		
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.

Amounts are in USD thousand

Notes, continued:

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

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.

Amounts are in USD thousand

Notes, continued:

34 continued:

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.

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.

Amounts are in USD thousand

Notes, continued:

34 continued:

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.

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

Amounts are in USD thousand

Notes, continued:

34 continued:

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
NOK	0.15	0.15	0.15	0.14
SEK	0.17	0.17	0.18	0.17

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.

Amounts are in USD thousand

Notes, continued:

34 continued:

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	
Fixed rate instruments	**2012**	**2011**
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)

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 equity:

	Effect on equity		Effect on profit before tax	
	2012	**2011**	**2012**	**2011**
Increase in fuel prices by 10%	2,909	1,648	0	0
Decrease in fuel prices by 10%	(2,909)	(1,648)	0	0

Amounts are in USD thousand

Notes, continued:

34 continued:

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.

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

Amounts are in USD thousand

Notes, continued:

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:

	Salaries and benefits		Number of shares held at year-end 2012 in thousands
Board of Directors:			
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 Janurary 2013. Total purchase price amounted to USD 8.5 million, of which USD 1.7 million had been paid at year end.

Notes, continued:

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:		
SmartLynx, Latvia, sold at year end 2011	–	100%

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

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

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:

	2012	2011
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

Amounts are in USD thousand

Notes, continued:

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

Amounts are in USD thousand

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

Corporate Governance Statement, continued:

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.

Corporate Governance Statement, continued:

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 Þórey 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

Corporate Governance Statement, continued:

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:

Year 2012	**Q1**	**Q2**	**Q3**	**Q4**	**Total**
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 before depreciation (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 income (expense)	139	3,317	3,767	(196)	7,027
Share of loss of associates	(43)	(20)	(157)	(146)	(366)
(Loss) profit 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 (loss) income	(2,570)	(1,945)	1,314	(2,220)	(5,421)
Total comprehensive (loss) income	(15,759)	12,374	52,676	(10,437)	38,854
Working capital 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 used in financing activities	(25,714)	(10,214)	(9,401)	(6,124)	(51,453)

Translated* Year 2011	**Q1**	**Q2**	**Q3**	**Q4**	**Total**
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 (loss) profit before depreciation (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	(3,458)	(1,468)	(3,703)	(1,358)	(9,987)
Share of profit (loss) of associates	8	73	33	(204)	(90)
(Loss) profit 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
Profit 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 (loss) income	(7,341)	677	46,794	(8,037)	32,093
Working capital (used in) from operations	(4,951)	25,204	76,223	5,816	102,292
Net cash from (used in) 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 from (used in) financing activities	9,078	(27,977)	(19,315)	10,612	(27,602)

*See note 2c

Amounts are in USD thousand